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Freshworks, Inc. (FRSH)

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MANAGEMENT DISCUSSION SECTION

Taylor McGinnis
Analyst, UBS Securities LLC

Awesome. Hey, everyone. So welcome to today's session. We have Freshworks' CFO, Tyler. So Tyler, thanks so much for joining us.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

Thanks for having us.

Taylor McGinnis
Analyst, UBS Securities LLC

Perfect. And for those in audience that might not know me, my name is Taylor McGinnis. And I head up our coverage of this SMID Cap application and SaaS base here at UBS. So Tyler, thanks for joining. Let's dive in.

QUESTION AND ANSWER SECTION

Taylor McGinnis
Analyst, UBS Securities LLC

Q

So maybe I think a good place to start would just be on what you guys are seeing in the demand environment. So if we look last quarter, you guys had good outperformance on revenue and billings. I think on an organic basis, it was maybe more in line to slightly below. So in terms of what happened in the quarter relative to your expectations, mind on opining on that a little bit and to the extent if you guys are seeing any green shoots, like what areas those might be in?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. So I think if you – we have two sides of business. So we really think about now our CX products and our EX products. CX is really playing into the long tail of SMB and all the way kind of up, but really focus now on SMB, low mid-market, and that's for literally 2.5 years now seen the most pressure of what we would call macro impact to the SMB space. That's one where we said in Q3, like maybe early signs of seeing a little bit of goodness but not a trend yet. I mean that the Asian expansion has been the biggest pressure on the business overall as the decline rate of expansion in CX. And that rate of expansion is the one that's, okay, maybe starting to level off a little bit, not coming back but leveling off.

The same time, we've been very focused on the things that we have control over which we think is churn, and retention obviously being reflected in that, and also just the health of the customer base in general. And we said it's, hey, the best churn rate we've ever had in CX ever. And then at the top of funnel, the conversion rates, starting to see some of the fruits of labor we're doing there and it's actually being reflected in the number of customers. So at over 800 net new high which had been coming down kind of quarter-over-quarter in the last three quarters, slightly starting to come up. So that's all goodness. I don't think it's a sign of macro coming back yet, but I think more of a sign that the work that we're doing internally is going okay. On the EX side of the business, that business is still doing great and nothing – in Q3, you asked, hey, did anything happen in Q3 or was it different than what you expect? No, it's totally what we expected. Europe, technically – typically a little bit slower in Q3, which what we saw. EX is really playing mid-mark – mid-market, low enterprise. So it's much more of an enterprise sale, which is much more susceptible to kind of that enterprise motion, which typically has a recovery in Q4. So we got to go and execute against that. So I would say no huge changes on the macro environment. I think expansion motions are still tough, but the markets that we're playing in are massive. So I think we've just got to go execute in the stuff we're in control of.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Yeah. Let's unpack the CX business because I think that that was probably the biggest surprise of the quarter and seeing that acceleration to 10%. So one, the 10% acceleration in ARR, does that mean the quarter might have been a little bit more backend loaded? Was there any of that? And then also to – you mentioned that you were maybe seeing some green shoots in the level of the seller decline and that seat maybe starting to abate a little bit. So how much of that acceleration was really driven by your own execution on the new logo side versus macro getting a little bit better?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.
A

I would say the former. I think it's all executional stuff for a control over. On the churn side, we've been very, very focused on looking at current installed base and really making sure we're addressing their needs. Whether that's through a digital adoption program, making sure that we get kind of adoption utility up as much as possible with our existing installed base, all the way through to the list of bugs and things like that, and making sure our engineering teams are addressing that fully.

On the new customer capture, I think we have not done ourselves a service in terms of how we've attacked the inbound top of funnel. We really hadn't innovated on that in years and we're starting to do that. We started talking about it in Investor Day a year and a half ago, and we call it PLG 2.0, product-led growth 2.0. So we're starting to see some of the signs that this is starting to work. I don't think this is a change in macro. I think it's more of the stuff we're in control of. Our top of funnel has always been pretty healthy. The conversion rates haven't been where they need to be.

