Corrected Transcript

07-Feb-2023

Freshworks, Inc. (FRSH)

Q4 2022 Earnings Call

CORPORATE PARTICIPANTS

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

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

Dennis M. Woodside
President & Director, Freshworks, Inc.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

OTHER PARTICIPANTS

Patrick Walravens
Analyst, JMP Securities LLC

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Richard Hilliker
Analyst, Credit Suisse Securities (USA) LLC

Brian Peterson
Analyst, Raymond James & Associates, Inc.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC

Scott Berg
Analyst, Needham & Co. LLC

Luv Sodha
Analyst, Jefferies LLC

David Hynes
Analyst, Canaccord Genuity LLC

MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by and welcome to the Freshworks' Fourth Quarter and Full Year 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] As a reminder, today's program is being recorded.

And now I'd like to introduce your host for today's program, Mr. Joon Huh, Vice President of Investor Relations. Please go ahead, sir.

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

Thank you. Good afternoon and welcome to Freshworks' fourth quarter and full year 2022 earnings conference call. Joining me today are Girish Mathrubootham, Freshworks' Chief Executive Officer; Dennis Woodside, Freshworks' President; and Tyler Sloat, Freshworks' Chief Financial Officer. The primary purpose of today's call is to provide you with information regarding our fourth quarter and full year 2022 performance and our financial outlook for our first quarter and full year 2023.

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, including our financial outlook, macroeconomic uncertainties, management's beliefs and certain other assumptions made by the company, all of which are subject to change. These statements are subject to risks, uncertainties and assumptions that could cause actual results to differ materially from those projected in the forward-looking statements.

For a discussion of the 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 the 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 will 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 & Founder, Freshworks, Inc.

Thank you, Joon, and welcome, everyone. Thank you for joining us today on Freshworks earnings call covering our fourth quarter and full year 2022. Overall, we executed well in the quarter. We exceeded expectations across our operating results for total revenue, non-GAAP operating income and free cash flow. We capped off a strong finish to the year with $133.2 million in quarterly revenue as we surpassed $500 million in annual recurring revenue. In this environment, as companies are seeking greater value for their IT spend, we are seeing the Freshworks value proposition resonate more than ever.

In Q4, we added approximately 1,800 new customers to our growing base and ended up with more than 63,400 total customers, including the San Francisco 49ers, Finchoice, Mahindra, Supara, St. Marche and Yulu Bikes. I'm incredibly proud of how we grew the business. We also improved our non-GAAP operating margin by 8 percentage points in Q4 on a year-over-year basis, and we generated positive free cash flow of $4 million in the quarter.

Our approach during this recent period of macroeconomic uncertainty was to focus on driving our growth through four key strategies. We believe these four business drivers will continue to move us forward in 2023. First is our continued focus on product innovation. In 2022, we expanded our unified CRM platform to include Freshchat. We launched Freshservice for business teams to extend Freshservice beyond IT. And we made our bots smarter across our CX, IT and broader CRM products to help businesses engage their customers faster.

Second, we saw results from our focus on larger customers, which is driving most of our growth. Today nearly 60% of our business comes from mid-market and larger companies with many of our Q4 deals starting with Freshservice. The third business driver is expansion. Despite the challenging macro economy, customers expanded through agent additions, cross-sell and upgrades into larger deployment. In Q4, our net dollar retention was 110% on a constant currency basis.

And finally, our focus on operating efficiency. We generated positive cash flow in Q4 and improved our non-GAAP operating margin. We plan to build on this momentum and improve our efficiency in the years ahead. During today's call, Dennis, Tyler and I will go deeper on these four business drivers and how they played a role in our Q4 results and how we see them contributing going forward. Starting with our product innovation. We continued to make improvements last year across our IT, CX and broader CRM solution. New business increased as companies chose Freshworks products as credible alternatives to expensive and bloated software. This is really important in the current environment that businesses want to control IT spend without sacrificing powerful functionality in mission critical applications. In fact, positive reviews from our customers this quarter earned us TrustRadius Awards for Best Value for the Price and Best Feature Set.

It is those two reasons why we believe Freshservice continues to grow and gain traction in the mid-market. Take Swire Coca-Cola for example. Swire is one of the world's largest Coca-Cola bottling partners in the US and Asia, and it chose Freshworks for the breadth of our features, fast deployment and lower cost of ownership.

Swire brought on Freshworks because they were looking for a platform that was comprehensive enough to support their complex needs while reducing their ITSM spend. Additionally, last quarter, we launched Freshservice for business teams, and in the past three months, we have seen strong early success.

As businesses eliminate siloed support and service management platforms, other departments like HR and Finance are able to use Freshservice to build a more modern and consolidated employee experience. New customers like Coherent Corporation, a semiconductor company with over 23,000 employees, chose Freshservice over a large incumbent. Thanks to our integrations and the ability to scale across IT and HR team.

In our CX business, we continued to enhance Freshchat and Freshdesk products with a focus on customer self-service and agent experience. In Freshdesk, we added new integrations with multiple telephony partners. Enterprises can now bring their own telephony solution into Freshdesk to create a comprehensive omnichannel customer service solution. In Freshchat, we introduced simpler ways to build self-service bot. In Q4, we added more bot languages and industry specific bot template extending the reach of our products to global markets.

