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# Freshworks, Inc. (FRSH)

Q2 2022 Earnings Call

## CORPORATE PARTICIPANTS

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Welcome to Freshworks Second Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions]

I would now like to hand the call over to Vice President, Investor Relations, Joon Huh. Please go ahead.

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**Joon Huh**

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

Thank you. Good afternoon, and welcome to Freshworks' second 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 second quarter 2022 performance and our financial outlook for our third quarter and the 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-Q 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 for our second quarter 2022 results, which we issued earlier today and is available on our Investor Relations website at [ir.freshworks.com](http://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 to learn more about Freshworks.

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

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## Rathna Girish Mathrubootham

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

Thank you, Joon, and thank you, everyone for joining us this afternoon.

I will start the call with a recap of our results and then highlight our latest product update and close with what we are seeing in the current market environment.

Overall, we had a solid second quarter. We continued to grow efficiently and came in ahead of our expectations on both revenue and non-GAAP operating loss. Our Q2 revenue grew 40% year-over-year, adjusting for constant currency, or 37% on a reported basis. Our net dollar retention 115% on a constant currency basis, and it has remained steady in the 115% to 116% range for the last five quarters, if you look at it adjusted for constant currency.

In Q2, we added nearly 1,800 net new customers. Angi Home Services, Cloudera, Sterling Bank and Thomas Cook are just a few of the brands we are proud to work with. We also saw healthy expansion rate among existing users and our multiproduct adoption continues to climb. Today, 23% of our customers use more than one Freshworks product. Overall, I am really proud of our team and the progress we made in Q2, continuing our mission to deliver business software that people love to use.

On the product front, let me start with Freshservice where continued demand in the mid-market is creating sustainable growth for our business. Companies like Toshiba, Dynatrace and WD-40 are using our easy to use ITSM solution to support their global workforces. Our partners continue to contribute to our mid-market growth. One of our largest Freshservice deals this quarter was sourced by a regional channel partner in Africa, and this was closed alongside Device42, our technology partner for enterprise asset management that we announced last quarter.

In Q2, we also strengthened our enterprise grade IT operations management capabilities with enhanced alert management and On-Call Management features. Using these new Freshservice capabilities, a large bank in Southeast Asia with nearly 4,000 employees was able to cut down their IT-related alerts by approximately 60%. The bank's IT teams now use their time to resolve actual incidents rather than wasting time on thousands of false positive alerts. Freshservice saves our customers time and money.

We're also seeing customers expand their Freshservice usage to other departments for internal employees support. For example, AMEX Global Business Travel, the publicly listed global travel management company uses

Freshservice for both their IT and HR department to deliver exceptional support to over 13,000 employees. We are proud to help companies of all sizes create a great employee experience with Freshservice.

Now let's shift to the customer side of the business, where conversational engagement is a key part of our strategy to help companies reach and retain their customers wherever they are. In Q2, we brought back our Freshchat brand, previously known as Freshdesk Messaging, to better communicate our ability to create a seamless conversational experience combining bot and live agent experience to our customers. With Freshchat businesses can use bot to automate transactional first level of support and gracefully hand over to a human agent for more complex use cases without sacrificing (sic) [sacrificing] (06:27) customer experience. Freshchat is a strong first entry point into consumer companies who often expand to Freshdesk or Freshmarketer.

After the launch of CRM for e-commerce in Q1, we took our conversational engagement strategy a step further by re-architecting our standalone Freshchat product to work on top of our Unified Customer Record platform, or UCR, along with Freshsales and Freshmarketer. Today, brands sell more and more through digital channels, and their customers expect instant support on these third-party messaging apps like WhatsApp or Apple Business Chat, for example. With the addition of Freshchat to the UCR, we can now sell to the marketing, sales or support organization first and then expand into the other departments by showcasing the power of unified customer communication.

Our Neo platform also gives us the flexibility to quickly add on messaging channels. In Q2, we added integrations for Instagram and Google Business Messages. Enabling conversational messaging across multiple channels is creating new growth opportunities for us and our customers. A leading digital bank and payments company with millions of customers and a long time Freshworks customer expanded their use of Freshchat in Q2 and increased overall customer satisfaction. Thousands of agents are now armed with live messaging capabilities that go beyond the website to provide customers with a seamless experience across iMessage and their mobile app.

Conversational messaging capabilities are also important for our B2B customers. In Q2, we built new Freshdesk Omnichannel integrations with telephony providers like Five9 to optimize agent productivity and supporting customers across chat, email, social and voice seamlessly. A new integration with workforce management software company, injixo also helps larger companies better manage their contact center, team, staffing, scheduling and workload.

Thomas Cook, a popular global travel company, has a customer operations team of 80 people responsible for managing over 20,000 contacts every week. Workforce management features integrated with Freshdesk enable Thomas Cook to forecast team workloads and schedule the right number of support agents to provide a great customer experience throughout the year.