So I think this is all goodness. We got to see it happen in Q4 again and then in Q1 and we'll keep talking about it. If we do think that's actually going to change the tone of the business. The reality is that business, it's about $350 million business growing just under 10% – 10% with FX. Net dollar retention is still just slightly below 1, even though we just had the best churn quarter. We're just trying to make incremental improvements there. And then if things start to get really healthy again, that'll really change the business model in general. CX is really important for us and we're very focused on it. But the reality is the majority of our growth is going to come from EX, which is doing really, really well.

Taylor McGinnis
Analyst, UBS Securities LLC
Q

Yeah. And in terms of what all this means for the 4Q guide when we look beyond, I think the 4Q guide on an organic basis for both billings and revenue implies a little bit of an acceleration. So in terms of the assumptions embedded in that, is that just that the EX business tends to be more 4Q skewed, right? So you're going to see maybe the fruits of that. Does it assume a similar macro environment, maybe some improvement? Can you help unpack that a little bit.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.
A

It doesn't assume much improvement on macro. It does – we do have – Q4s tend to be much more enterprise influence. Actually, SMB actually has a lower Q4 typically because the SMBs act like individuals. They don't buy as much during holiday seasons. So it'll be probably more skewed toward the field motion, which means it will be more skewed to EX. Those deals are bigger. They have more annual in advance characteristics and things like that which have more billings influence. But it's not like we're not expecting any type of recovery, we're just expecting to go execute on what's right in front of us.

And it's kind of the same for next year. Actually, we gave a glimpse for next year and we said low- to mid-teens in terms of revenue growth. That one, we're still in Q4. We got to go execute, we got to get through those numbers, that will have a big influence on what next year's revenue will be. We're still in the kind of the middle of the planning process and so update at the end of year. But we're saying, okay, that's what we see right now, which is kind of in line of what we see for Q4. What we are very comfortable about is the bottom line. So we said greater than 16% non-GAAP operating profit and greater than 25% free cash flow margin, which we think we have a lot of control over and we're doing really well on. And so nothing like dramatically different in the business, but we're starting to see early good signs, and we just got to keep executing.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Perfect. And before we get into next year, so definitely have some questions around that. But when we think about the EX business, so you mentioned that that business has been performing fairly well. If I look at the Analyst Day and some of the disclosures that you guys gave roughly, let's call it, a year ago, I think that business was growing closer to 40%. And don't get me wrong, 30% is still a very good growth rate in this type of environment, but that decel from 30% to 40% or 40% to 30% on an organic basis, how much of that was truly macro? Like what changed relative to your guide's initial expectations because I think the hope was that business could stay at a CAGR of, let's call it, low-30s. So can you help us understand what may have changed and how much of that is really attributed to macro?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. I don't know if it's as much macro. I think it is execution. I think it's more law of larger numbers. Those 40% at Investor Day, which was June 30, 2023 numbers, it was 30% in Q2, 30% in Q3 organic, 40% inorganic. And so it kind of maintained that 30% growth. We do expect there to be pressure on growth just as we get bigger, but the reality is, okay, that's ours to look after from a new business and expansion perspective to keep it up there. And so our goal internally is not to let it decrease, but we have a lot of work to do. I do think everybody should focus on the organic numbers that we are trying to break out. We did do the Device42 acquisition, did have a huge revenue install base and we actually were pretty open that we expect that install base to have disruption to it because it was mainly through a partner competitor. And so we expect a lot of that to go away. The thesis of that buy was on cross-selling into our existing Freshservice install base, but also higher win rates, specifically as we're moving up enterprise. And we're competing more and more service now. And so that one is playing out and that will play out all throughout next year.