In Q4 alone, Freshchat powered hundreds of millions of bot conversations. With the rise of modern messaging apps, companies have rapidly shifted to engaging with customers over conversational messaging channel. [indiscernible] (00:08:10), an active lifestyle brand in the US, Canada and Australia, started with Freshdesk and later bought Freshchat to handle repetitive support requests like returns and order status more efficiently. By automating responses across email, chat and call, they've reduced resolution time by several hours.

Turning to our broader CRM solutions in sales and marketing, we improved analytics and reporting. We launched a new revenue attribution capability to help marketers better understand the sales impact of their cross-channel marketing campaigns. We also added integration to analyze sales calls to scale the effectiveness of their customer conservation. I'm super proud of our product innovation in 2022 and our dedication to building new capabilities that can deliver value to our customers through a challenging macro environment.

As we look ahead at our product priorities for this year, we will continue to differentiate the service as a comprehensive IT service, IT operations, and enterprise service management solution. In CX, we will continue to deliver on the promise of an omni-channel customer support experience with self-service automation, conversational experience and ticketing. And finally, we'll continue to build a unified CRM with an out-of-the-box customer data platform and AIML insight.

I'll now turn it over to Dennis to talk about what we are seeing in the market, how larger customers are driving our business growth, and how customers are expanding on our products.

Dennis M. Woodside

President & Director, Freshworks, Inc.

Thank you, G, and hello, everyone. Thanks for joining us today. I'm five months in at Freshworks and I'm excited by the progress we're making in the business.

We closed the year on a high note, beating our financial estimates and improving our operating efficiency. In a tougher market environment, we improved our execution to drive the highest new business quarter ever. We saw increased competition for many of our deals and yet we still improved our win rates for our CX and ITSM products. This was especially true for our larger deals in the field with Freshservice leading the way as a scalable and cost-effective solution that is delivering incredible value to our customers.

G talked about our first of four business drivers, product innovation. I'll cover the next two. Our success with mid-market and enterprise customers and our expansion motion. I'll start with our enhanced focus on mid-market and enterprise customers. Over the last 18 months, we've made substantial investments in people and tools to expand our go-to-market notions. We believe those investments which are now reflected in our cost base are paying off in higher win rates, participation in more deals, and the expansion of our mid-market and enterprise business.

In 2022, our new business wins increased with companies spending more than $50,000 in ARR. And in Q4, this customer cohort grew 35% year-over-year and now represents 44% of our business. While our business was historically more in SMB, our revenue base has shifted over the years towards more mid-market and enterprise customers. Today, nearly 60% of our business is coming from mid-market companies those with 251 to 5,000 employees and enterprise customers with more than 5,000 employees. That's because our cost-effective yet powerful products are delivering real value fast. They can scale to serve thousands of agents and millions of customer and employee interactions.

These benefits resonate with companies of all sizes, especially in the current economy. The days of selecting a vendor only based on market share or brand name awareness are over. Customers want rapid impact and lasting value at a reasonable cost, and Freshworks delivers. That's why Freshservice was chosen by Carrefour Belgium, a subsidiary of the 8th largest retailer in the world. Their team of 300 IT professionals now have a more simplified and nimble approach to IT service management to support more than 11,000 employees.

While legacy incumbents are focused on the 2000 largest companies in the world, Freshworks has the opportunity to serve hundreds of thousands of others who are dissatisfied or underserved by bloated and expensive software. We provide mid-sized organizations like Databricks, TaylorMade and Georgetown University with a better choice, powerful yet cost-effective solutions.

Turning to expansion, I'm pleased to say that despite the macro conditions, our customers are still expanding through seat additions, cross sales and upgrades. In Q4, net dollar retention was 110% in constant currency, as the overall churn rate for our business remained in the high teens. We see better retention rates in our mid-market and enterprise customers, which helps our overall net dollar retention.

While seat additions continue to drive the vast majority of our expansion today, we expect cross-sell to be a bigger contributor to our growth over time. The percent of customers using more than one product remain relatively the same as the prior quarter at 24%, with just a slight increase in Q4. We are implementing specific initiatives to create more bundling and cross-sell opportunities for our go-to-market team this year.

Take Addison Lee for example. The British private hire cab and courier company started as a Freshservice customer in 2015 and in 2022 added on Freshsales and Freshdesk. They believe their previous CRM system from a large incumbent caused low-agent productivity and did not deliver sufficient value. Our Freshsales suite was selected to replace the older CRM for our modern intuitive UI built for the end user.

Looking at our customer cohort of over $50,000 in ARR, we added a net 191 customers in Q4. Well, this customer number benefited from FX movements and new deals in the quarter. The biggest driver continued to be expansion as customers increased their spend on our products and especially for the ITSM market. An example is iQor, a managed services provider with more than 35,000 employees in 10 countries. As part of iQor's digital transformation strategy, the company expanded the use of Freshservice and Freshdesk bots to its IT, HR and finance teams to immediately answer questions before transferring to a technology team member. The platform enables iQor team members to focus on more complex tasks and creates a better experience for both employees and customers.

To me, it's customers like the ones you heard about today, they validate my decision to join Freshworks. I believe we have the opportunity to build a large, impactful company that can serve hundreds of thousands of businesses over time. By focusing on the four business drivers of product innovation, mid-market and enterprise customers, expansion and efficiency, we believe we can grow well beyond our current levels. I'm excited about the progress we've made to better align our go-to-market teams and the many opportunities ahead of us.