Companies of all sizes are realizing the importance of streamlining and automating customer communications across all channel to help customer-facing sales, marketing and support teams understand and serve their customers better. I'm confident that our vision of a Unified Customer Record and the progress we had made in Q2 will provide the long-term growth opportunities for Freshworks going forward.

Overall, we had a solid quarter, despite the changing macro environment. Now let me talk about what we are seeing in the market. In Europe, we are pleased that we improved our execution and achieved higher close rates compared to Q1. We continue to monitor the region as it feels the pressure of rising inflation and an ongoing war. Among our global customer base, we are seeing varying degree of impacts across segments. Our SMB customers are feeling the macro pressures and we are seeing this translate to higher churn especially at the lower end of SMB, in companies with fewer than 50 employees.

In contrast, our larger customers in mid-market, enterprise are showing more resilience and they continue to grow their investment with us. As our business has moved more upmarket, our larger customers today represent the majority of our business at approximately 57% of our ARR. As a result, our overall churn rates for the company were roughly the same quarter-over-quarter as the higher SMB churn was offset by improvement in mid-market and enterprise segment. Additionally, we are seeing steady increases in the average revenue per account reflecting our ongoing customer expansion and larger deal sizes.

We have a global business with a very diverse customer base across multiple products and industries. In an environment where companies are spending more conservatively, I'm confident that Freshworks' affordable products will continue to deliver incredible value to our customers around the world and continue our long-term growth.

With that, over to you, Tyler.

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## **Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Thanks, G. And thanks to all of you for joining on the call and via webcast.

As G mentioned, we're pleased with our solid execution in the second quarter. We maintained our strong expansion motion with a 115% net dollar retention adjusting for constant currency, while adding new business and customers across our three broad product categories in customer support, sales and marketing and ITSM.

Although the negative revenue impacts from FX increased throughout the quarter, we beat expectations for revenue, non-GAAP operating loss and billings growth in Q2, demonstrating the resiliency of our business model in a changing macro environment. In fact, Q2 revenue growth would have been approximately 1% higher if currency rates remained the same from our Q1 earnings call.

With FX volatility increasing over the past several quarters, I'll spend more time on the call today talking about constant currency comparisons both year-over-year and compared to our prior estimates last quarter. So you'll get a better view of our underlying business fundamentals. As I normally do, I'll review our financial results from the recent quarter, provide background on key metrics and close with our expectations for the upcoming quarter, Q3, and full year 2022. I'll focus most of my financial results discussion around non-GAAP numbers, which exclude the impact of stock-based compensation and related expenses, payroll taxes on employee stock transactions, amortization of acquired intangibles and other adjustments.

So, starting with the income statement, revenue grew 40%, adjusting for constant currency, or 37% as reported to \$121.4 million in Q2. We maintained a healthy expansion rate for our products similar to Q1, with additional agents receipts being the largest driver of this expansion. We're also seeing a steady increase in our multiproduct adoption, up 1% again to 23%. These customers now represent nearly half of our business.

From a product line perspective, Freshservice continues to deliver strong growth and was the largest contributor to ARR growth in the quarter. We maintained steady non-GAAP gross margins at 82%, which was in line with the prior quarter and continued to be at robust levels as we scaled the business. In Q2, non-GAAP operating expenses increased \$115.4 million. As we mentioned last time, our annual merit cycle takes effect during the second quarter each year, resulting in higher personnel costs, and this drove the majority of the increase in all three expense categories.

Additionally, for sales and marketing, we had increases in travel activity, field marketing initiatives and in-person events including our Global Jam events, which contributed to the higher expense this quarter-over-quarter. As you would expect, rising inflation resulting in elevated supply cost and travel expenses for the business.

Our revenue [ph] beat (14:20) combined with effective cost management led to a non-GAAP operating loss of \$15.8 million, and \$1.7 million ahead of our expectations for Q2. So I'm pleased with our ability to execute toward our financial goals in the current market.

Moving to our operating metrics. Net dollar retention was 111% and 115% on a constant currency basis in the quarter. The consistency of net dollar retention, or NDR, adjusting for constant currency over the past five quarters reflects the ongoing expansion activity in the business and also our ability to effectively manage churn over this time. Now as we look forward into Q3, we expect FX rates and a slowing economy to impact our overall expansion rates, resulting in a reported NDR ticking down to about 110%.

Turning to our customer metrics. Customers contributing more than \$5,000 in ARR grew 22% to 16,212 in the quarter and continues to represent 86% of our ARR. With a meaningful number of customers falling below the threshold of \$5,000 in ARR because of FX moves, we're also providing the growth of this metric on a constant currency basis for Q2, which was 25% year-over-year. For our larger customers contributing more than \$50,000 in ARR, this customer count grew 42% to 1,648 and now represents 43% of our ARR. Adjusting for currency, this customer cohort grew at 48%. Lastly, our total customers grew to over [ph] 59,900 (15:59) with a net add of nearly 1,800 customers in Q2, as our average revenue per account continued to increase in the quarter.