Taylor McGinnis
Analyst, UBS Securities LLC

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That's really helpful. And then as we think about the EX business and the CX business and the growth rates that they're growing at and potentially the durability of those, any comments you can give there because you're seeing more stability in the environment, maybe some areas of green shoots. Does that mean these growth rates maybe could be a little bit sticky going forward? And the reason why I ask is because I think if you run that math, you could come to a conclusion that low to mid-teens growth next year, like, seems fairly prudent. So can you help us bridge that gap and how you're thinking about the growth of each of those?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Right. I think that's a fair question. I think – so we went through a strategic exercise kind of in the same time. Dennis was appointed our CEO at the end of April, beginning of May, [ph] and forward (09:19), said, hey, you got to come back with a strategy. We took it seriously. We did a lot of work internally. We hired external firm to help us out and we presented to the board at end of Q2 and then actually talked about it Q2 call. That strategy is, hey, really, growth is coming from EX and we are actually underinvested on the EX. So let's rectify that and really focus new investments as well as the outbound motion on EX, which is the big opportunity. CX, let's go focus on where we have a right to win, which is really SMB and midmarket, but really going to be SMB and commercial. So a lot of our new business acquisition and roadmap stuff is going to be focused on building for that segment for

CX, and then AI across all products. If you look at that, it's like we do expect there to be some disruption in what would have been midmarket and low enterprise acquisition on CX because we're not going to be attacking that. So we built that in. At the same time, we actually think there's going to be some acceleration on the SMB side because we're focused there.

On the EX side of the house, we are kind of modeling out what we see today and expansion rates that we see. And we're not being aggressive in terms of what acceleration because we have to let kind of the new motions play out. But we do expect that to actually maintain. When you look at the combination of business, that's where you get to the low 13 – kind of low to mid teens is what we said, which is very similar to how we're ending this year from a billings perspective, right? And it's not anything dramatically different. We are going to have a pretty tough compare towards the end of the year because of the Device42 business that came in. And as I mentioned, there is a degradation of the business that we inherited. So you kind of have this pressure on their existing base that we have to rebuild, which was the thesis of the deal. And so that is kind of like a one-time year pressure that we're going to lap that on June 30. So Q3 and Q4 of next year is actually going to have a tougher compare.

Taylor McGinnis
Analyst, UBS Securities LLC

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Perfect. And you alluded to this a little bit, but is there any way to get a sense of the expansion rates that might be embedded in that outlook, or how to think about the mix of expansion versus new logo relative to what we're seeing this year if you are starting to see maybe that funnel activity and conversion rates start to improve?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. We look at net dollar retension and we also look obviously expansion in churn. The net dollar retention for the CX business we said is just under 1 right now, and we don't expect it – we haven't modeled in, oh, my gosh, that's going to come up to no – single, like, high single digits or anything like that. We kind of think it's going to maintain. We're very focused on churn, but the reality is we don't have as much control over the expansion motion. That's where we've seen the most pressure. If that comes back at all, then this conversation is very, very different. Right? But we just don't feel like that's in our control. On EX, that expansion motion, we have to play out. But our biggest kind of sales plays for the year as well as product plays are going to be Device42 integration, which is coming out in Q1, ESM purpose-built workflow starting with HR, enterprise-grade feature set which is really about competitive dynamics and win rates and things like that, not as much of an expansion. But future stuff coming out later in the year hopefully will be stuff like MSP, purpose-built feature functionality for MSPs and for [ph] SLED (12:35), state and local. Those things are really going to be reflected in revenue throughout the year, but they should be reflected in bookings kind of back half of next year. But we have to get it out. We have to play it out next Q.

