03-May-2022
Freshworks, Inc. (FRSH)
Q1 2022 Earnings Call
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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Freshworks First Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers’ presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today’s conference maybe recorded. [Operator Instructions]

I would now like to hand the conference over to your host today, Joon Huh. Please go ahead.

Joon Huh
Vice President-Finance, Investor Relations & Treasury, Freshworks, Inc.

Thank you, Joon. Good afternoon and welcome to Freshworks' first quarter 2022 earnings conference call. Joining me today are Girish Mathrubootham, Freshworks’ Chief Executive Officer; and Tyler Sloat, Freshworks’ Chief Financial Officer. The primary purpose of today’s call is to provide you with information regarding our first quarter 2022 performance and our financial outlook for our second quarter and full-year 2022.

Some of our discussion and responses to your questions may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on Freshworks' current expectations and estimates about its business and industry, management's beliefs and certain assumptions made by the company as of the date hereof, all of which are subject to change. These statements are subject to risks, uncertainty, and assumptions that could cause actual results to differ materially from those projected in the forward-looking statements.

For a discussion of material risks and other important factors that could affect our results, please refer to today’s earnings release, our most recently filed Form 10-K and our other periodic filings with SEC. Freshworks assumes no obligation to update any forward-looking statements in order to reflect events or circumstances that may arise after the date of this presentation, except as required by law.

During the course of today's call, we'll refer to certain non-GAAP financial measures. Reconciliations between GAAP and non-GAAP financial measures are included in our earnings release which is available on our Investor Relations website at ir.freshworks.com. I encourage you to visit our Investor Relations site to access our earnings release, periodic SEC reports, a replay of today's call or to learn more about Freshworks.

And with that, let me turn it over to Girish.

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Thank you, Joon. Good afternoon, everyone and welcome to Freshworks' Q1 earnings call. We delivered a really good quarter of results in Q1. Revenue grew 42% year-over-year to $114.6 million. Non-GAAP operating margin was nearly breakeven and well ahead of expectations. And we continue to drive the business for efficient growth by generating positive operating cash flow in the quarter.

In Q1, we continued to witness strong demand for our products, adding more than 2,100 new customers. We ended the quarter with more than 58,100 customers, including brands like Allbirds, California Credit Union, Ticket
Network, and Sodexo. Our net dollar retention increased to 115%, aided by ongoing improvements both in multiproduct adoption and churn. This led to another good quarter for customer expansion in our business.

In the last earnings call, I talked about the changing trends in customer experience in CRM. Every consumer-facing business is looking to engage with customers across their preferred mobile, social and online channels. We are prioritizing our product investments around these trends. And in Q1, we released new capabilities in our conversational engagement product, Freshdesk Messaging, that offers self-service bots and conversational agent experiences over more digital channels. We added text messaging as a new channel and enhanced capabilities for WhatsApp conversations.

These new capabilities enable businesses to provide a conversational experience to their customers and automate support over text messaging and WhatsApp in addition to existing channels that we support, like Apple Business Chat and Facebook Messenger. One example is a publicly-traded retail company based in South Africa with over $1 billion in annual revenue. The company uses our Freddy bot and Freshdesk Messaging on WhatsApp to automate customer support. Our APIs help customers track their orders, search for products and locate nearby stores. The retail giant has automated 30% of their support queries with our chatbot solution. If customers need more help with complex use cases, the bots gracefully hand over to a human support agent. So when you have a global customer base, a bot talking to your customers in a language they best understand helps improve the customer experience. We have now added support for 10 additional languages in our multilingual bots product. So our bots can now engage with users in 50 different languages.

I’m excited to share that we recently launched our Freshworks CRM for e-commerce. This is a unified CRM that combines marketing automation, conversational support and sales, powered by our unified customer record. Let me share the story of The Lip Balm Company, a popular D2C cosmetic brand with over 100 products sold online. They use the built-in Shopify campaign templates in our CRM products to drive revenue by running personalized marketing campaigns on WhatsApp to bring back customers who abandoned their shopping carts. Their support team also had frequent inquiries from customers calling in to check the status of their orders, and now that is fully automated with our WISMO bots purpose-built for Shopify. WISMO is short form for Where Is My Order. Support agents are now freed up to perform more complex tasks.

Direct to consumer brands and e-commerce companies can now offer a personalized experience for buyers on modern messaging channels with our new CRM offering. We are excited that Freshworks CRM for e-commerce is now available on the Shopify App Store with the potential to reach over 1 million storefronts. We plan to extend integrations to other market-leading e-commerce platforms in the future.

Turning to Freshservice, we continue to make progress in the mid-market. The German industrial robot manufacturer, Kuka, with $3 billion in annual revenue, chose Freshservice to simplify IT support for its 14,000 employees. With Freshservice, Kuka now has visibility into its technology assets to give leadership a quick view of IT team performance.

We also added new enterprise-grade IT service management capabilities to Freshservice through an expanded partnership with Device42. The new product integration and joint technical support with Device42 provides our customers more visibility into their hardware and software assets, improving their IT asset management capability.

We talked about expanding use cases for Freshservice previously. So let me highlight a couple of examples of customers leveraging Freshservice for enterprise service management needs. A US-based multi-billion dollar scientific instrumentation and software company chose Freshservice to automate their internal sales processes.
With the ability to integrate their custom deal desk applications directly into Freshservice, the company can more quickly receive email requests, create an order and close service deals faster. Another ESM use case Allbirds, the global sustainable footwear and apparel company, implemented Freshservice to manage their entire employee life cycle. From IT to facilities and HR, the company’s employee facing teams can automate and customize processes, features, forms and service catalogs to meet the needs of their department and the employees they serve. We are really excited about the potential of Freshservice to help many internal teams delight their employees.