Turning to billings. Q2 calculated billings outperformed our expectations as this metric grew 33% year-over-year, despite a negative 5% impact from FX movement. Other factors also impacting this growth rate include billing duration mix and reserve activities, each at positive 1%. Adjusting for these factors, our normalized calculated billings growth rate was approximately 36% in Q2, up slightly from the prior quarter. Given that calculated billings growth can fluctuate quarterly due to these factors, we're providing a preliminary view for Q3 billings. We estimate our reported calculated billings to grow approximately 25% in Q3.

Moving to our balance sheet and cash items. We ended the quarter with cash and marketable securities of approximately \$1.2 billion, similar to the prior quarter. Free cash flow was negative \$10.2 million for Q2 and in line with our expectations. We continued to net settle vested equity amounts and used approximately \$18 million under financing activities for Q2. As a reminder this financing activities excluded from free cash flow. We expect to continue net settling vested equity amounts for the foreseeable future, resulting in quarterly cash usage of approximately \$16 million at current stock price levels.

For free cash flow expectations, we are maintaining our prior estimates. We expect free cash flow to be negative \$20 million for the full year of 2022, with estimates of negative \$10 million for Q3 and slightly positive for Q4. We feel good about our cash balance, and we are well positioned for durable growth. We expect to use less than 2% of our cash balance this year and reach positive free cash flow by Q4 with no debt. We have a strong balance sheet and an improving financing model and we'll continue to drive operating efficiencies as we scale the business.

Looking at our share count for the quarter, we had approximately 322 million shares outstanding on a fully diluted basis using the treasury method as of June 30, 2022. The fully diluted calculation consists of 286 million shares outstanding and approximately 36 million related to unvested RSUs and PRSUs.

Now turning to our forward-looking estimates. Let me go through the numbers initially and I'll provide background commentary afterward. For the third quarter of 2022, we expect revenue to be in the range of \$124.5 million to \$126.5 million, growing 29% to 31% year-over-year. Adjusted for constant currency, this reflects growth of 31% to 33% year-over-year. Non-GAAP loss from operations to be in the range of \$14.5 million to \$12.5 million and non-GAAP net loss per share to be in the range of \$0.07 to \$0.05, assuming weighted average shares outstanding of approximately 286.7 million.

For the full year 2022, we expect revenue to be in the range of \$493 million to \$497 million, growing 33% to 34% year-over-year. Adjusting for constant currency, this reflects growth of 35% to 36% year-over-year. Non-GAAP loss from operations to be in the range of \$42.5 million to \$38.5 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 284.6 million. These estimates are based on FX rates as of July 29, 2022.

As you know, we're trying to provide our best view of the business as of today and have taken all of the following items into account in arriving at our estimates. A few notable items to keep in mind. First, on FX. We have approximately 25% of revenue exposure related to the euro and British pound. As the dollar has strengthened versus these currencies, this has resulted in a negative impact of approximately \$4 million to our full year 2022 revenue compared to our previously provided estimates. Second, on Europe. While we improved our execution quarter-over-quarter with higher close rates and productivity from our fields, this region is feeling a greater impact from the current macroeconomic environment.

Third, on SMB. Smaller customers are feeling the macro pressures, so we're seeing slower growth in this segment, especially on the very low end of SMB. We are planning for similar trends in the second half of the year.

Fourth, on operating loss. We are maintaining our operating loss estimates for the full year. While we may see higher costs in certain areas, we plan to manage the business overall to deliver on our efficiency goals for the year.

Let me close by saying we delivered a very solid quarter results in Q2. We are delivering real value to our customers with our products in this changing macroeconomic environment, and we remain confident in our long-term growth opportunities.

With that, let us take your questions. Operator?

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Our first question comes from the line of Brad Sills from Bank of America. Brad Sills, your line is open.

**Brad Sills**

*Analyst, BofA Securities, Inc.*

Q

Oh, great, hey guys. Thanks for taking my question. Wanted to ask on the macro impact, you talked about very small end of the business, I think, some churn there potentially and that factored into – slow growth there factored into the guide. What about the upmarket business, it sounds like you had some real good results there that – that enterprise customer cohort growth at 25%, constant currency holding very nicely there. How much of that would you attribute to the effort to move upmarket, productivity and some of the hires you've had? So just a two-part question there. One, how is the productivity ramp in the enterprise going? And then, two, any macro that you're seeing impact in the enterprise and very small end of the market?