Taylor McGinnis
Analyst, UBS Securities LLC

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Yeah. This is probably going to be the segue to talking about AI. But when you think about the biggest expansion opportunities that you have next year, let's say seats remain subdued, and you're still seeing some challenges there. What are the biggest expansion opportunities? Is that really AI or maybe there's some emerging functionality that you guys are excited about?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Sure. For CX, it's absolutely going to be AI. So what we're seeing on attach rates for – so we have two AI products in market today. We have our Copilot, which is attached to an agent as an upsell is $29. And then we have our self-service and AI agent products, which are really about kind of L1 deflection through chat. For CX, the – and not – actually for across all products what we said the attach rates in new business are really, really healthy. Deals over $30,000 has greater than 50% attached on Copilot, and SMB deals have double digit attached on Copilot. And on the self-service products, they're not really attach rates where you get an entitlement to self-service. And as you use, you have to buy more bot sessions. Right now, it's 1,100 customers that had to buy more bot sessions. So it's an indicator of usage. As that comes up, then revenue will follow, right? That's all – like the usage on the self-services there and it's an existing customer, the attach rates are new deals which we would expect, okay, that's going to be going forward.

And we're not actually asking customers to be binary whether you buy 100 agents, you have to buy 100 Copilot. We're actually allowing them to buy a sub-segment and test and see that. The toughest on CX, but I actually think the biggest upside will be on upselling customers on Copilot in CX. And it's actually kind of hard because you get customers who have already purpose built training for their support agents and you have to change that training. It's a business process change. And so we're actually attacking cohorts of customers and we're seeing good traction on that effort. It's an effort, right? You have to go in and do it. And so that actually, I think for CX is the main upside for next year. On EX, we actually have a bunch. We've got Device42, we've got ESM, and we have AI capabilities. And so we're going to – we have sales price across all three of those.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Perfect. I want to get into Device42, but before that, let's dig into this AI conversation a little bit more. So when you think about the opportunity with CX, I know it's very early. I think even the numbers that you guys have disclosed suggests it's still low single digits penetration across your entire customer base. But in terms of what you're seeing in that cohort of customers, any even high level color you can give on when you add in AI or Copilot, what you're seeing in terms of average deal sizes. As you mentioned, that there's differences across customer segments for those larger customers, are they migrating to some of the higher level packaging in order to get chat embedded? Any just color that you can share there I think would be really interesting.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. I think it's pretty new. What I can say is that the Copilot pricing is holding up. So at $29, the ARPUs that we're seeing is actually holding up in the discounts. What would be – are proportional to the discount on a deal, right? So if it's a 30% off deal in enterprise, the Copilot's can be 30% off as well. The utility, the early signs of utility are actually really good. And so I think you got to get these products and you've got to see customer see value, and then you're in the right to go zone, right? And that is really what I think the future is going to be based off of. So as we can demonstrate utility and value and efficiency, they will buy more.

So we even have a strategy. If a customer is not buying it, we'll give it away for free for six months and just say, hey, go use it. And then, theoretically, at six months, we can turn it off. There's no risk to us or it's going to be an upsell, natural in there. And actually, sometimes like those deal is better than selling it on the initial land because it is just a built-in upsell motion. And so we're starting to do those as a kind of a sales play as well.

I do think it's early on the total – what is it going to mean for incremental value in general to ARR. Right now, ARPUs are going up, and we actually haven't seen any seat degradation that we would say is as a result of AI. It's just we're not seeing that at all. Theoretically, over time, the expectations, you would see some of that, right? Or at least you'd see efficiencies, so that customers wouldn't have to buy more agents because they can do more with less. But the pricing was designed to anticipate that. So we'll see.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

That's perfect. Yeah. Because I think that, that was going to be my next question, right? So what's the risk? You got some seat degradation and maybe ARPU like stays the same as it was before, but it sounds like you guys incorporated that in your outlook and you expect it to be accretive. So in terms of what gives you comfort in that, is that because you have some customers, let's say, that are a little bit further along, you've seen them go through that journey. You're not – maybe they are like taking down seats, but you're seeing the offset be much greater, like, what's giving you guys that visibility and comfort that that will be like the outcome? I know it's a tough question but...