Now over to Tyler to talk about how we are improving efficiency as Freshworks continues to grow.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

Thanks, Dennis. Looking back on our Q4 and full year 2022 performance, I'm pleased with our ability to drive operational efficiencies in the business. Starting last year, we knew that 2022 would be a big investment year, building out our go-to-market teams, investing in product development, and taking on a full year of G&A public company costs. What we didn't know was how the macro economy would play out and how that would impact the overall market for our products. During a year of a slowing demand environment, negative FX movements and pressure on small businesses, we still beat the high end of our 2022 estimates for revenue that we laid out one year ago by $3 million. More significantly, we effectively managed our costs throughout the year to beat the high end of our 2022 estimates for non-GAAP operating income by over $26 million. We believe we have a durable business model and we're improving our operational efficiency as we drive business growth.

In Q4, we had another quarter of increased efficiency with revenue [ph] beating (00:16:47) expectations, non-GAAP operating loss outperformed expectations by $6.5 million in the quarter. We improved our non-GAAP operating margin year-over-year and our business inflected to generate positive free cash flow of $4 million and non-GAAP EPS of $0.01 in the quarter. As I normally do, I'll review our Q4 financial results, provide background on key metrics, and close with our expectations for the first quarter and full year of 2023. I will also include constant currency comparisons to provide a better view of our business fundamentals. Most of our discussion will be focused on non-GAAP financial results, which exclude the impact of stock-based compensation expenses, payroll taxes on employee stock transactions, amortization of acquired intangibles and other adjustments.

Starting with the income statement, revenue grew 30% adjusting for constant currency, or 26% as reported, to $133.2 million. Although the FX trend for the dollar against the euro and pound reversed in Q4, we continued to see the trailing negative impact to revenue resulting from FX movements earlier in the year.

As Dennis mentioned, we had a strong quarter of new business driven by Freshservice, while expansion continues to see pressure from the effects of the broader economic slowdown. Smaller customers continue to feel the pressure as churn rates increased slightly for the SMB segment, leading to slower growth. Overall, churn for the company remained relatively stable, ticking up less than 100 basis points in the quarter. As a whole, we have made good improvements to our gross churn rates over the past several years.

In Q3 and Q4, we were able to keep gross churn relatively stable, but do see potential risk of churn increasing slightly going into 2023. Moving to margins, our non-GAAP gross margins were roughly similar to Q3, rounding up to 83% for the quarter. We continued to achieve strong non-GAAP gross margins with over 82% for the full year as we scale the business.

In Q4, non-GAAP operating margins improved 8 percentage points year over year to negative 2%, driven mostly by lower R&D and G&A costs as a percentage of revenue. Specifically for G&A, expenses in the prior year included non-recurring litigation settlement costs that were not included in the most recent quarter. On quarter-over-quarter basis, we had a very small improvement to non-GAAP operating margins as we largely maintained our run rate cost base and matching the business growth.

Similar to Q3, we had a one-time type benefit of approximately $4 million related to the reversal of accrued expenses from earlier in the year. Our revenue outperformance, combined with an improving cost base, led to non-GAAP operating loss of $2.8 million in Q4. I'm pleased with our ability to control cost in the current market environment and expect to drive more operating leverage as we go forward.

Turning to our operating metrics, net dollar retention was 110% on a constant currency basis or 108% as reported. That is largely in line with our commentary from the prior quarter. As expected, we saw expansion slowdown in the quarter, reflective of the overall macroeconomic trend. Looking ahead, as we expect the broader trend to continue, we estimate Q1 2023 constant currency net dollar retention to be 107% and holding FX rates constant reported net dollar retention to be 105%.

In terms of our customer metrics, customers contributing more than $5,000 in ARR grew 20% to 17,722 customers in the quarter and now represents 87% of our ARR. On a constant currency basis, this customer cohort grew 21% year-over-year. For larger customers, contributing more than $50,000 in ARR, this customer account grew 35% to 1,908 and ticked up to represent 44% of our ARR. Adjusting for constant currency, this customer cohort grew at 38%. Lastly, we ended the quarter with a total customer account of more than 63,400, and our average revenue per account continued to increase.

Moving to our billings, balance sheet and cash items. In Q4, calculated billings grew 21% to $147.8 million and holding constant currency over the past year calculated billings grew 25%. The other factor impacting the growth rate was billings duration mix of negative 4%. Adjusting for this, the normalized calculated billings growth was approximately 29% in Q4. Looking ahead to Q1 of 2023, our preliminary estimate for calculated billings growth is 20% on a constant currency basis, or 17% as reported basis on current FX rates. For the full year 2023, we expect calculated billings growth to be similar to our expected revenue growth for the year of approximately 17%.

Turning to our balance sheet and cash items, we maintained a steady cash balance as we ended the quarter with cash and marketable securities of approximately $1.1 billion. In Q4, we generated $4 million of free cash flow coming in ahead of our estimates. Looking back on the full year, we outperformed our initial free cash flow estimate of negative $25 million by more than $10 million in 2022, despite a tougher economic environment, further demonstrating our ability to drive efficiencies in the business. We continued to net settle vested equity amounts and used it nearly $16 million under financing activities for Q4.

For the full year, we used approximately $167 million for the net settlement of nearly 9.8 million shares. As a reminder, this financing activities excluded from free cash flow. We plan to continue net settling invested equity amounts, resulting in quarterly cash usage of approximately $17 million at current stock price levels.