**Rathna Girish Mathrubootham**

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

A

So, thanks, Brad. This is Girish. I'll take this question. So, broadly, I think macro seems to be impacting all businesses, right. But as we called out specifically, we are continuing to see demand and the mid-market and enterprise is continuing to expand and grow with us. So in the really lower end of the SMB is where we saw an increased churn. Conversations continue with customers where people are talking about being more conservative in their spending, et cetera. But overall, I think we have not done anything significantly new to close more enterprise deals or anything like that. We have both motions continue to grow, but I think we are seeing that our Freshservice business is actually more resilient and – enterprise, mid-market, larger customers are becoming more resilient, and we are seeing this across product lines as well.

**Brad Sills**

*Analyst, BofA Securities, Inc.*

Q

That's great to hear. And you called out Freshservice as a relative area of strength, and I noticed that you've got more modules there. Can you – project management, virtual agents, SaaS management? Are you seeing customers coming in at different entry point now that you've kind of rounded out that, that suite for ITSM and Freshservice? Thank you.

**Rathna Girish Mathrubootham**

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

A

So, we have all those modules but we don't land with those modules. So the value proposition for Freshservice is to have a unified product experience. So the primary land is through ITSM, but people use SaaS license management, project management, they're also planning to add on enterprise service management and ITOM, but we don't have separate land products for each one of those. In general, the land is through the unified product.

**Brad Sills**

*Analyst, BofA Securities, Inc.*

Q

Thanks so much.

**Rathna Girish Mathrubootham**

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

A

Thank you.

**Operator:** Thank you. Our next question come from the line of Keith Weiss of Morgan Stanley. Keith Weiss, your line is open.

**Ryan Bressner**

*Analyst, Morgan Stanley*

Q

[audio gap] (24:45) taking my question. This is actually Ryan Bressner on for Keith. Maybe just first, quickly, can we just dive into your comments about multiproduct adoption? You called that about 23%, I think, of customers who are doing multiproduct. How do you view that moving forward? Is the risk that as IT budgets come under greater scrutiny that continues – maybe see the headwinds, or will that accelerate as customers try to consolidate spend with fewer vendors? Thank you.

**Rathna Girish Mathrubootham**

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

A

Thanks, Ryan. Tyler, do you want to take this?

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

I can take that, Ryan. This is Tyler. So just a commentary. We've just seen steady progression in that multiproduct number. I mean, it ticked up 1% this past quarter from 22% and it's just steadily been growing. And I just think it's a factor mainly of as customers land, they are adopting just like G said, additional products, right. A lot of it is coming from our omnichannel solution, still on our Freshdesk side, but we're starting to see it now on the ITSM side as well as we add new modules that people can adopt. We don't see macro pressures actually slowing that down. We would actually see probably the opposite of [indiscernible] (25:53) that we would continue to see more adoption of those products. The expansion motions on agents is where we would probably see more pressure, right. If companies aren't adding more employees, and that's where we would see the pressure on the expansion side.

**Ryan Bressner**

*Analyst, Morgan Stanley*

Q

Got it. Thank you. Maybe just one more quick. When you speak of the weakness in Europe, is that staying consolidated in that region or has that started to spread into other areas yet?

**Rathna Girish Mathrubootham**

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

A

Yeah. I can take that Ryan. So I think Europe, we are seeing a little bit more pronounced macro impact than the rest of the regions, especially like – I think North America and – and like we have APMEA, which is Asia-Pacific, Middle East, Africa. That's not – we cannot say same level of impact across all regions, I think also because of the ongoing war, the currency effects. And we did call out that compared to last quarter we actually felt that our teams executed better, we closed more larger deals, we had better conversion rates. But however we are monitoring the situation because the macro is a little bit more pronounced in Europe compared to other regions. And I think we have factored all of that into the guidance as well.

**Ryan Bressner**

*Analyst, Morgan Stanley*

Q

Got it. Very helpful. Thank you.

**Operator:** Thank you. Our next question comes from the line of Patrick Walravens of JMP Securities. Please go ahead, Patrick Walravens.

**Patrick Walravens**

*Analyst, JMP Securities LLC*

Q

Oh, great. Thank you. Hey, G, do you guys price your products in dollars? I mean, if I'm buying Freshworks in France, are the prices listed in dollars or in euros?

**Rathna Girish Mathrubootham**

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

A

For euro and British pounds – we have multiple currencies, specifically the bigger currencies that we have exposure to are dollar, GBP in Europe. So...

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Yeah. Pat, we have about 25% of revenue exposure to euro and pound.

**Patrick Walravens**

*Analyst, JMP Securities LLC*

Q

Yeah, because I'm on the France site this says dollars...

[indiscernible] (27:59)

**Patrick Walravens**

*Analyst, JMP Securities LLC*

Q

...so it just confused me.

**Rathna Girish Mathrubootham**

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

A

Yeah. I think that the sites will have you land based on where you are logging in from.