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. No. It's not. I just think it's early, right? I think adoption and all these products are still early. Right now, for the customers that we do have that are early adopters and they've been using it, they're not reducing counts. And so that's, I think, the early signs. And we literally can't point to a single customer as doing that as a result of Freddy capabilities. But they are giving us feedback that they're making their agents much more effective, which is great. And that's what Copilot is supposed to do. I think the thing that's the earliest is going to be on the self-service, like we've had self-service for a long time, which is kind of customized bots and really built for specific workflows. AI Agent is the latest version of that and we still have to have some innovation to combine these two, but AI Agent is truly conversational and really pointing at your knowledge articles internally. We've proven that we can get a customer up and running like 30 days on that and really have a high level of deflection, an easy L1 stuff. And I think over time, that's the one that's kind of noise for a lot of companies. And to be able to reduce that and get their support CX capability – people really focused on harder issues is going to be the big one there. And so like – but again, it's early.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Yeah. Yeah. I wanted to ask you on Freddy AI Agent. Because I thought that that was a really interesting announcement. So in terms of how that differs from some of the self-service offerings you've had before, can you elaborate on that a little bit more? And it sounds like part of the goal is to speed up, right? The pace of adoption here. So what were you seeing in the market that maybe was the catalyst for that?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. I think all of the [ph] LM (19:24) capabilities make allow you to have a conversational interface, to truly make it conversational with intelligence that it can learn over time. The thing that we don't – as we have two versions today and customers can choose which one we're seeing more of the SMBs choose now AI Agent, which is brand new. It's only – it's been out for three months. But it's been data for longer than that.

And what they're saying – okay, if we can point it back to our knowledge or articles and all of our facts internally, that can solve a ton of that frontline customer issue coming in. The more sophisticated customers are going to be like, well, actually, I want that chat capability to actually do true workflows for customers. So not like a conversational but, hey, if I'm an airline company – we have a bunch of airline companies. My ticket got canceled. I need to rebook. Being able to tie that chat session in to, say, in order management system or ticketing system, that's what we don't have on AI Agent right now and that's what we will come out with. And so that's where you have the bifurcation, right? And so there's still a set of customers who want to have that more sophisticated prebuilt bot experience but can handle the complex workflows versus just the ones that would be answering questions based on a knowledge articles or facts. They will come together over time. That's our next big innovation that will come out, right? But we don't have a date for that yet.

Taylor McGinnis
Analyst, UBS Securities LLC

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Perfect. Thanks for that. Maybe let's switch gears to Device42. So I think there's two big questions that we get, which is, one, the time to when this will really be a bigger cross-sell opportunity. So it sounds like that there's some tinkering that has to be done to make this more cloud-enabled, right? So I'd be curious one on that.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Tinkering, it sounds like my technical...

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Yeah. I figure we might be putting it lightly. But in terms of what needs to be done there, right, to really facilitate that cross-sell opportunity and also to, I would imagine, the integration piece is one. Could you maybe give us an update on that journey? And when you expect to be finished with that, such that this can be – you could see like an acceleration, I guess, in that cross-sell momentum?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Sure. So there's, I think, three main things that are coming out with Device42. First is that – Freshservice, we already had ITAM, which actually had pretty good capabilities, especially for some cloud offerings, and arguably maybe even easier to use than what Device42 had for really like simple ITAM. So one thing that's actually building into Device42 equal and better capabilities and what traditional Freshservice had. So there's going to be no confusion on, do I use a legacy Freshservice stuff or do I use Device42. So that one is already being solved. Integration into Freshservice, which is really being able to take all of the Device42 data and present it to the agent and admin sitting in Freshservice. That integration is coming out in Q1. And that's actually going to be the biggest kind of catalyst for that cross-sell into our existing install base. So we can go to them, demo out a product that looks and is seamless to their current Freshservice agent and admin. And that, I think, is going to be one of the things that allow us to go really penetrate our existing install base.