As we look forward to 2023, we expect to generate approximately $10 million of free cash flow for the year with approximately $3 million in Q1. We have some seasonality and spend throughout the year. So we anticipate Q2 and Q3 will be near breakeven and the remainder of the free cash flow expected in Q4. With positive free cash flow now coming from the business, no debt and a strong balance sheet, we believe we are well positioned to drive sustained growth into the future.

Turning to our share count for Q4, we had approximately 324 million shares outstanding on a fully diluted basis as of December 31, 2022. The fully diluted calculation consists of 289 million shares outstanding, approximately 32 million related to unvested RSUs and PRSUs and 3 million shares related to outstanding options.

Let me now talk about our forward-looking estimates. I'll go through the numbers first and then provide background commentary afterwards. For the first quarter of 2023, we expect revenue to be in the range of $133 million to $135 million, growing 16% to 18% year-over-year. Adjusting for constant currency, this reflects growth of 19% to 21% year-over-year. Non-GAAP loss from operations to be in the range of negative $9 million to negative $7 million, and non-GAAP net loss per share to be in the range of negative $0.03 to negative $0.01, assuming weighted average shares outstanding of approximately 290.2 million shares.

For the full year 2023, we expect revenue to be in the range of $575 million to $590 million, growing 15% to 18% year-over-year. Adjusting for constant currency, this reflects growth of 16% to 19% year-over-year. Non-GAAP loss from operations to be in the range of negative $14 million to negative $6 million, and non-GAAP net income or loss per share to be in the range of negative $0.01 to positive $0.03, assuming weighted average shares outstanding of approximately 293.8 million.

We want to provide our best views of the business as we see it today and in a changing market environment, it can be tough. So a couple of areas and assumptions to call out. First on FX, the weaker dollar trend in Q4 create a slight benefit to revenue and billings metrics compared to the prior quarter. But on a year-over-year comparison, we still saw a negative impact. These estimates are based on FX rates as of February 3, 2023. So any future FX moves are not factored in it. We started to hedge a small portion of our INR-based expenses in January 2023 and expect the impact of the hedging program to increase throughout the year, which will improve the predictability for operating expenses moving forward.

Second, on profitability, I'm pleased that we delivered on our commitment to reach positive free cash flow by Q4 last year. Now as we head into 2023, we're driving additional efficiencies to show quarter-over-quarter improvement throughout the year. As such, we expect non-GAAP operating loss to improve to negative $6 million in Q2, near breakeven in Q3, and then turn positive by Q4. We plan to maintain sustained profitability in the years ahead.

Let me close by saying, I'm pleased with our execution in the quarter. Our ability to operate efficiently over the past year highlighted the durability and resiliency of our business model. Our view is that we're well positioned to execute through a changing market environment in the near term. We remain bullish on our long-term opportunities.

With that, let us take your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] And our first question comes from the line of Pat Walravens from JMP Securities. Your question, please.

Patrick Walravens
Analyst, JMP Securities LLC

Q

Oh! Great. Thank you very much. And congratulations. I have two, if that's okay. The first one is on the macro, which is just, you know, last quarter, you guys were talking a lot about companies reducing their growth forecast and head count [indiscernible] (00:27:22) seems so much better now, did the macro – I mean, I hate to even say this, but did the selling environment for you guys improved in some way in Q4?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey, Pat. This is Tyler. I'll start the answer because this – is it the first part? Do you want to ask the second question as well?

Patrick Walravens
Analyst, JMP Securities LLC

Q

Yeah. And the second part is just – I think it'd be great to have Dennis. I mean, obviously he's on the board of ServiceNow and he's at Dropbox and Google, you know, why he [indiscernible] (00:27:52).

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Well, let me start on the macro. Yeah, look, we had a really good quarter, especially on new business, right. And we called that out and that felt strong, which I just think is a testament to our products and the value that they can bring to customers, even in tough markets. The place that we continue to see pressure was on expansion and that macro is still playing there, right, and that the expansion motion did slow down throughout the year, but we talked about that throughout the year. We expect to continue to see that for a while. But on the new business side, yes, we are upbeat because we're optimistic because we had a good quarter on new business. But I'll hand it over to Dennis.

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. Just some commentary on the new business front. So I think over the last 18 months, we've made substantial investment in the products themselves. So if you think about our ITSM product, we announced enhancements that allow us to fulfill ITOM requirements in the second half of last year. We rolled out an ESM product. So we're able to address broader and broader needs of larger customers. And really, this is just a continuation of a trend and a set of investments that have taken place over the last 12 months or so that really are starting to pay off in terms of those new business wins. We are seeing better win rates, competitive win rates in Q4 than we did in Q3, both for Freshdesk and for Freshservice.

And we're getting involved in more deals. So we're – companies are looking to us when they're evaluating better solutions, solutions with lower total cost of ownership. Everybody is looking for value. So we're getting more swings and we're hitting the ball more often. And I think that really started to show in Q4.

In terms of why I joined, I see an opportunity to build a company that does serve every business in the world. Every business in the world has a need for the products that we currently build. We can serve companies, employees and customers equally well. And I think the vision that the G has laid out and the products that he's built around creating a seamless, easy-to-use, easy-to-implement set of business software is super compelling. So that's why I joined.