**Patrick Walravens**

*Analyst, JMP Securities LLC*

Q

Okay. So here's my real question. So my real question is we all understand that the impact of the stronger dollar in terms of the difference between constant currency growth and reported revenue growth. What I'm wondering is, is the stronger dollar resulting in an effective price increase for customers, let's say, in EMEA? And does that affect the price increase reduce the demand for your products?

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

No, not necessarily, because that would be true if we had a dollar price and we're constantly adjusting the euro and pound based on that dollar price, right. But our euro and pound prices have stayed consistent, right. So, through the customers there the price looks the same, except as we translate it back, obviously we're getting less USD for it.

**Patrick Walravens**

*Analyst, JMP Securities LLC*

Q

Okay. Great. Thank you.

**Rathna Girish Mathrubootham**

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

A

Thanks, Pat.

**Operator:** Thank you. Our next question comes from the line of Brian Peterson of Raymond James. Brian Peterson, your question, please.

**Brian Peterson**

*Analyst, Raymond James & Associates, Inc.*

Q

Hi, gentlemen. Thanks for taking the question. So first one, I wanted to follow up on prior comment on the number of seats or users. As we're thinking about the macro this year and I know there's a lot of moving parts [indiscernible] (29:24), is that something that you guys are seeing broadly across your customer base yet? Or how do we think about that trend line as we get through 2022?

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

[audio gap] (29:36) expansion motion. So, Brian, this is Tyler. Our expansion motion has still been driven primarily by a number of agents and seats that are coming up. We also have our cross-sell motion that adds to that and then customers moving up the addition chain that they're in using product. Now, going forward, when we look at the back half of the year, half of the adjustment we made to revenue was on FX. The other half we kind of attribute to macro, and we could see pressures from expansion definitely if – anecdotally if companies are not hiring, right, we would expect that they would not be adding more agents. And so that just kind of makes sense. So we do think there might be some pressure on the expansion side.

**Brian Peterson**

*Analyst, Raymond James & Associates, Inc.*

Q

Understood. Thanks, Tyler. And maybe just a follow-up. I'd be curious, obviously, the close rates in Europe, that sounded better. But as we think about the linearity through the quarter, is there anything that you'd call out on trends in the quarter and maybe what you've seen so far in July? Thanks, guys.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Yeah. We're not commenting on July specifically or the quarter beyond what the guidance we gave. And obviously, we're talking about our expectations today, so we're kind of building on what we think is going to happen this quarter based on what we know as of today. So, Europe in general, I think there are a combination of things going there, but there's also historical seasonality in Europe for summer months, right. And that's – we're seeing [indiscernible] (31:05) there as well.

**Brian Peterson**

*Analyst, Raymond James & Associates, Inc.*



Thanks, Tyler.

**Operator:** Thank you. Our next question comes from [indiscernible] (31:13) of JPMorgan. Your line is open. Go ahead, [indiscernible] (31:20).



Thank you. Hey guys, congrats on the quarter. Girish, on Freshchat and overall on the Unified Customer Record architecture, it seems like you have now three products kind of architected that way. What are you hearing from customers on that point? Is that a big factor that people are kind of clinging on to and when do we see Freshdesk, I guess, is that the plan as well to be – to be that re-architected under the Unified Customer Record architecture.

**Rathna Girish Mathrubootham**

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



Thanks, [indiscernible] (31:54). Yes, absolutely. That is the direction which we are going. I think our entire vision for the customer side of the business is built around the fact that we want to help businesses understand everything about their customers. So with the latest move of the standalone Freshchat product on to the UCR platform, so now we have marketing, sales and conversational support and bots, all integrated into a single customer record. And we are working on moving Freshdesk, which is our largest business onto the platform and we will quickly – we will update on that soon, as soon as it's ready, but we are making progress on that front. It's our – very important priority for us.



Understood. Thank you for that. And one for Tyler. The billings guidance for next quarter. I know it's everybody's favorite subject, but it seems like a big decel from 33% at least in USD to 25%. Help us understand maybe some of the assumptions there. It seems like revenue – it seems you're assuming about a 1 point headwind for next quarter, maybe DR has a bigger impact from FX, but is there – what else are you assuming – are you assuming close rates to deteriorate sequentially going into Q3, anything else, help us kind of understand that decel.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*



Yeah. I mean, what we've built in is kind of what we – we talked about in terms of the macro stuff. So we are seeing on the SMB side, right, we said we're – churn is picked up a little bit. So that impacts your billings number there. Europe, we are expecting it to – we're cautious, right, as we go into [indiscernible] (33:39) we're looking at it right now. Now again the 25% we're talking about is going to be the as reported number and we – what we've done every single quarter is kind of done these adjustments. We don't like billing as a proxy for how we're billing necessarily because there's so much noise in it, so we have been providing these adjustments, these adjustments typically include some FX stuff, some reserve activity, duration of activity. And so we're kind of – the number we can speak to now is kind of what we see what would be in the system and then what we would see based on historical trends. But they haven't been perfect, but that is a preliminary view of what we see today.