On the partners front, we held our Partner Summit virtually last month where we rolled out the new tiered program and certification framework for our partners. Our SI partner TCS announced successful completion of 150-customer projects on the Freshworks platform. In addition to Device42, we also announced partnerships with Good Data and Yext for enterprise-grade analytics and search. Today, the Freshworks Partner Program includes more than 500 partners in over 50 countries around the world.

Overall, Q1 was a really good quarter of customer and revenue growth, combined with continued business efficiency. Looking ahead, there is some market uncertainty with the changing macro environment and the ongoing war in Eastern Europe. While we have limited exposure to Russia and Ukraine directly, we will continue to track the European market for any potential impact to the business. More importantly, we understand that some of you may have family members or friends in the region who may be impacted. Our thoughts are with them and the people of Ukraine right now.

As we move forward with the business, we will continue to focus our efforts on executing across sales, marketing, product and engineering to achieve our 2022 goals. I'm excited about the tremendous opportunity across all three markets we operate in, customer experience, sales and marketing and ITSM, as we continue to build the business with the right mix of sustainable growth and profitability.

I’ll now turn it over to our CFO, Tyler, to share further details about our financial results.

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Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Thanks, G and thanks to all of you joining on the call and via webcast. Despite the volatile markets, we got off to a really good start for the year with another solid quarter of financial results in Q1. We’re seeing healthy market traction for our products as we execute on our priorities for fiscal 2022. For our call today, I’ll cover the financial results from our first quarter while providing some background on the key drivers and trends we’re seeing in the business.

Later, I’ll close with our forward-looking commentary and expectations for Q2 and full-year 2022.

As a reminder, for our financial results, I’ll focus most of my discussion around non-GAAP numbers. These non-GAAP numbers exclude the impact of stock-based compensation and related expenses, payroll taxes on employee stock transactions, amortization of acquired intangibles, and other adjustments.

Starting with the income statement, revenue in Q1 grew 42% to $114.6 million, which includes a negative impact of a little over 1% due to FX. We saw healthy expansion activity in the quarter and the largest driver continues to be seat or agent additions as this is the simplest or most natural path for increasing usage of our products.

As we mentioned earlier, our multiproduct adoption continues to make incremental improvements as customers are using multiple products, especially in our Freshdesk product line with the adoption of omnichannel with a
combination of support desk and messaging. Our ITSM product, Freshservice, continues to be a big growth driver as mid-market customers are finding tremendous value in our right size solutions.

In Q1, we maintained a healthy non-GAAP gross margin of 82.2%. This was down slightly from the prior quarter as we had a higher contribution from a lower margin product that includes pass through costs from an outside provider. Our non-GAAP operating expenses were $94.8 million for Q1, an improvement of $3.4 million compared to Q4. Most of this improvement came from non-GAAP G&A expenses as this decreased $5 million compared to the prior quarter as Q4 included higher costs related to a litigation matter that was settled in Q4.

Non-GAAP R&D expenses increased by $1.4 million quarter-over-quarter as we continued to invest in our product and technology efforts. We also invested in our go-to-market efforts, but non-GAAP sales and marketing expenses were relatively flat compared to the prior quarter as Q4 expenses included costs from our Refresh conference that were not included in Q1.

Our revenue outperformance, combined with expense improvements, led to a non-GAAP operating loss of $0.6 million for the quarter, resulting in a nearly breakeven operating margin on a non-GAAP basis. We believe this clearly highlights our ability to drive business efficiency as we continue to scale and grow the business.

Turning to our operating metrics, our net dollar retention rate increased 1% to 115% from the prior quarter. On a constant currency basis, this figure was 116%. This number not only reflects the robust expansion activity from our customers, but also the incremental improvements we're seeing in multiproduct adoption and churn in the overall business. As we said before, we expect this metric to naturally land in $110 million-plus to low teens range for the business for the foreseeable future. So we're pleased with this performance.

Our second operating metric of customers contributing more than $5,000 in ARR grew 27% in Q1, ending at 15,639 customers and now represents 86% of our ARR. For larger customers contributing more than $50,000 of ARR, this customer count grew 54%, ending at 1,547 customers and represents 42% of our ARR. Our total customer count grew 15% to over 58,100 customers as we added over 2,100 customers in the quarter, reflecting the highest net adds since Q3 of 2020. Similar to prior quarters, the average revenue per account continues to increase and contribute to our revenue growth as customers are expanding on our products as we engage in larger deals.

Now, turning to billings and the balance sheet items, our Q1 calculated billings was $128.9 million, reflecting 32% growth year-over-year. As you know, the billings growth rate can fluctuate from quarter to quarter based on a number of factors, so specific items in Q1 include approximate impacts of billing duration mix of negative 2%, early renewals and FX movements, each negative 1%, and reserve activity of positive 1.5%. Normalizing for these factors, calculated billings growth will be approximately 35%.

From a new business perspective, billings growth was impacted by a lower number of large deals closed in the quarter. While we added a healthy number of new customers in Q1, the average customer size was smaller compared to prior quarters, as our field operations continue to build out and ramp up productivity for the mid-market and larger customers.