Patrick Walravens
Analyst, JMP Securities LLC

Q

Awesome. All right. Thank you.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Ryan MacWilliams from Barclays. Your question, please.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

Thanks for taking the question. Tyler, I want to hear about maybe how we should think about net retention as they move through this year. And just on your full year guide, how does this contemplate the macro? And have you guys thought about scenario where should things get worse from the economic perspective plan to get to breakeven faster from here? Thanks.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. You bet, Ryan. So net dollar retention, to start off, we did say something on the call there that we do expect that to decrease a little bit. The net dollar retention churn, there's two sides of that coin. We've been pretty open that we had made really good progress on gross churn over the last couple of years. In Q3 and Q4 of this past year, churn kind of remained stable and just essentially stayed flat, which churn includes downsell for us so that, that was a good thing. Our goal right now is to try to keep it there because I do think that's going to see some additional pressure.

The expansion motion, you guys know our base form of upsell is agent addition. And we started to see that kind of after Q1, we talked about it last year, and we saw it throughout the year. And we expect to continue to see pressure on that. And that is what's driving the net dollar retention down. And, yeah, we said it could come down in Q2 – in Q1. It could come down a little bit after that in Q2. But obviously we're going to work as hard as we can to normalize that.

In terms of our guidance, we've built in everything that we see and we were trying to call it as we see it. And we have – we do expect that expansion motion to see some pressure. We are looking at other ways that we can expand with our customers, specifically like our Freshservice for teams, our new ESM application. We're really excited about that and, obviously, we're going to continue to lean in on new business, which was really good in Q4.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

Great. And just to follow up on Patrick's question, the customer adds above 5,000 ARR appeared strong in the quarter. Just given what you mentioned on headwinds, the seat expansion, was the strength in these adds [ph] primarily (00:32:42) from net new customers or perhaps maybe customers renewing larger with upsells or upgrading the plans? Just like the piece of part the strength there. Thanks.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. We talked about the 50,000 that, that actually the biggest adds to the 50,000 were expansion and that actually helps the 5,000 as well. But the 50,000 I think was helped a little bit more. We also – there's a little bit of FX on both sides. But, yes, also driven by new customer lands, which we had – we really had a really strong new business quarter in Q4. And, obviously, we're going to continue to lean in on that. But customers are still expanding net dollar retention. You know, we're still – it came down slightly, but it was still good. And even though there's pressure there, we do have customers who are growing on us. And that was a number one reason for the greater than 50,000 and also helped the greater than 5,000.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

Appreciate the color. Thanks, guys.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Pinjalim Bora from JPMorgan. Your question, please.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Hey, thank you for taking the questions and congrats on quarter. I was – I wanted to get on the guidance a bit. Basically trying to understand if you added billings growth of about 29% if I heard that correctly adjusted and the guidance is I think about 17.5% revenue growth next year. I'm trying to think would you go – are we expecting kind of a step down in macro from here? When I look at the additions to revenue, I think in 2023 versus what you added in 2022, it's something like a 33% decline. It seems pretty conservative. I mean, would you go as far to say it is de-risk at this point? Like how should we think about the guidance?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. Again – Hey, Pinjalim, this is Tyler. Again on guidance in general, we are trying to call it as we see it, and that what we've done is we've taken into account that we expect to see continued pressure on the expansion motion. And that as our biggest form of upsell is agent addition. And when we look at that the Q1 calculated billings, you said 17% and 20% on a constant currency. And then, obviously, if we've seen the adjustments like the 4% you mentioned that we talked about in Q4, I will add that at the end of the quarter to provide more color. But in general, we're calling as we see it. I can't say it's complete de-risk because I don't know how long the macro conditions are going to hold. I think there's upside. If companies go back to growing, we would clearly expect to take advantage of that growth with them. But if things get worse, we could actually see pressure there as well.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Understood. Thank you for that. And one for Girish. We recently hosted one of your partners and he seemed pretty bold up on ITSM. And you are seeing good traction on the ITSM side. Seems like you are taking share. How do you see that the position of Freshservice at this point in the market? Maybe talk about it with respect to

Atlassian seems like entering the market as well. And how should kind of investors think of that business, sustainable growth of that business, minus any macro?

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

A

Sure. So, hey Pinjalim. So from a Freshservice business standpoint, let me talk to you about the competitive landscape and our positioning and strength. So clearly, we know that ITSM is a huge market, and from a TAM standpoint, now we expanded into ITSM, ITOM, as well as enterprise service management. So there's no doubt on how big the market is. Now Freshservice is today the most credible alternative to ServiceNow in the industry, and we are seeing that come into play, especially in mid-market and enterprise companies, specifically in this environment where businesses are scrutinizing their spend very clearly, like every dollar of IT spend. So we are actually competing against and winning against ServiceNow, and we have also replaced ServiceNow anecdotally even in the last quarter multiple times. So that is on the enterprise side, where that is ServiceNow.

Now, before I comment on Atlassian, you should also understand that there is a kind of legacy out there, like BMC Remedy and Ivanti, Cherwell. So we actually – Mahindra, one of the largest conglomerates in India, moved off of a large legacy incumbent in 2022. So specifically with Atlassian, we are seeing them in some of the lower end of the mid-market deals, but we win. Freshservice wins purely based on the fact that we are built from the ground up as a full blown ITSM and ITOM solution. Whereas Atlassian I think has made around four acquisitions and they're trying to stitch together a unified product experience. I think our customers choose us because of the unified product experience.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Got it. Thank you very much.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Rich Hilliker from Credit Suisse. Your question, please.