Q

Just so I understand, are you expecting the macro environment to deteriorate from what you saw in Q2 in that billings number?

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Well, I think what we're saying is that the macro environment – I think the macro environment from a quarter ago, FX has continued to move against us, right, as – if you consider that macro. SMB, I do think is getting impacted from three to six months ago, it is. Europe is still just kind of a little bit of an unknown. And so that – we're building all of that in as we have to obviously our guidance.

Q

Got it. Thank you very much.

**Operator:** Thank you. [Operator Instructions] Our next question comes from the line of Alex Zukin of Wolfe Research. Alex Zukin, your line is open.

Q

Hey there, guys. [indiscernible] (35:15) on for Alex Zukin. Thank you for taking the question. Glad to see the execution improved in the quarter. I was wondering if you'd call out specifically maybe the top things that you saw improved in the quarter. A quarter ago we were talking about some of the go-to-market issues in Europe and so forth. So, why don't we start with that? I'll have a quick follow-up. Thanks.

**Rathna Girish Mathrubootham**

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

A

Yeah. I'll take that. So I think specifically on Europe, we invested last quarter, as we said, in ongoing training and sales enablement of our reps. So all of that is on track and we saw that translate into a better execution, resulting in higher conversion rates in the field in Q2 when compared to Q1.

We are continuing to ramp and improve productivity in the field. Specifically on the other areas of improvement, I think we are also looking at what are the more efficient places in which we could channel investments, like, for example, we are looking at investing more in Freshservice for the short term as it brings more mid-market customers. So that's an area that we're currently working on. So, we are closely monitoring the region and the macro and – because we are multiproduct, we have the ability to kind of adjust the levers that we have in our control and control the expense accordingly.

Q

Got it. Thank you. And then just as a quick follow-up, I wanted to touch on gross retention. Understanding that gross retention is kind of, as you called out, seeing more pressure in that sub-50 cohort and this has been

something that's kind of been in the region of high-teens, low-20s. Can you just talk about how that was for your over 50 employee cohort, and maybe the overall business relative to the prior quarter? Thanks.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Yeah. We haven't broken out the kind of the churn rates by cohorts. What we've said is that we're squarely in the high-teens from an overall churn rate as a company. And then what we've just kind of indicated that, hey, we actually have seen churn pick up a little bit on the SMB side. So it's actually picked up for all of the SMB, but actually, it's – it's probably worse than that 0 to 50 bucket. That being said, our mid-market, enterprise business has proven to be even more resilient and it's kind of outweighed any of the negative impacts of that churn. So we're still – kind of our overall churn rates have stayed roughly the same.

Q

Thank you.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

You bet. Thanks, [indiscernible] (37:45).

**Operator:** Thank you. Our next question comes from the line of DJ Hynes of Canaccord. DJ Hynes, your question please.

Q

Hey, this is [ph] Luke (37:57) on for DJ. Thanks for taking the question. So I'm curious, in a recessionary environment, do you change your go-to-market or marketing playbook at all, whether that's prioritizing certain product, messaging around ROI and time-to-value or specific product use cases?

**Rathna Girish Mathrubootham**

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

A

Sure. I'll take that. So first of all, I would like to start off by saying one of the key value propositions of Freshworks is that we're not just easy to use and easy to set up, but we are also more affordable compared to expensive enterprise vendors. And anecdotally we have seen that businesses come to us when they want to save costs. So now having said that, as we look at the recessionary environment and as we look at the different parts of our business, we are clearly seeing areas where we could channelize our investments better, and once such area is clearly – like we are clearly looking at ITSM as one area where we could invest more, conversational engagement is another. So we are prioritizing our go-to-market investments for the short term. Longer term, our priorities haven't changed because we believe that there is enough growth left in each one of our three large markets.

Q

Got it. That's great to hear. And then just quickly on the billings guidance for Q3. Does that assume a different exchange rate or currency impact relative to what you saw in Q2?

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

No, no, we kind of assumed the same.

A

Q

Okay. Thanks.

**Operator:** Thank you. Our next question comes from the line of Brent Bracelin, Piper Sandler. Brent Bracelin, please go ahead.

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

Good afternoon. Thanks for taking my question. And I actually had three topics I wanted to touch base on, churn, competition and cash. Let's start with churn. I know you talked about kind of seeing an uptick in churn. But if I look at the mix of the business relative to, let's say, SMB, well, it's 70%-plus of the logos. It's only 14% of ARR. So as you think about churn in the smaller customer cohort, how much would that actually impact the overall revenue if it's only less than 15% of the business from a revenue perspective?

Q

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Yeah, I think...

A

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

I guess the impact of logos but...