We're also seeing a very competitive hiring environment on the go-to-market site, especially in Europe. So this has impacted our sales realization in that region. While we don't manage the business to a calculated billings metric, due to the overall uncertainty around the European market and the time it takes to build up go-to-market operations, we expect the calculated billings growth to moderate in Q2.
Moving to our balance sheet, we ended Q1 with cash and cash equivalents of approximately $1.2 billion, down from the prior quarter as we used approximately $120 million to net federal vested equity amounts in meeting tax requirements, which we noted on our prior call. We plan to continue [ph] to net our (00:17:00) shares and expect to use approximately $25 million in Q2. Nearly all of the net federal activity amount is captured in our cash flows and finances. So this will reduce our cash balance, but as a reminder, does not impact free cash flow.

In Q1, our operating cash flow was $1.4 million, which further underscores the efficiency of our business model even as we invest for growth. Free cash flow, which includes the impact of CapEx and capitalized software, was negative $1.4 million and ahead of expectations as we realized savings in the quarter and also had some payments shift to later in the year. As a result, we expect free cash flow for the full year to improve by $5 million to negative $20 million. With Q2 and Q3 estimated to be negative $10 million each, for Q4, we expect to be slightly positive and positive thereafter. Given the volatile economic environment, I'm pleased with our ability to manage through these times and do it prudently.

In terms of share count, we had approximately 317 million shares outstanding on a fully diluted basis using the treasury method as of March 31, 2022. A few items to note as we move to our expectations for Q2 and the full year. First, on revenue. Our revenue guidance estimates are based on the currency rates as of the end of Q1, consistent with our normal financial planning processes. Using currency rates as of the end of Q1, we're expecting FX to have approximately a negative 1.5% to 2% impact to Q2 and a negative 1.5% impact for full year 2022 growth rates. Thus far in Q2, we're seeing increasing strength of the US dollar and if this trend holds would result in additional negative FX impacts to our results, which is not included in our guidance.

Also related to revenue, we've made improvements to our financial operations in areas of collections and reserves, which we've called out previously. These improvements have created slight benefits to our revenue in the past couple of quarters, but we do not expect this to continue going forward as we are nearing optimal levels.

And third, as a reminder from our prior call, Q2 expenses include the impact of our annual merit cycle and other related costs, leading to increased expenses quarter-over-quarter. In addition, we have timing impacts as certain Q1 projects and investments shifted to Q2 and later in the year. We have factored these impacts into our estimates going forward.

So, for the second quarter of 2022, we expect revenue to be in the range of $117 million to $119 million, non-GAAP loss from operations to be in the range of $18.5 million to $16.5 million, and non-GAAP net loss per share to be in the range of $0.08 to $0.06 assuming weighted average shares outstanding of approximately 284.4 million.

For the full year 2022, we expect revenue to be in the range of $495.5 million to $501.5 million, non-GAAP loss from operations to be in the range of $43.5 million to $37.5 million, and non-GAAP net loss per share to be in the range of $0.18 to $0.16, assuming weighted average shares outstanding of approximately 284.4 million. Let me close by saying that we're off to a good start to the year.

And with that, let us take your questions. Operator?
QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from the line of Scott Berg with Needham. Your line is open. Please go ahead.

Scott Berg
Analyst, Needham & Co. LLC

Hi everyone. Congrats on the quarter and thanks for taking my questions here. I guess a couple, gee, I want to start with the net revenue retention. You sound pretty pleased with cross-selling additional modules or at least seeing some additional traction there. How should we think about the typical customer today in terms of what they're landing with or what they're buying? Is there a pattern there that's kind of emerging that may be easier to repeat or is it just general customer satisfaction of product that's leading them to maybe buy more?

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Thanks for the question, Scott. Our multiproduct adoption, first of all, I would say we are happy with the way our net dollar retention has been tracking, specifically driven by multiproduct adoption and churn improvements this quarter. So, we – in the past, we have told that we expect to be 110% to mid-teens kind of net dollar retention, but on a constant currency basis, it was 116%, so we’re obviously happy with that.

Our multiproduct adoption numbers also improved. Like last quarter, I think we mentioned it was 21%. We saw a slight uptick. Now, the number is at 22% for our customers using more than one Freshworks product. What is primarily driving this are a few patterns that you're seeing. One is our omnichannel Freshdesk customers who buy the omnichannel product. So that is one.

We also see customers using our Freshdesk product and our Freshdesk messaging product that is in line with the trends that we’re seeing in businesses adopting conversational engagement to kind of engage with customers on digital channels. So that is another repeatable trend which we expect moving forward.

And last week, we also announced our unified CRM for e-commerce, so we can actually – again, it's too early, but that can become, as we have told earlier, the unified CRM can actually help us win multi-persona deals where customers can land with like only sales, only support, or only marketing, and then kind of add on or upgrade to the full suite. So I think we have multiple patterns. But as of now, primary drivers are omnichannel and Freshdesk and conversational messaging. We also have customers within Freshdesk and Freshservice, probably that's the top three drivers.

Scott Berg
Analyst, Needham & Co. LLC

Thanks to you. That's super helpful. And then, Tyler, from a follow-up perspective, I wanted to delve into the European hiring weaknesses, I guess, that the company is having there. I guess two-part question. One, can you quantify maybe how far behind you are on your hiring plans there? And then secondly, how do you correct that going forward at this point outside of just throwing more cash at someone? I don't know, you're changing how you're recruiting over there to maybe try to get caught up. That's all I have. Thank you.
Tyler Renwick Sloat  
Chief Financial Officer, Freshworks, Inc.