Moving Device42 to the cloud is an on-prem business today with a control unit that has to be on-prem and then a thin client out there on all the devices. The thin client will stay, moving that on-premise to be part of a multitenant solution in the cloud with Freshservice, that's scheduled for the end of 2025. And I think that's going to be more – it's definitely going to help from selling perspective to a customer that don't actually have to go do that and put it in, but it's actually more of a – it's going to have a financial impact as well because the revenue recognition is different for the on-prem stuff. And so that, again, is going to be at the end of 2025. Integration is Q1. So we've already started those cross-sell motions in anticipation of that. And the sales cycles for Device42, a little bit longer because it's a little bit more complex solution but they're starting right now.

Taylor McGinnis
Analyst, UBS Securities LLC

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Perfect. And can you give us a sense of how ITAM compares in terms of average deal size to what you see with Freshservice today? Just so we can gauge how big of an opportunity this could be.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. I think it's going to vary, but it's anywhere from, I would call it, like a 20% to 50% uplift on deals. And so that was one of the impetus to buy, right? It is truly an enterprise grade solution. If you are a smaller company, you don't need ITAM. So it's actually not going to be – it's not going to be relevant for certain part of our existing installed base, specifically kind of that lower mid-market kind of customers that we have which are really – Freshservice might be their very first ITSM solution. They might need their robust ITAM. But as we're getting to kind of a lower enterprise, that 10,000 to 20,000 employee organization, the actual footprint that they have is really pretty complex. And that's where it could actually be a pretty good upsell.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Perfect. And one question we've been getting from investors on Device42 is when you look at the guide, I think this last quarter, we saw a contribution of $8 million. It looks like the guide implied something of $4 million. So I think there's some questions on why might you see some of that volatility from one quarter to the next. So do you mind just offering some thoughts there? And as a second part to that question, I think you've also been getting questions on, though, when you look into next year, is there the risk that this becomes a bigger headwind? So yeah, anything you could share there will be helpful.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. So Q3 came in higher than what we had actually and originally kind of guided and forecasted and we said $4 million for Q4. We have to make an estimate on the deal term. Because it's a term license, a one-year deal is actually dramatically different than a three-year deal in terms of how much revenue we recognize, because a three-year deal has – and it's almost – it's like 80/20, 70/30, 60/40 is the way you kind of think about it, where that for a three-year deal, 60% of all three years is recognized in advance. Whereas for a one-year deal, it's 80%, right? And the way the term license. So we had a higher percentage of three-year deals in Q3 than what we anticipated. The Q4 estimate of $4 million anticipates that it's going to be back to kind of a norm. And there's two things. It's the new deals, what the duration is, and then the renewals that are coming up, what those durations are, and they both can impact. And so it's an imperfect science right now, I'd say.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Perfect. Awesome. And then, maybe let's shift to margin. So when we think about the, like approximately, 13% head count reduction, I guess, why now, and when you think about where those layoffs happened, how you're trying to align cost, maybe you could provide a little bit more color there. And is the goal of this to take those savings, realign and invest all that back into the business or might you actually see some of that fall to the bottom line?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

I think we're going to see just efficiencies in general, to answer the last part of your question. We gave a glimpse of next year. We said that low to mid-teens on top line. We have to finish up the planning and get through Q4, but we're very confident on bottom line. So greater than 16% non-GAAP operating margin, greater than 25% free cash flow. It does assume that we are actually going to reinvest some of the savings that we just had in the reduction, of course, that we made, which was 13% across the board. The question of why now, it really was very much aligned with that strategy exercise I just mentioned. So that strategy exercise is all about focus, all about go-to-market focus, and how we're going to go to market next year on EX and CX, but also on the products that we're doing and what we're building.