Q

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Yeah, so...

A

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

...it doesn't feel like it'd be a huge material impact unless you saw churn creep up in the mid-market, large enterprise space.

Q

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Yeah. So one thing, Brent, is that the stratification of the greater than \$5,000 and the greater than \$50,000 customers doesn't necessarily align with what we define as SMB and then mid-market, enterprise, right? So we definitely have – SMB customers to us are 1 to 50 employee businesses. And we definitely have customers in there that are paying us greater than \$50,000. So it's not quite aligned that way now. Of our ARR base that we would say is SMB, it's just over that 40% number. And in that, yes, we are seeing a little bit – the churn pick up a little bit. And then what we highlighted is in that 1 to 50, which is kind of the low end of SMB, it's even a little bit more. That being said, you're right that the broad – the majority of our ARR is coming from that mid-market,

A

enterprise and that base has remained really resilient and is kind of offsetting a negative pressure right now that we're seeing from the SMB side.

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

Q

Got it. So think of SMB as the kind of more 40% of the ARR base, and then that's really where you're starting to see some churn pick up. Very helpful color there.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Yeah.

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

Q

And then on competition, obviously, as things start to get tough in the environment, you have some private companies that you compete against that obviously funding might become an issue. You have larger competitors that are in the process of being acquired. Are you seeing any sort of irrational behavior on the competitive side, either on pricing or discounting on large deal? Just wondering if you're seeing any sort of unusual behavior – bad or good behavior on the competitive front in the last, let's say, three months?

**Rathna Girish Mathrubootham**

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

A

I'll take that, Brent. I think nothing much has changed. It is similar to prior quarters. If you look at the value proposition of why people choose us over competition, it continues to be the same rapid time to value, easy to use, easy to onboard and more affordable pricing. We actually have some recent wins that are encouraging, especially in the CX space. Also, we have seen the larger enterprise vendors actually reporting like longer sales cycles and so on. We are not seeing anything like that. But I wouldn't call out – okay, we are not seeing any impact on private-funded companies doing any irrational behavior yet, so nothing new.

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

Q

Okay. That's helpful color. And then last question here. You're in the enviable position to have over \$1 billion of cash and investments. Obviously, if I think about the track record of the business, you've been generating positive free cash flow in fiscal 2020 and 2021, looks like you'll burn a little bit of cash flow this year, so you're not going to consume much of that \$1 billion in cash that you have. So what's the plan – as you think about the current environment, valuation reset, what are the plans to put some of that cash to use to either broaden the product portfolio, would you consider kind of M&A as a path to accelerate product development? Love to better understand how you view that \$1 billion in cash as a strategic opportunity to enhance the business. Thanks.

**Rathna Girish Mathrubootham**

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

A

Yeah. So we have a road map to where we want to go in terms of our product portfolio and we have a corporate development team that constantly looks at any opportunities that may come up, and which areas we want to kind of look at. But especially given the private markets have been like really super high, I think the valuation resets will probably take some more time for the founders to kind of adjust to the new price. But we're not in any hurry, where we continue to look at opportunities, if something interesting comes to us, which gives us a technology

advantage or a go-to-market advantage, we may consider that. But we don't have to acquire for revenue. It's more like anything that is – really good teams, tech, or a go-to-market advantage is why we are looking at it. It'll be usually – we're not looking at making large acquisitions.

**Brent A. Bracelin**

*Analyst, Piper Sandler & Co.*

Q

Totally makes sense. I appreciate the color on those three topics. Thank you.

**Operator:** [audio gap] (46:18) from the line of Brent Thill of Jefferies. Brent Thill, your line is open.

**Brent Thill**

*Analyst, Jefferies LLC*

Q

[audio gap] (46:24) on Europe you mentioned the execution improved. I'm curious if you strip out the macro and just rate at the execution now, are you back to 80%, 90%, are you still at 70%? How would you characterize your health meter in the European execution ex the macro? That's it. Thanks.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

I think from a – hey, Brent, this is Tyler. The conversion rates we're actually really happy with in Q2 and it was – did a lot better in Q1. In Q1, we talked about how we had – there's some deals we weren't – we didn't close and a quite push, right, and so we kind of looked at as – that's why it was execution based. And in Q2, our conversion rates were really good. We also had seen attrition come down and so that means we'll get to ramping – reps were ramped quicker. And so, yeah, we do feel pretty good about execution right now. And then obviously it's hard to parse out these things, right, on – on these broader macro things and to really remove all the variables. So that's why we're still calling out, because Europe is in general still under some pressure. And so that's why we've called it out.

**Brent Thill**

*Analyst, Jefferies LLC*

Q

Thanks, Tyler.

**Operator:** Thank you. Our next question comes from the line of Ryan MacWilliams of Barclays. Ryan MacWilliams, please go ahead.