Yeah. You bet. Hey, thanks for your questions, Scott. Actually, the hiring, the impact is mainly from attrition we saw last year and we're actually – have hired back and have started to catch up in the field and we'll continue to hire in the field in almost all areas. And we've also seen attrition get better this quarter than what we saw last year. And I think last year was probably part of the great resignation that we talked about that we were not immune to. So I think we experienced what a lot of other companies experienced.

As we rehired, those folks take times to ramp. And as they're ramping, they're getting to know Freshworks and getting productive. And so it feel like we're starting to get back on track, but again, it's not like – it's not an ongoing thing. I think it was mainly from impact of – towards the tail end of last year as we're coming back into it.

In terms of overall philosophy, we're doing a lot of what, I guess, a lot of other companies are doing. And it's not just on field or anything else. It's about making sure our employees are just having an incredible experience working at Freshworks, but also making sure they're fairly compensated. It's one of the thing that's driving our expense that's coming up in Q2 because our entire focal process actually kicked in on April 1, which it typically does, and that's one of the things that is raising the costs for Q2 compared to Q1, which is those compensation adjustments.

Scott Berg  
Analyst, Needham & Co. LLC

Got it, helpful. Thanks again. Congrats on the quarter's results.

Tyler Renwick Sloat  
Chief Financial Officer, Freshworks, Inc.

Thanks, Scott.

Operator: Thank you. And our next question comes from the line of Brad Sills with Bank of America. Your line is open. Please go ahead.

Brad Sills  
Analyst, BofA Securities, Inc.

Oh, great. Thanks, guys, for taking my questions. Just one to start, please, on the traction you're seeing in that customer segment greater than $5,000, real nice result here, 27% year-over-year growth, holding with that high 20s you saw last quarter. You mentioned some deal size coming down there a little bit. Should we take that to mean there's potential upsell opportunity? Maybe some of these enterprise customers are starting with a smaller footprint. You've got a lot of new product out here that you're seeing some good traction to cross-sell. Could there be a cohort of customers in there that we might see the opportunity to upsell more so than in the past?

Rathna Girish Mathrubootham  
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Thanks for the question, Brad. So overall, I would start by saying we had – we are pleased with how we did from a customer growth standpoint this quarter. As we mentioned in the call, we added 2,100 customers and that is the highest net add of customers since Q3 of 2020. So, clearly, a lot of those customers came from smaller deals, so – which also we saw like an increase in customers for the CRM. So these are positive things.
And as Tyler mentioned in the script, so we – in Europe particularly, we didn’t close a few larger deals, but we see that as an opportunity given our multiproduct play. We see that and we don’t specifically – I just would like to remind everyone here that at Freshworks, we don’t hunt for elephants, we hunt for deer and rabbits. We are focused squarely on mid-market and SMB customers. So a lot of times when we land, we are not specifically managing to a greater than $50,000 number. So that I would like to – we are confident that that will give us the opportunity to expand into larger deals over time.

Brad Sills  
Analyst, BofA Securities, Inc.

Excellent. Great to hear. Thanks so much. And with the launch of the e-commerce solution, what does this mean for your kind of overall footprint in the front office with – you’ve got sales CRM, now you’ve got e-commerce, really rounding up that suite. Do you think that customers might land with e-commerce and then add CRM sales, vice versa, just more of an upsell opportunity? Just any expectations in the near term for that? Thank you so much.

Rathna Girish Mathrubootham  
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Yeah. So the way to look at the Freshworks CRM for e-commerce is more like a vertical solution for D2C brands and consumer-facing like our e-commerce companies which want to engage with customers on digital channels. So what we have really launched or given the opportunity for D2C brands and e-commerce brands, really get a full 360 view of their customers from – by combining data from their Shopify orders, the lifetime value of the customers, in conjunction with the entire history of conversations that the business has had with the customer and also have visibility into the marketing campaigns that the customer has responded to. So that kind of visibility was not available through e-commerce companies and sellers for them to understand more about their buyers. So that’s what we have launched and we will continue bringing the power of our unified customer record into other verticals over time.

Brad Sills  
Analyst, BofA Securities, Inc.

Thanks, Girish.

Rathna Girish Mathrubootham  
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Thank you.

Operator: Thank you. And our next question comes from the line of Ryan MacWilliams with Barclays. Your line is open. Please go ahead.

Ryan MacWilliams  
Analyst, Barclays Capital, Inc.

Thanks for taking the question. Sales and marketing as a percentage of revenues came in nicely below our expectations for the quarter. Tyler, maybe just besides the Refresh conference, what were some of the puts and takes that led to this overspend maybe versus our expectations?

Tyler Renwick Sloat  
Chief Financial Officer, Freshworks, Inc.
Hi. In general, it was mainly the Refresh conference from last year. We also had some other events that we were spending money on. In Q1, we had things like our SKO, which was originally going to be in-person and have been a virtual event. We ended up saving some money there. We did hire pretty aggressively and we continue to do so, and we’re going to continue to do that with adding some incredible talent across our marketing to sales organization. So we’re pretty optimistic about that.