And so every single department actually participated in that, but it was actually disproportionately kind of weighted against the go-to-market side, which is okay. It was also very much focused on making sure we have the right people in the right roles, just not a lot of people. I still think we have the capability to even be better on efficiency and where it's going to place out over the years. I mean, we've gone from 0% free cash flow marginal in public three years ago to now 25% next year, which I think is pretty good. And I think we can continue down that path. On the go-to-market side, we're very focused on efficiencies, but we're not going to be – we're not going to sacrifice growth for dollars on the bottom line. I think we can do both. If we feel like we can lean in and grow faster, we're absolutely going to do it, right? But I think we're appropriately funded right now.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Perfect. And yeah, I would agree. I think that the 16% and 25% operating income margin and then on the cash flow side definitely stood out, right? So in terms of those areas, because you did say you are reinvesting some of that. So in terms of the areas of the business that you found that you are able to drive more cost savings and more operating efficiencies, can you give us a little bit more color on what that is?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

A

Yeah. So on the go-to-market side, we're kind of restructuring a little bit what's that CX is going to be very much inbound led and really focusing on SMB and low midmarket. EX is going to be outbound and it's going to be fed by some inbound. But our entire field motion is going to be really focused on EX. We're also going to look at what we call Tier 3 and Tier 4 countries, and those are really going to be partner first. And to the extent that we had started to build out employee bases in countries, we're probably going to retrench and make sure those are partner only. And so these are all things that are all about focus that will lead to efficiencies in some regard, but actually doubling down in others where I think that we have a lot of capacity to grow specifically in the countries in our backyard that we can be very focused on.

On the engineering side, it's the same thing. We moved 200 engineers from our CX team into our EX team. We are streamlining a lot of the engineering efforts, but also streamlining a lot of the products that we're focused on, and where we're putting in the innovation dollars. And we're going to continue to see that thing. We actually also have a lot of products that we've been building that we don't necessarily monetize. And the thing is that we don't have a specific strategy on how we're actually going to influence the top line that we should be doing it. And that is part of strategy efforts as well. The other piece of the business like on G&A, those are just economies of scale. We'll get that over time. One area that we've done really well on is gross margins. We're already at 85%. I don't expect us to get much better at it, but we've proven that we can run a plus $700 million business at really an efficient rate as good as much larger peers of ours, and I think that is a competitive advantage. And we're going to play into that and continue to do so.

Taylor McGinnis
Analyst, UBS Securities LLC

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Perfect. And then the follow-up question to that is, is any time you're shifting things around the business, there's always this question of, does that – could you see disruption risk off the back of that? So in terms of what you guys are seeing today, what you're embedding into the guide next year, is that a consideration at all?

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

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I think there is. We have embedded some disruption, right? A little bit, like if outbound is not focused on CX and we don't expect to close much business on the outbound. So we've built that in for CX. Our Freshsales and Freshmarketer products, we've combined that into CX. And if we're not going to aggressively go pursue new business there, then we should expect that to tail off a little bit. And so we built a little bit of that in, but we're not abandoning in any of that. So we'll see how it all plays out. I think from an innovation perspective, that doesn't necessarily get reflected in numbers, but will get reflected in kind of products and just the pace of innovation. We've also made two recent new hires. We've have hired a CTO in Murali, and we just hired – we announced our brand new CPO in Srini, who just came of – they're both out of our San Mateo headquarters. Murali came from ServiceNow, and Srini just came from RingCentral. One product, very much CX background with EX, and one, very much EX focused. And it's really just gained a ton of domain expertise in that they're going to look at their teams as well and continue to make changes. Kind of same evolution that we went through on the fields – on the go-to-market side this year, I would expect they will have their footprints on the product and engineering side.

Taylor McGinnis
Analyst, UBS Securities LLC

Perfect. Awesome. Well, that's all that we have time for. So Tyler, thank you so much for attending. And thanks for everyone listening in as well, too.

Tyler Renwick Sloat
Chief Financial Officer & Chief Operating Officer, Freshworks, Inc.

Thank you.

Taylor McGinnis
Analyst, UBS Securities LLC

Perfect.