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Freshworks, Inc. (FRSH)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the Freshworks' Fourth Quarter and Full Year 2023 Conference Call. At this time all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to turn the conference over to your speaker for today, Joon Huh, VP of Investor Relations. Please go ahead.

Joon Huh

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

Thank you. Good afternoon and welcome to Freshworks fourth quarter and full year 2023 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 2023 performance and our financial outlook for our first quarter and full year 2024.

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. Such risks include but are not limited to our ability to sustain our growth, to innovate, to reach our long-term revenue goals, to meet customer demand, and to control costs and improve operating efficiency.

For a discussion of additional material risks and other important factors that could affect our results, please refer to today's earnings release, our Form 10-Q from the quarter ended March 31, 2023, 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 call, 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 for historical periods 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, supplemental earnings slides, 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, Founder & Chief Executive Officer, Freshworks, Inc.

Thank you, Joon, and welcome everyone to Freshworks' earnings call covering our fourth quarter and full year of 2023. A year ago, we laid out growth strategies to focus on product innovation, winning in enterprise, landing and expanding to drive revenue growth, and improving our operating efficiency.

Over the course of 2023, we launched the Freshworks Customer Service Suite and a range of AI capabilities like Freddy Self-service, Copilot and Insights, all in pursuit of our mission to power businesses with AI-enabled software that helps customers optimize their work and boost productivity.

We landed or expanded with big brands like Big Lots, S&P Global, Fila, Cineworld, Forbes, LA Dodgers, Nucor, Giant Eagle, and Johnsonville Sausage. We've significantly improved our operating efficiency and inflected our financial model. We went from using cash for operations in 2022 to generating $78 million of free cash flow in 2023.

Turning to the quarter, I would like to thank the entire Freshworks team for delivering a strong Q4 as we outperformed across our key business metrics. Our revenue exceeded the high end of our financial estimates coming in at $160.1 million for the quarter. We outperformed on non-GAAP operating margin and delivered a record amount of free cash flow, generating $28.6 million in Q4. For the full year 2023, we finished with revenue of $596.4 million and free cash flow margin of 13%.

During today's call, I want to highlight three of our key differentiators and how they helped finish out the year with a strong Q4. The first is the power of our Neo platform, which underpins our product portfolio, giving us the ability to serve enterprise buyers and cross sell into more departments with multiple products. Second is our AI innovations, which are already helping customers achieve concrete productivity improvements. And third is our talented product development team in India that drives our innovation velocity and brings products to customers faster.

Our Neo platform is a critical component of our success and provides all the services that power our product analytics and Freddy AI, offers extensibility and interoperability for our customers through marketplace apps, and offers a unified customer data model across our products.

The development and launch of Customer Service Suite illustrates the power of our platform. Customer Service Suite combines three distinct Freshworks product capabilities, generative AI bots, conversational messaging and ticketing, in one integrated solution to meet the many needs of our customers.

For example, ClickFunnels, a provider of sales, marketing, e-commerce, and analytics tools replaced their previous support solution with our Customer Service Suite. The long developer times required to make even the smallest change forced the funnel marketing company to search for a more robust and agile solution. ClickFunnels chose CSS because of our integrated offering that is powered by AI capabilities resulting in improved resolution rates.

According to a Forrester Total Economic Impact report published in Q4, Freshworks CSS customers surveyed could achieve over a 200% return on investment over three years.

Our platform also helps us with rapid adoption of new technologies into all of our products. For example, we built generative AI capabilities across our products in just a few months. We started with Freddy Self-service through bots, and later introduced Freddy Copilot, built for Freshchat first and then extended to Freshdesk and Freshservice.

We are excited about the AI opportunity and potential monetization as Copilot became generally available recently, and we plan to launch Freddy Insights later this year. With Freddy Copilot capabilities in the hands of our customers, we are encouraged by the early results. Several power user customers realized approximately 50% reduction in the resolution times for their customer service agents with the help of Freddy Copilot.

As customers grow, many of them will use acquisitions as a part of their growth strategy. And when they do, they have a choice to either cobble together inherited disparate software solutions or pick one unified solution that works for all like Freshworks.

For example, Frasers Group in the UK, a retail customer that has grown over four decades and completed several acquisitions. It now represents 70 store brands including sportswear, games, homeware, fashion, and beauty.

After they chose Freshdesk in 2022 to consolidate 16 customer support systems into one, the company saved over $1 million in software licensing costs. Then in recent months Frasers Group added our AI-powered bot, and can now deflect more than a quarter of their customer interactions from human agents saving more time, and money for the company. For our partners we are seeing them utilize Freddy Copilot for developers to significantly accelerate the app development cycle.