And then I mentioned one of the upticks for Q2 in what we expect is that a lot of the compensation adjustments that are normal, it's part of our normal focal process, those kick in in Q2 and some of those are effectively non-cash because it's things like adjusting our vacation balances and whatnot that adjusted your P&L, but they're not necessarily cashing out one-time adjustment. So – but the Refresh event and some other kind of one-offs are really the differences between the Q4 and Q1, even though head count went up.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Appreciate that. And just on your comment for calculated billings growth to moderate in the second quarter, do you mean on a normalized basis as well? And then can you just kind of elaborate maybe on some of the macro challenges that you highlighted impacting how you're thinking about the growth there over the next few quarters. Thanks.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Yeah. We're essentially looking at that billings growth number. And again, we don't manage to billings, right? Billings has a lot of nuances to it. So we kind of call it as we see it. We can make some estimates. But as billings come in – as new deals close, right, they're going to have different mixes in terms of whether they're paid-only or whatnot. Our expansion motion is actually pretty unpredictable as how it relates to billings, because as you can imagine, if a customer is expanding and they're on an annual deal that often results in a stub payment, not a full annual payment. So we kind of – we look at it. We can kind of estimate. And based on what we see, we are a little bit cautious just based on the macroeconomic environment.

In Europe, I don't know if anybody knows what's really going to happen. We are a little bit – we're cautious, we're tentative, we're growing and it feels like we have folks that are ramping up there and coming into their own in terms of as they ramp, getting productive. But that being said, we are cautious on the whole macroeconomic environment in general.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

[indiscernible] (00:32:18).

Operator: Thank you. And our next question comes from the line of Mark Murphy with JPMorgan. Your line is open. Please go ahead.

Mark R. Murphy
Analyst, JPMorgan Securities LLC

Thank you. Girish, how much difference in business confidence or deal pipeline or bookings growth do you see if you try to compare right now especially between North America and EMEA? I think specifically, we're mostly wondering just how is the tone of business in Europe, if you think of it kind of outside of your own sales ramping and productivity, what is the tone coming from customers, I guess, considering the proximity to the war there?
Well, thanks for the question, Mark. First off, let me start by acknowledging what we already said that we have seen some softness in Europe, primarily because we didn’t close enough large deals. It also has to deal with some seasonality in Q1 that we see compared to Q4 where, as you know, a lot of mid-market deals close.

But on the macro itself, specifically to the ongoing war in Russia and Ukraine, so I think we are consciously observing what’s happening. We don’t have or we have limited exposure to Ukraine and Russia, and it’s currently less than 1% of our revenue from that region. So we are not necessarily seeing a slowdown from a macro standpoint in Europe. So – and we are working to fix our execution challenges in terms of ramping up of the GTM folks, hiring leaders and investing in sales enablement. But when you look at all the product investments that we are making, we are confident that while being cautious about the macro, the confidence that our big markets give us the ability to keep executing for a long, long time.

Okay. And then, Tyler, just a quick follow up for you. When – the comment on the Q2 billings, you grew billings 35% normalized in Q1. I understand you don’t really manage to billings. But I’m just curious because I think you’re saying it’ll slow in Q2. Consensus already has it slowing in Q2, I believe, if I wrote it down, right, something like 27%, 28% and I think possibly even slower in Q3. So I guess I’m just trying to understand, are you expecting us to hear that comment and actually kind of reduce it further or do you think, I mean, if we’re already kind of contemplating something like seven or eight point decel in Q2, do you think that that’s sufficient?

Yeah. Mark, I’m more speaking to the quarter-over-quarter comparison from Q1 going into Q2.

Okay. So the sequential comparison will be...

Maybe not, we expect it to moderate from Q1, growth rates.

The sequential billings growth rate...

Not necessarily comparing to what consensus is out there. But I’m more speaking to our growth rate in Q1, we would expect it to moderate a little bit in Q2.
Mark R. Murphy  
Analyst, JPMorgan Securities LLC

Okay. So, kind of less than – like less than a 5% sequential, just to be clear on that.

Tyler Renwick Sloat  
Chief Financial Officer, Freshworks, Inc.

Well, Mark, we're not guiding to a number. I'm just saying we would expect it to be a little bit less growth rate than we had in Q1.

Mark R. Murphy  
Analyst, JPMorgan Securities LLC

Okay. Got it. Thank you.

Operator: Thank you. And our next question comes from the line of Ryan Bressner with Morgan Stanley. Your line is open. Please go ahead.

Ryan Bressner  
Analyst, Morgan Stanley

Hi. Thanks for taking my question. Just wanted to maybe go back into some of the broader product conversations around e-commerce and how it fits in maybe to sales and marketing push and even longer term Freshteam. I'm just kind of wondering what the statuses on that and how it fits in portfolio longer term?

Rathna Girish Mathrubootham  
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

I'm sorry. I couldn't hear the question. Can you please repeat?

Ryan Bressner  
Analyst, Morgan Stanley

Sure. Just wanting to see if you could talk a little bit more about how Freshsales, Freshmarketer are doing and maybe looking out a few quarters, where Freshteam fit in the product portfolio and kind of how that is envisioned?

Rathna Girish Mathrubootham  
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Sure. As we said, like, Freshsales, the newly launched D2C CRM for e-commerce product is a combination of Freshsales, Freshmarketer and conversational engagement. So this is the first unified CRM product that we have launched based on the UCR, the unified customer record that's built on the Neo platform. So we are very encouraged by the early results that we're seeing. We called out the use case of The Lip Balm Company, which is one of our early customers. On the broader Freshsales product, we are seeing that business, even though it's early days, growing nicely in terms of both in the sales CRM market as well as the marketing automation. Freshteam, I would say it's still in incubation, it's too early to comment on our plans for Freshteam. So we would talk to you about it when it's more meaningful in terms of contribution.