Q

[audio gap] (47:51) for Ryan. Thanks for taking the question. So you mentioned your expansion motion primarily being driven by seats. Is there any more color you can give around the net retention split between seats versus cross-sell? And if this has shifted over time as you've built out your product suite? Thanks.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Yeah. We have not broken out the kind of the percentages of where expansion is coming from, but it is – by far the majority of our expansion does come from agent and seat expansion. And so that is still the majority, cross-sell is second, and then I think addition/upgrades is third.

Q

All right. That's it for me. Thanks.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Okay.

A

**Operator:** Thank you. Our next question comes from Scott Berg of Needham. Scott Berg, your line is open.

**Scott Berg**

*Analyst, Needham & Co. LLC*

Hi, G and Tyler. Congrats on a really nice quarter. Thanks for taking my question. I guess, two.

Q

**Rathna Girish Mathrubootham**

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

Thanks, Scott.

A

**Scott Berg**

*Analyst, Needham & Co. LLC*

One is kind of a follow-up to, I think, Brent Bracelin's question on the competitive environment, you had a competitor in the service desk environment, recently get taken private, obviously, the transaction is not closed yet. But how do you think about those opportunities? I would say it's a well-known vendor in the space, for sure we're all familiar with who it is. But do you get some new opportunities or gain some new opportunities as that transaction progresses?

Q

**Rathna Girish Mathrubootham**

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

So, Scott, we have always been competing with Zendesk and so it's like pretty much every deal we go head to head in most of the time. I think customers have still not reacted in a major way. But I think having said that, like quite recently we saw some – like two encouraging wins, one in the fintech space. Both are the north of \$50,000 kind of deals. So we kind of are starting to see that. And I think we would hope that if they get taken private that some – we are doing everything that we can in order to kind of execute better and continue to win.

A

**Scott Berg**

*Analyst, Needham & Co. LLC*

Great help. And some follow-up question, Tyler, one of the questions I've received from different shareholders and different stocks over the last couple [indiscernible] (50:09) pretty heavily is on share-based compensation and expectations going forward for a variety of reasons, whether it's where stock price is right now or other maybe company specific reasons, but your share-based comp in the quarter as a percentage of revenue trended at about 40%, which is higher than the typical SaaS company. Do you expect that to trend down to kind of more normal ranges that most of the industry sees or [indiscernible] (50:36) for maybe extended periods. Thank you.

Q

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Over time we do expect it to trend down. We did have, grants last year and even grants this year that we're taking, that expense and a lot of that's taken over four year kind of straight line method. And so it's still going to run at kind of current rates for the foreseeable future. But yes, over time, we would expect that to come down.

**Scott Berg**

*Analyst, Needham & Co. LLC*

Q

[indiscernible] (51:06) congrats on the really good quarter.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

A

Thanks, Scott.

**Rathna Girish Mathrubootham**

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

A

Thanks, Scott.

**Operator:** Thank you. Our final question comes from the line of Nick Altmann of Scotiabank. Nick Altmann, your line is open.

**Nick Altmann**

*Analyst, Scotia Capital (USA), Inc.*

Q

Great. Thanks guys. Just to kind of go back to some of the go-to-market tweaks you alluded to. Just given the strength you're seeing in midmarket, with Freshservice, I'm just wondering if you could put maybe a finer point on the go-to-market tweaks there as you start to lean in some of the stronger areas. Is it allocating more reps to the US, is it allocating more reps away from SMB to the mid-market? Just if you could put a little bit of a finer point on that, I think that'd be super helpful? Thanks.

**Rathna Girish Mathrubootham**

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

A

Sure. Let me take the question and welcome, Nick to the Freshworks coverage. So Freshservice, clearly – okay, overall longer term, we are continuing to do a lot more in Freshservice. What we specifically called out was how can we do more in the short term. And a lot of that boils down to like digital spend, so that is what can help us drive a little bit more in the short term, right, because, as you know, mid-market, enterprise deal pipeline gen, which if we start today, it may take at least one or two quarters for it to build. We are doing a mix of everything, but primarily the most important priority is in addition to the R&D investments that we have done in [audio gap] (52:43), but primarily the most important – the most immediate thing that we're considering is how can we do more in the digital SMB segment of our Freshservice.

**Nick Altmann**

*Analyst, Scotia Capital (USA), Inc.*

Q

Got it. Thank you.

**Rathna Girish Mathrubootham**

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

A

Thanks.

A

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Thanks, Nick.

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**Operator:** Thank you. At this time, I'd like to turn the call back over to Freshworks for closing remarks.

**Tyler Renwick Sloat**

*Chief Financial Officer, Freshworks, Inc.*

Great. Thank you so much for joining us. If you have any questions, please feel free to reach out and we'll talk to you next time. Thank you.

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**Operator:** This concludes today's conference call. Thank you for participating. You may now disconnect.

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