Richard Hilliker
Analyst, Credit Suisse Securities (USA) LLC

Q

Hi, everyone. Thanks for taking my question. So you mentioned it was the highest new business ever in this quarter. I think you talked about for some customers they were expanding. I think you called out the ITSM side. Tyler, I think you mentioned some stable retention. The question is, I'm wondering what portion of overall bookings would you say came from newer expansion versus renewal in this quarter? And maybe for the new business, can you give us a sense of duration of those deals?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. Rich, I'll take that. We don't break out the new versus expansion in terms of quarter. But we did have one of our best new business quarters ever and we did say that where it's coming from Freshservice is still smaller than Freshdesk from an ARR perspective, but it continued its trend of being the biggest ARR contributor in the quarter, which it has been for the last couple of quarters and it's growing faster than Freshdesk.

On a duration perspective, we got about let's call it 60% of our business roughly, those aren't exact, that are on annual contracts, and that there was no big change on that. Now, what does happen is that the bookings mix can change based on the expansion motion, right, because it depends on where you are within the contract on expansion and how much that billings would look like. But in terms of the new business, there wasn't any significant change. There has been this steady change of moving more to annual over the last couple of years.

Richard Hilliker
Analyst, Credit Suisse Securities (USA) LLC

Q

Okay. Great. Yeah, that makes sense. And then maybe one last one here for you, Dennis. I was wondering if you can talk a little bit about your vision for unlocking multi-line of business selling. I know you guys disclosed multi-product, but multi-line of business is kind of where I'm kind of zeroing in here. Maybe what do you still need to stand up or mobilize to ignite this even further? Thanks.

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. Yeah. Thanks for the question. Well, first of all, I would just say that it's happening, right? You know, one of the examples that we talked about was Addison Lee. Addison Lee originally was a Freshservice customer for a couple of years, satisfied with the product. You know, we're serving their IT department and they decided they're not satisfied with their existing CRM, large incumbent. They're not getting value out of it. Very expensive to continue to maintain. And so they look to us. And so that kind of situation we're seeing across the pitch. iQor was another account that was an expansion from Freshservice into Freshdesk.

So it's happening right now. I think the focus has been very much on new business. But as we kind of continue to scale up and we continue to have success with these larger accounts, iQor is a company with 35,000 employees. There's lots of opportunities for ESM and for other product expansion there. We're going to be leaning into that motion much more. But like I said, so far, a lot of the emphasis has been on new business and we're getting natural kind of product cross-sell. We call it [ph] persona of (00:41:40) cross-sell. That's going to become an increasingly important part of our business going forward and a big opportunity for us.

Richard Hilliker
Analyst, Credit Suisse Securities (USA) LLC

Q

Understood. Thank you all so much.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Brian Peterson from Raymond James. Your question, please.

Brian Peterson
Analyst, Raymond James & Associates, Inc.

Q

Hi, gentlemen. Thanks for taking the question and congrats on strong quarter. So I just wanted to hit on the net adds. Obviously, I think it was better than what we were expecting. Is there any commonality in terms of the geo where you guys are having more success, or I actually want to understand to maybe what you guys are displacing in terms of what you're picking up from net new? I know it's different by product segment, but any color there would be helpful.

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Thanks, Brian. This is Dennis. So on net adds overall by geo, for Q4, we saw a pretty good performance across the board. Our North American business was actually a little bit stronger than the rest of the world and Europe and Asia-Pac. But our European business performed well. We're pretty satisfied with kind of each of the geographic units. So I wouldn't say there's any specific trend geographically that is driving the business.

In terms of who we're displacing, you know, customers come to us with a wide variety of current IT footprints and situations. In some cases, we're displacing very much kind of old on-perm systems, think of BMC that where the product this is not scaling to what the customer needs and they are looking to make a change. In other cases, we are displacing the likes of Zendesk or ServiceNow or Service Cloud, where the customer is no longer satisfied with the overall value proposition, especially in the current economy, and they're looking for much better value.

They're looking for a simpler product that they can deploy quickly and get fast time to value. And they're looking for a product that doesn't require them to have a number of consultants or specialists on staff just to maintain the product and make sure it does what it's supposed to be doing. So it's – there's not – I wouldn't say there's one competitor. I wouldn't say there's one situation. It's really a fairly wide range of situations that's driving our growth.

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

Great. Thanks, Dennis, and maybe a follow-up. I'm curious have you seen any changes in the pricing environment over the last 90 days and maybe anything that you guys have seen so far in 2023? Thanks, guys.

Dennis M. Woodside
President & Director, Freshworks, Inc.
A

Yeah. So, this is Dennis. We haven't seen any major change in pricing. I would say the second half of last year on the Freshdesk side, the Service Clouds of the world and Zendesk have been very aggressive on pricing. But that's – that was true in Q3 and really continued into Q4. I wouldn't say there's any discernible trends on the ITSM side to note.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Elizabeth Porter from Morgan Stanley. Your question, please.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thanks so much. You mentioned earlier just the better win rates and I wanted to get a little bit more color if you're seeing any particular improvement at the low end versus the high end or if it's broad based. I know you guys have been doubling down on functionality. And then second, just kind of within those competitive conversations, in your conversations, is there any bit more of a lean towards just the product functionality versus price being the incremental driver that, that tilts your deal – the deals your way? Thanks.

Dennis M. Woodside
President & Director, Freshworks, Inc.
A

Great. It's Dennis. I'll take that one. The trends that we're seeing on win rates are broad based. So it's not confined to any one segment or any one product. Both our Freshdesk and Freshservice product in Q4 saw higher win rates than Q3. That said, for mid-market and enterprise, the mid-market and enterprise segment, our win rates improved at a higher rate. So we saw meaningful improvement there.