Ryan Bressner  
Analyst, Morgan Stanley

Got it. Thank you.
Operator: Thank you. And our next question comes from the line of Brian Schwartz with Oppenheimer. Your line is open. Please go ahead.

Theodor Thun
Analyst, Oppenheimer & Co., Inc.

Hi, this is Theodor Thun on for Brian Schwartz. Thanks for taking the question. I had a question on your go-to-market motion and specifically your partner ecosystem. So with Freshservice and Freshdesk continuing to move upmarket and with the strong momentum that you’re seeing sort of in the largest customers, can you walk us through again how you think about the partner ecosystem and maybe also how we should think about the interest of larger partners helping your ambitions to move upmarket further? And then I have a second question for Tyler for me.

Rathna Girish Mathrubootham
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Sure, Theo. First off, let me start by telling you that we are not necessarily targeting a move into the larger enterprise. That is not part of our go-to-market motion. While our focus is still SMB and mid-market, we do have teams from larger companies coming to us, specifically when they are looking at us to replace like, let’s say, an enterprise solution like ServiceNow or Salesforce. So we have had wins there.

So our partners specifically play an interesting role in multiple dimensions. One, I would say is – I’ll start with the SI partners. So we spoke about TCS, which is a large tier 1 SI, but they have a special group for us where they understand that Freshworks’ products actually do not require the traditional 12-month, 18-month implementation cycles. So it’s a high velocity model, where they have actually completed 150 projects, mostly mid-market companies, but our products can be taken live in 8 to 10 weeks. So the SI companies are adopting a newer velocity model to be able to bring us to market. So that is working for us.

In terms of how we drive customization and integration needs of mid-market companies, so we use our app marketplace where partners can build custom apps which are required by mid-market companies to kind of integrate into their systems, in house systems. So the partners actually build apps to make that happen. We also have – today, we have more than 500 channel partners in more than 50 countries where they source leads in terms of bringing new business to the Freshworks customer base.

Theodor Thun
Analyst, Oppenheimer & Co., Inc.

Got it. Thank you. That’s very helpful. And if I can ask a second question for Tyler, so on your international exposure, given that 85% of your head count is located abroad and I think less than half of your revenue is derived from outside of North America, could there be larger FX impact to your expense line that provides a tailwind to margins or is the dollar amount affected by FX somewhat balanced between revenue and expense? So any color would be helpful on that?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Sure. And thank you for the question. The majority of our head count are in India and the INR has in general held up against the USD. That being said, it is starting to move a little bit, I think about 10%. But it definitely hasn’t moved as much as the pound and euro. So our revenue exposure has been greater than our expense exposure.
So they haven't quite been lining up. We've been able to run the business really efficiently and did really well financially in Q1 even with the top line FX exposure, but they're not quite matched up.

**Theodor Thun**  
*Analyst, Oppenheimer & Co., Inc.*

Okay. Great. Thanks for taking my questions.

**Operator:** Thank you. And our next question comes from the line of Shrenik Kothari with Baird. Your line is open. Please go ahead.

**Shrenik Kothari**  
*Analyst, Robert W. Baird & Co., Inc.*

Hey, thanks. This is Shrenik on for Rob. Just a quick follow up on the lowered deferred portion of the revenues, you said it's due to like lower number of large deals closing in the quarter, mostly Europe related, if I got it right, and the average customer size was like smaller compared to prior quarters. If you can provide some color around like what you saw in terms of, like, the mix of deals? I think you mentioned about annual versus monthly. So if the deals are shifting in any meaningful way like vis-à-vis monthly versus annual mix? I know it has been kind of pretty steady or growing. The annual mix was about 62% last you mentioned. So just kind of wanted to get a sense of if there is a shift happening within the customer base regarding the mix?

**Tyler Renwick Sloat**  
*Chief Financial Officer, Freshworks, Inc.*

Yeah. Hey, Shrenik. This is Tyler. So first of all, in general, really pleased with revenue performance in the quarter and the overall financial performance. The commentary was mainly around billings, and when we looked at billings, we said we didn't close as many large deals and we kind of called out specifically Europe and the team's still ramping up there.

On the flip side, we also said that we closed net new more customers than we have in the last year and a half. And that's a really positive sign with over 2,100 new customers. So, clearly, a lot of those customers are smaller that our CRM product – our new CRM products is driving a lot of those ads, which we're super optimistic about, even though it's too early to talk about the contributions from that. There was no meaningful shift in billing terms for new customers. As I did mention, when we have expansion which was still healthy which is also reflected in our net dollar retention number, that's an unpredictable number when those expansion comes through, because as customers expand, they could be paying stub period. So if they're on an annual deal and they're expanding with just four months left in their deal, oftentimes they're just paying for four month's stub as opposed to a new annual deal. And so, that expansion motion is little bit less predictable as it relates to billings. But in general, no meaningful shift in billings [ph] relation (00:44:33).