In Q4, one partner Connectify, went from publishing four apps per month to building an average of seven per month, a productivity improvement of 75% with the help of Copilot for developers.

With the introduction of ChatGPT-4 last year, every company had the chance to reimagine its use of the latest AI technology. One of our strategic advantages in this moment was our access to high-quality talent in India. Our product and engineering teams were able to quickly innovate on our product road map. In 2023, this included integrating generative AI into our platform to leverage the latest large-language model.

This year we plan to continue to advance our AI features across our products and platform. In CS we expect to migrate more customers to our integrated Customer Service Suite which is designed to improve agent productivity.

In Freshservice we plan to enhance ESM, ITOM and verticalized offerings to fuel upmarket growth, and expansion across departments. And we plan to make significant upgrades to our sales, and marketing products to drive more inbound demand, and cross-sell opportunities.

Let me now turn it over to Dennis to share what we are seeing in the marketplace, how larger customers are driving our business growth, and how companies are expanding the use of our products.

Dennis M. Woodside

President & Director, Freshworks, Inc.

Thank you, G, and congratulations to the team for our strong finish to 2023. G talked about our enterprise-grade platform, AI capabilities, and the strategic advantage of our India teams.

Now let me spend some time talking about how these played out for us in our go-to-market success. Macroeconomic pressures and a greater emphasis on fast time-to-value are leading enterprise companies to choose a smaller number of platform solutions to build their businesses. We believe Freshworks is well positioned to continue taking advantage of this trend.

In 2023 we continued our progress in winning up market. In Q4 we closed the year by adding 229 more customers contributing more than $50,000 in ARR. This represents the highest number of quarterly adds for this customer cohort ever.

We also closed a record number of new deals over $100,000 in both IT and CS segments contributing to our strong quarter. These include a US-based footwear, and apparel company operating in over 120 countries, and a leading wholesaler to millions of restaurants, hotels, and catering firms.

As G said, we win with large businesses because of the power of our Neo platform underpinning our multi-product offerings. This enables us to rapidly roll out new technologies like AI all at a third the cost of larger competitors.

Customers across a variety of industries are quickly realizing the benefits. In the CPG sector Tata Consumer Products is a prime example of our enterprise customers leveraging improved automation workflows. As one of India's leading food, and beverage companies they are the world's second largest tea manufacturer, and operate Starbucks in India. Their legacy ITSM solution provided no control over admin configuration, making it difficult to create automation workflows. At the same time the company faced an overwhelming volume of email and phone calls. Since adopting Freshservice email queries have fallen by 21% in five months. In addition, Tata Consumer Products is one of the highest users of Freddy Copilot.

For industrials, Klöckner and Company supplies more than 90,000 customers worldwide with steel and metal products. The company is also digitizing and largely automating its supply and service chain. They needed to find a new self-service tool that's easy to use, fast, and a trustworthy daily assistant. Freshservice beat the competition helping them optimize budget, and repurpose funds for other IT initiatives.

Shifting to expansion. We have several paths to grow our business with existing customers. These include agent seat additions, product cross-sells, addition upsells, and enhanced pricing.

Shifting to expansion. We have several paths to grow our business with existing customers. These include agent seat additions, product cross-sells, addition upsells and enhanced pricing. Our recent introductions of AI capabilities, including bot sessions and Copilot add-ons, offer additional opportunities across our 67,100 customers.

Digging into our Q4 numbers, we're pleased that our net dollar retention increased 1 percentage point quarter-over-quarter to 107% on a constant currency basis. We closed several large expansion deals in Q4 as growth expansion improved from the prior quarter and reversed declining trends from earlier in the year. We also continued to improve our dollar base churn incrementally from the prior quarter.

Lastly, our multi-product adoption increased to 26% of our customer base. For example, we saw higher adoption for Freshservice for business teams as accounts grew more than 50% quarter-over-quarter, ending the year with more than 1,000 customers.

One of these customers is Brunel University London, a college highly recognized for its research. They serve up to 18,000 students and more than 2,500 staff across the academic year. Already a Freshservice customer, they saw an opportunity to improve and provide a more consistent service experience to departments beyond IT. These include health and safety, campus service, the student center and student welfare. By adding business agent licenses and workspaces, they reduced the average ticket resolution time from a previous backlog of several weeks to around four hours and achieved over 85% positive customer feedback.