Now, in terms of why are – why is that happening? Well, most of the customers that we're talking to now, one of the number one things on their mind is value, either total cost of ownership. They're looking at – they need a business case and ROI. And part of that equation is what is the cost to implement the products, what is the timeline for implementation, how fast can we get the value, and what's the ongoing maintenance cost to get the functionality out of the products that they need? And in many cases, we are superior on all three dimensions.

Now, from a product functionality standpoint, if you were to wind back the clock 12 or 18 months, we've done a lot in the last 12 months, 18 months to be able to compete on a feature-by-feature basis with the likes of Zendesk or Service Cloud or ServiceNow. And the product functionality has gotten better. The robustness has gotten better. Product is scaling incredibly well. We support thousands of agents, millions of customer interactions across our customer base.

All of those investments that we've made over the last 12 or 18 months are paying off. And that really is helping drive those win rates up. So we think it's quite promising for the future and for where our buyers are going. We think the product we have is the right product, the right strategy for where the market is today. And that's a big opportunity for us.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC

Q

Great. Next...

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

A

Dennis. Sorry, Elizabeth, I just wanted to add on just – this is Girish. So – on the product functionality itself, so it's important to note that if you take CX, for example, Freshdesk and Freshchat together offers the most comprehensive omnichannel customer service solution today, covering the whole spectrum of automation – self-service automation with bots as well as conversational agent experience on modern messaging channels combined with ticketing, right?

If you take Freshservice, like we have a unified single product across ITSM and ITOM and ESM, which is Freshservice for Business Teams. So I think that is the value that we're talking about. Really customers not having to buy four or five different tools and struggle with integrating all of that. So that is the superior product value that everything is built organically in one platform.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much. And then just following up, you mentioned just now the conversational kind of bots and the seamless kind of one platform. Earlier this week, there was the announcement just around the Meta kind of messenger integrations in bots. And there's a good amount of buzz in the market post that announcement. So just wanted to get a little bit more color from you on the opportunities around that function and feature set [indiscernible] (00:49:07) either add new customers or accelerate revenue per customer? Kind of how are we thinking about those capabilities more specifically that were recently announced?

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

A

Sure. I'll take that. So, first of all, let me clarify by saying that our partnership with Facebook and Meta goes a long way since 2011, where we were the first – Freshdesk was the first help desk to integrate Facebook Messenger when they introduced that. So the recent announcement that we did was more of calling out some of the customers usage of this. And we know that conversational clearly been picking up in the last few years. And like the Messenger apps in the – under the Meta portfolio, like which is WhatsApp or Instagram or Facebook

Messenger. So there are more than a billion messages every month that businesses are sending over these channels.

And so this announcement was specifically to call out some of the customer wins that we have with our conversational product and showcasing how we are powering those conversational customer support experiences, specifically for B2C companies. So I just wanted to call out that it is our partnership with Meta is like it's not a new one and it's been ongoing. And so this is more to showcase some of our customer work.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much.

Operator: Thank you. One moment for our next question. And our next question comes from the line of Scott Berg from Needham. Your question, please.

Scott Berg
Analyst, Needham & Co. LLC

Q

Hi, everyone. Thanks for taking my questions. I just have a couple. First is on kind of sales process. As you look at calendar 2023 here, we all know what's happening with macro last year and into this year. But as you look at your sales processes in overall go-to-market strategies, I'd say maybe just leaning into something like ITSM that's selling a little bit better. Is there anything that you're changing in those processes that would be noteworthy to try to effectively maybe get some of these new customers over the line faster?

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Hey, Scott. It's Dennis here. So, yeah, there are a number of things that we're doing. I think before I get to the sales specific ones, I would just go back to the product side. A number of the features and big enhancements that we launched in the second half of last year, we're really getting traction with now and into Q4 things like ITOM, things like ESM, and the enhancements on the conversational side to Freshdesk that G referred to. So a lot of it is. Hey, we've got products that really are well suited to the market.

In terms of the field side, one of the – a couple of the adjustments that we've made have been to focus on bigger deals and focus more squarely in the mid-market. So I would say this is just an enhancement to the strategy that we've been pursuing for the last year or so. One of the things we did was we shifted our field team to focus on accounts with employees from 500 to 5,000 employees as the ideal customer profile. And in the past, the field team would focus from 250 to 500. We can serve those 250 to 500 employee companies very well and more efficiently through our India operations through inbound.

Many of them, most of them are coming to us anyway through a response to a marketing message or coming to our website and signing up for a trial. So that was one pretty meaningful change. Another change, we've created a set of product specialists to focus on Freshchat and Freshsales in particular, both of those products are fairly complex. The competitive set is complex, so we feel the specialization on the sale side is really important. And we think that, that will result in continued improvement in win rate for those products. And in general, the field team is pretty jazzed up about kind of what the product set looks like, the competitive positioning, and kind of where we are in the market. So we're excited about this year and I think we're going to see quite a few opportunities.