**Shrenik Kothari**  
*Analyst, Robert W. Baird & Co., Inc.*

Got it, got it. Thanks for further clarification, and appreciate, Tyler. And just one for Girish here, I know you kind of briefly mentioned about the e-commerce plans. If you can comment on the Shopify partnership specifically, how is that shaping up? And kind of when do you expect in terms of the timelines, like, rough timelines of that kind of momentum to pick up? And how do you envisage that?
Sure, Shrenik. So what we have launched today is a CRM product that is tightly integrated with the Shopify ecosystem. We are listed on the Shopify marketplace. So for the first time for Shopify sellers, we have brought together capability that helps them drive personalized marketing campaigns, self-service automation through bots and conversational agent experience to live support agents, and the bots, agents, as well as the marketing campaigns can now work across WhatsApp, across text messaging or any of the other modern digital channels. So, the plan is to expand beyond Shopify and go into other e-commerce platforms like WooCommerce and Magento coming later this year.

So, we are excited with the early traction that we are seeing. We have closed a few customers and we will share more. But maybe in the coming quarters we would share more stories of customers and what we're hearing from the market.

Hi, gentlemen. Thanks for asking the questions. So I wanted to follow up on the partner developments. Can you maybe talk about, like, how much of the revenue or new bookings is coming from the partnership channel today? And as we see that growing, does that mix increase and what are the longer-term ramifications from kind of a LTV to CAC perspective?

Yeah. So, Brian, I'll start with that. So partners are really important part of our go to market motion. Right now it's about 15% to 20% of our business is coming from our partner channel. Now the partners, it is a mix, right. We have partners who are working kind of solely in some areas that we don't have natural language capabilities. We're also partnering with partners, NGOs in North America and Europe where we have field presence. So the compensation mix actually is different as well, so – in some of those cases, right, where we're compensating partners differently based on what they're doing with us. I don't think it will have a meaningful impact to our LTV to CAC over time, except for the fact that when, as that increases, we should be able to drive efficiencies from that channel.

Understood. And Tyler, I wanted to follow up and I don't want to belabor the point here on billings because I know you guys don't manage to it. But when you're talking about the moderation in the second quarter versus the first quarter, I just want to be clear, is that versus the 32% reported or the 35% adjusted when you were making that comment? Thanks, guys.
Tyler Renwick Sloat  
*Chief Financial Officer, Freshworks, Inc.*

Yeah, that's against the 32% reported.

Brian Peterson  
*Analyst, Raymond James & Associates, Inc.*

Understood. Thanks, Tyler.

Tyler Renwick Sloat  
*Chief Financial Officer, Freshworks, Inc.*

You bet.

Operator: Thank you. And our next question comes from the line of Mauro Molina with Piper Sandler. Your line is open. Please go ahead.

Mauro Molina  
*Analyst, Piper Sandler & Co. (Broker)*

Hi. This is Mauro just taking a – just asking a question on behalf of Brent. So, as we think about the size of the different customers you serve, it'd be helpful to get some color on what proportion of the customers in the $5,000 ARR – or the $50,000 ARR cohorts are customers that sort of graduated into that scale of spend? Are most customers kind of starting out smaller or were they sort of already at that level of spend when they first signed on?

Tyler Renwick Sloat  
*Chief Financial Officer, Freshworks, Inc.*

Yeah. Hey, Mauro. This is Tyler. We actually have broken out the makeup of those of that ARR base and the customers in that ARR base and where they came from, it's a healthy mix of both, right. Our expansion in both units is really strong. And so we do have customers who graduate up, and if you go back to kind of like our IPO presentation, we demonstrated customers we landed really small and then there are now considerable multiples of what they'd landed with us on. But we are also landing with larger customers as well. The lands with larger customers is not as often, but it is not uncommon to land about $50,000, especially with our desk and service offerings. So it is a healthy mix of both. We just haven't broken it out yet.

Mauro Molina  
*Analyst, Piper Sandler & Co. (Broker)*

Got it, got it. Thank you. And then just one more from us, in terms of adoption momentum, were there any products that kind of surprised you or otherwise stood out from a demand perspective during this quarter? And if not, maybe any verticals where you're seeing more success or outsized success driving adoption?

Rathna Girish Mathrubootham  
*Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.*

I'll take that Mauro. So, we continue to see healthy demand for our ITSM product-based service where we are today the most credible alternative to ServiceNow. We continue to win against them and replace them, both cases have happened. Our CRM, we're really excited about what we are hearing, because this unified solution is being appreciated by customers for the value that we're bringing, the visibility into their customers, their users that we're bringing. And of course, in CX business, the conversational support and bots, this is a trend where every
consumer-facing businesses wanting to add on the ability to engage with their customers on digital channels. And we are seeing, like, early signs of good traction there as well.

Mauro Molina
Analyst, Piper Sandler & Co. (Broker)

Got it. That's helpful. Thank you.

Operator: Thank you. And our next question comes from the line of Alex Zukin with Wolfe Research. Your line is open. Please go ahead.

Ryan Krieger
Analyst, Wolfe Research LLC

Hey, guys. This is Ryan Krieger on for Alex. Thanks for taking the question. Just a quick one on the inflation, I'm sure you guys are seeing that impact costs to some extent. So I'm just wondering how you're thinking about potential pricing changes to compensate or how do you manage pricing or think about that dynamic going forward?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Yeah. Thanks, Ryan. This is Tyler. On costs, for sure we've seen it, and especially mainly on compensation, right. And I think everybody has seen it. And so, we're obviously doing the right thing by our customers. We don't have a -- like, a price increase strategy. It has really never been part of the company. And I can't say we have a structured play to go out and systematically try to increase prices across the base for our customers. Clearly, we would want our customers to pay for the value that they're receiving. But I can't say it's part of our strategy to just wholeheartedly just go do that.