We're also seeing expansion from early Freshdesk adopters to the newer Freshworks customer service suite. For example, Canadian-based CarltonOne made the switch and has since achieved a two-hour first response SLA. They are resolving over 1,000 tickets daily and landing a 60% first contact resolution rate through AI and bots.

And finally, Freshworks interoperable products give us a natural expansion path across solutions. For example, Agiito, a mid-market travel management company in the UK, first bought Freshdesk. This was to replace an on-premise customer support solution that couldn't deliver unified analytics and limited collaboration across teams. Later they added Freshcaller and Freshchat to unify support channels, and more recently, in Q4, they rolled out Freshsales to generate more qualified leads.

In addition to our powerful platform and multiple expansion paths, what we believe makes Freshworks unique is our go-to-market motions, which include both inbound, product-led growth and field sales. Our inbound business is primarily marketing-led, while our field business is sales-led. As our company matures, we have hired two proven leaders across these distinct go-to-market motions that can help us scale.

In Q4, Mika Yamamoto joined us in the new role of Chief Customer and Marketing Officer to drive greater inbound activity, including responsibility for our customer support, SMB and commercial sales. Under her leadership, this team will drive our inbound product-led growth motion. Our field sales team will be led by Abe Smith, who I'm excited to announce has joined as our Chief of Global Field Operations this week. He is a sales executive with nearly 25 years of global experience at Zoom, Oracle and Cisco, and will lead our talented field team to scale the business.

With these changes in the organization, Pradeep Rathinam, our CRO, will be departing Freshworks at the end of this month. Paddy stepped up to lead and stabilize our go-to-market teams during a transition period and delivered a strong Q4 to finish out the year. After joining us in 2020 through an acquisition, Paddy made countless contributions, first as our Chief Customer Officer and later as CRO. We thank him and wish him all the best in his future endeavors.

Now, over to Tyler to go through the Q4 and full-year financials and talk about how we're driving efficiency.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

Thanks, Dennis; and thanks again to everyone for joining us.

As I reflect on Q4 and 2023, I was really pleased with our ability to adapt to a changing macroeconomic environment to deliver durable revenue growth, while also improving our operating efficiency throughout the year. Specifically, we continued our product innovation cycles, injecting generative AI capabilities into our offerings; we retooled our go-to-market approach to more efficiently serve our diverse customer base; we brought on new leaders and team members to help drive additional growth. At the same time, we significantly improved our full-year non-GAAP operating and free cash flow margins by 12 percentage points and 16 percentage points respectively compared to the prior year.

For our call today, I'll cover the Q4 and full-year 2023 financial results, provide background on the key metrics and close with our forward-looking commentary and expectations for Q1 and full year 2024. I'll include constant currency comparisons for certain metrics to provide a better view of our business trends. As a reminder, most of our discussion will be focused on non-GAAP financial results, which exclude the impact of stock-based compensation expenses and other adjustments.

Starting with the income statement, Q4 revenue grew 20% year-over-year to $160.1 million. Adjusting for constant currency, revenue growth was 19%, as we saw the positive impacts from currency rates for the euro and pound against the US dollar over the past year. Similar to prior quarters, ITSM continued to drive the majority of our growth in Q4. In addition, we were encouraged to see an improvement in our CS expansion activity quarter-over-quarter.

Looking at our margins, non-GAAP gross margin remained flat compared to Q3 at 84% as we are efficiently scaling the business. Similarly, for the full year 2023, we achieved strong non-GAAP gross margins of 84%, which represents 150-basis-point improvement from the prior year.

Turning to our operating metrics. We have two key business metrics, net dollar retention and customers contributing more than $5,000 in ARR. Net dollar retention was 108% in the quarter, which includes a 1 percentage point benefit from FX, and came in ahead of our previous estimates of 105%. In Q4, we saw improvements in both gross expansion and churn rates quarter-over-quarter. The higher expansion rate was mainly driven by strong execution from our field teams, closing a number of large deals with existing customers. This was despite the overall macro demand continuing to feel pressure in Q4. Looking forward, we are planning for Q1 net dollar retention of 106%.

Moving to our other key business metric of number of customers contributing more than $5,000 in ARR, this metric grew 14% year-over-year on an as-reported and constant currency basis to 20,261 customers in the quarter and now represents 89% of our ARR. For our larger customer cohort contributing more than $50,000 in ARR, we saw strong growth in this cohort of 31% year-over-year to 2,497 customers and it now represents 48% of our ARR. Adjusting for constant currency, this cohort grew at 30%.