Scott Berg
Analyst, Needham & Co. LLC

Q

Got it. Very helpful there. And then from a follow-up perspective, Tyler, as you look at your guidance to start fiscal 2023 here, have you changed it at all with regards to what you're seeing in the macro compared to maybe a year ago? I know you talked about you're trying to call it as you see it right now, but as you think about that general philosophy, just curious to know if there's anything different about it?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

There's no change in philosophy, Scott, I mean, like trying to take everything into account that we know. A year ago, we did not know the impact of kind of the macro. Right? We did not expect the expansion motion to just slow down the way it did throughout the year. And so, now it's kind of the opposite. We actually expect it to continue to be tough for a while and we've built that in. And we'll see how it goes throughout the year. And, obviously, we're going to do our best to find other ways to grow with customers. But in terms of the philosophy itself, there is no big change.

Scott Berg
Analyst, Needham & Co. LLC

Q

Excellent. Thanks for taking my questions.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

[indiscernible] (00:54:29).

Operator: Thank you. One moment for our next question. And our next question comes from the line of Brent Thill from Jefferies. Your question, please.

Luv Sodha
Analyst, Jefferies LLC

Q

Hi. This is Luv Sodha on for Brent Thill. Thank you for taking my question. Just wanted to ask one for Girish on ESM. Could you maybe – to categorize that opportunity, could you maybe give us an attach rate to core Freshservice? How should we think about the opportunity within the installed base that you already have?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Sure, Luv.

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

A

So if you really think about Freshservice for Business Teams, one of the things I would like to tell you is even before the launch, we knew that almost 4,000 plus customers of Freshservice were actually using it outside of IT, like in departments like HR facilities, legal and finance. So I think that gave us the real product validation that we needed to create the new module to kind of price it separately, give the workspaces that are required. So we actually think there is tremendous opportunity to go into all of the existing customer base and actually encourage them to use Freshservice inside those other teams.

And also the Freshservice for Business Teams is actually priced lower than an IT agent. So we think it'll be attractive for that. So that is a expansion motion play which we will be taking on to take this to existing customers. Having said that, we also have multiple new lands where we are landing in multiple departments, not just IT. So I think both of this will allow us to extend Freshservice for Business Teams into multiple departments within the company.

Luv Sodha
Analyst, Jefferies LLC

Q

Got it. And then one quick follow-up for Dennis. In terms of the go-to-market organization, I know last quarter, obviously, Paddy was appointed as the interim CRO. Any other changes, I guess, in terms of the organization itself? And do you feel like you have all the resources you need to execute this year? Thank you.

Dennis M. Woodside
President & Director, Freshworks, Inc.

A

Yeah. Thanks. Yeah. So, first of all, Paddy has done an amazing job taking on the CRO role and a number of the changes that I described earlier around the focus on 500 to 5,000 employee companies [indiscernible] (00:57:17) the team's focus on larger deals, winning larger deals, some upskilling that's going on across the organization, that all is being driven by Paddy. So – and all very positive. And I think it's incremental changes from where we were. But it's really meeting the customers where they are coming to us. And as I've said earlier, as our product market fit is becoming much more apparent to the market, that's creating a lot of opportunity for us to move up. So we're pretty – we're very pleased with where things are in the go-to-market side right now.

Luv Sodha
Analyst, Jefferies LLC

Q

Got it. Thank you.

Operator: Thank you. One moment for our next question. And our next question comes from the line of D.J. Hynes from Canaccord. Your question, please.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Hey, guys. Thanks for taking the question. G, maybe I could just follow up on Luv's question there around the broader ESM strategy. I mean, how much attention do you think investors should be putting on that today? Like if we fast forward, could ESM be ultimately a bigger opportunity than core IT? Like how are you thinking about sizing the two relative opportunities within the Freshservice portfolio?

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

A

So I think right now it is still early days for us. So – and also we are landing ESM through IT departments, right? We are not actually starting a go-to-market motion where we're trying to sell this to HR teams or finance teams.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Okay.

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

A

So I think in that sense, we are – our go-to-market is go to IT and then focus on organizations where IT is helping HR, legal and finance teams to do that. So I don't expect ESM to be much bigger than IT in the short or in the coming say short term. So I would still say that we will land with IT and then expand into other or maybe co-land into multiple departments.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Yeah. Yeah. Okay. Okay. That makes sense. And then, Tyler, on the sales and marketing side, how much of your spend is variable versus fixed? And I'm really getting at kind of that the inbound side, which I think is largely driven by digital marketing spend. Like how much flexing up and down can you do there to control margins and where are you on that spectrum today?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. We don't think of it as [ph] flexion (00:59:46) up and down. We do look at the digital marketing spend, we plan it out and then we do kind of change if we're seeing big changes in auction rates or conversions. And – but it's not one that we're using as a margin lever necessarily because it does feed one whole side of the business, right, which is that kind of that SMB, that lower than 250, a lot of that is fed by digital marketing spend. And outside of that, that's a variable component.

And for the SMB, it's the biggest kind of cost on the flipside for the field and where most of our business is coming from now, which is that, that field business, which is kind of like greater than 500, the variable component there's commissions, but it's all head count, right? And that that's mainly head count driven. It is important to note that we spend a lot of kind of end of 2021 and a lot of last year building out that field presence. And we think we have a lot of those piece parts in place right now. We still are hiring [indiscernible] (01:00:51) reps where we think we need them. But we have built out a lot of that already.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Yeah. Perfect. Okay. Thank you for the color, guys.

Operator: Thank you. This does conclude the question-and-answer session of today's program. I'd like to hand the program back to Joon Huh for any further remarks.

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

Great. Thanks everybody for joining us today. If you have any unanswered questions, please feel free to call or email. We look forward to catching up with you throughout the quarter. Thank you.

Operator: Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.