Ryan Krieger
Analyst, Wolfe Research LLC

All right. Thank you.

Operator: Thank you. And our next question comes from the line of Brent Thill with Jefferies. Your line is open. Please go ahead.

Brent Thill
Analyst, Jefferies LLC

Hey, Tyler. Good profitability in the quarter, but you're not guiding to any improvements. So, maybe if you could just talk through if growth continues to slow and I think the broader concern at the macro heads a little south in the interim, are you going to be either, a, spend through it, or, b, do you feel like you'll put more there breaks on expenses and show a little more leverage? How do you think about that if we continue on the pace that we're on or continue on the macro side?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Yeah. So, I mean, for growth, we guide to what we see, right. We are cautious, because, again, Europe, I don't know if anybody really understands what's going to happen. And so, we are cautious in what we see there. In general, though, I think we've already demonstrated that we're running a really efficient business, right. We did
really well in Q1 against our loss number and our cash flow number and we kind of look at the whole year now and we’re able to talk about improvements we’re going to make throughout the whole year. We brought our burn number down and our operating loss number down pretty considerably. And so, nothing’s changed there. And we have kind of been running this model that we like to spend after we achieve certain numbers. We are still investing pretty heavily on a go-to-market side though. And we are going to continue to do that because we see traction and we have all these different levers, right. We’ve got our inbound motions and our field presence and across multiple geographies and multiple products. And so, and we’ve talked about some of these products that we’re actually really excited about. And if there’s certain areas that we don’t see the traction, then we still spend, but we don’t try to spend out of it. We will go, you know, deploy capital in other areas that we think we can get a better return.

Brent Thill  
Analyst, Jefferies LLC

Thank you.

Operator: Thank you. And our next question comes from the line of David Hynes with Canaccord. Your line is open. Please go ahead.

Luke Hannan  
Analyst, Canaccord Genuity Corp.

Hey, this is Luke on for DJ. Thanks for taking the question. So I was wondering if you could refresh us sort of on the vision and strategy for Freshsales in the market. And the reason I ask is because when I think of Zendesk, it sort of had a hard time breaking into the CRM market. And the same could kind of be argued for HubSpot breaking into service. So I guess the genesis of my question really is why do you think others have been slow to bridge that gap? And what are you doing differently do you think to achieve a better result? Thanks.

Rathna Girish Mathrubootham  
Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.

Yeah. Thanks for the question, Luke. See, our strategy for not just Freshsales, but the broader CRM market is how do we solve for today’s biggest problem in the CRM market, which is data that is siloed between marketing teams, sales teams and support teams, not to mention other teams like customer success, right. So that’s the core of our vision, where we want to bring an out-of-the-box product experience for CRM by combining all this data into a unified customer record. And what you saw in the announcement last week was, as we move one step closer to unlocking this vision of a unified customer record, today we have done that for e-commerce sellers that we are able to combine data across marketing, conversational support, self-service bots, as well as sales into a single unified customer record.

We are making progress to bring our Freshdesk product on to the unified customer record, and we truly believe that companies of the future which do not have a legacy of existing sales CRM or marketing clouds, or companies that want to break down the silos will be able to adopt a single customer cloud as opposed to these siloed. So that’s our vision and we are making good progress and we’ll share more details in the coming quarters.

Luke Hannan  
Analyst, Canaccord Genuity Corp.

Excellent. That’s it for me. Thanks.
Rathna Girish Mathrubootham  
*Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.*

Thank you.

**Operator:** Thank you. And our last question comes from the line of Pat Walravens with JMP Securities. Your line is open. Please go ahead.

Pat Walravens  
*Analyst, JMP Securities LLC*

Oh, great. Thank you. So, G, just very big picture here because we've been talking about it a lot, you guys beat on revenue, but you missed on billings and the tone is kind of cautious. So just so investors understand, where you happy with the performance of the sales organization in the quarter? Did José actually hit his number or was it a bit soft?

Rathna Girish Mathrubootham  
*Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.*

So, thanks for the question, Pat. So, let me start by saying, like, we really feel good about Q1, how we performed and we exceeded revenue expectations and we, like, continue to see efficiencies in our business. So, we are happy with how we came in from the operating margin and net dollar retention.

So, one of the things that we kind of and you know this, is we don't manage to really large customers, right. So we don't try to hit a certain number of large customer deals. So, that is kind of a realization that happened that, hey, we did not close enough large logos or land with the big deal. But when I look at all the product investments and the roadmap and it's paying off, the investments in [indiscernible] (00:58:10) is paying off. So broadly we are happy with our performance in Q1. So we beat revenue and we did significantly better on operating margin. So we are pleased with the quarter.

So, moving forward and specifically on the softness, I think it is an internal execution on the GTM side where we're still dealing with ramping reps who have to kind of close more deals. And we have made the investments and we are confident that it will pay off in the coming months and quarters.

Pat Walravens  
*Analyst, JMP Securities LLC*

All right, Great. Thank you very much.

Rathna Girish Mathrubootham  
*Chairman, Chief Executive Officer & Co-Founder, Freshworks, Inc.*

Thanks, Pat.

**Operator:** Thank you. And this does conclude our question-and-answer session and I'd like to turn the conference back over to the company for any further remarks.
Great. Thanks everybody for joining the call. Please let us know if you have any questions. And we look forward to staying in touch throughout the quarter. Thank you.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.