As G and Dennis mentioned earlier, we're excited about our ongoing success in winning upmarket deals. For total customers, we added over 500 net customers and ended the quarter with over 67,100 customers. The lower net adds in the quarter was primarily impacted by higher logo churn from smaller customers in the customer service segment, but we continued to see improvement in ARPA as we focus on attracting higher-yielding, more profitable customers.

Moving to calculated billings, balance sheet and cash items. Calculated billings grew 22% year-over-year to $180.4 million and 20% on a constant currency basis. Factors including timing duration of contracts created a slight benefit of 2% to these growth numbers.

Looking ahead to Q1 2024, our preliminary estimate for calculated billings growth is 16%. For the full year 2024, we expect calculated billings growth to be similar to our expected annual revenue growth rate of 18% to 19%.

During the quarter, we generated $28.6 million in free cash flow; and for the full year, we generated $78 million in free cash flow. This annual figure was nearly $70 million above our initial estimates we provided at the start of the year as we realized efficiencies throughout the year. This improvement was driven by lower-than-expected head count costs, improvements on our infrastructure spend and consolidation of vendor spend resulting in both ongoing efficiencies, as well as some onetime benefits.

For the full year 2024, we expect to generate approximately $110 million of free cash flow with approximately $26 million of that in Q1. We ended Q4 maintaining a similar balance to Q3 for cash, cash equivalents and marketable securities with $1.19 billion. We continued to net settle vested equity amounts using $16 million during the quarter and $68 million for the full year 2023. This activity is reflected in our financing activities and is excluded from free cash flow.

Since our IPO in 2021, we have used approximately $239 million in net settlement of vested equity. As we look forward to Q1, we plan to continue net settling vested equity amounts, resulting in Q1 cash usage of approximately $21 million using current stock price levels. For the full year, we expect to use approximately $80 million to net settle vested equity amounts.

Turning to our share count for Q4. We had approximately 326 million shares outstanding on a fully diluted basis as of December 31, 2023, representing share growth of less than 1% from the prior year. The fully diluted calculation consists of approximately 297 million shares outstanding, 27 million related to unvested RSUs and PRCs, and 2 million shares related to outstanding options.

Let me now provide our forward-looking estimates. For the first quarter of 2024, we expect revenue to be in the range of $162.5 million to $164.5 million, growing 18% to 19% year-over-year. Non-GAAP income from operations to be in the range of $12.5 million to $14.5 million. And non-GAAP net income per share to be in the range of $0.07 to $0.08, assuming weighted average shares outstanding of approximately 305 million shares.

For the full year 2024, we expect revenue to be in the range of $703.5 million to $711.5 million, growing 18% to 19% year-over-year. Non-GAAP income from operations to be in the range of $52 million to $60 million, and non-GAAP net income per share to be in the range of $0.29 to $0.31, assuming weighted average shares outstanding of approximately 306.1 million shares.

We want to provide our best view of the business as we see it today; and as part of that, I want to call out a couple of assumptions in our financial model. First, our forward-looking estimates are based on FX rates as of February 2, 2024. So any future currency moves are not factored in.

Second, we have seasonality in our business with expenses typically stepping up in Q2 as our annual merit increases come into effect. As a result, we anticipate non-GAAP operating income to be approximately $6 million in Q2, $15 million in Q3, and the remainder coming in Q4 to add up to the full year amount.

Let me close by saying, I'm pleased with all that we accomplished in 2023. We continued our rapid pace of innovation and enhanced our go-to-market efforts, all while making meaningful improvements to our operational efficiency. As we look to 2024, we are focused on our growth initiatives and we're excited for the many opportunities ahead.

And with that, let us take your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question that we have today is coming from Scott Berg of Needham. Your line is open.

Scott Berg
Analyst, Needham & Co. LLC

Q

Hi, everyone. Really nice quarter on the sales side, and thanks for taking my questions here. I got a couple. G, I wanted to start with what you're seeing on some of the AI front, with some of the functionality that you have in beta. I think one of the concerns amongst investors in enterprise software is the more prevalent these technologies become, the more they have a chance [ph] to eat at (00:26:58) seats in a seat-based model, like what Freshworks is. And you had commented that one of your beta customers made a 50% improvement in resolution timeframe.

How do you think about the use or the impact of AI in terms of what your business looks like going forward? Is it just going to be a module that adds maybe some ARPU uplift for customers? Or is there some seat opportunity maybe on the positive or the less positive side that might be impacted as well?

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

A

Yeah. Thanks for the question, Scott. So let me start off by saying, right from the very early days, even before AI, one of the goals for Freshworks, and in particular, and for most technology vendors in customer service or employee services, how can we help businesses drive more automation. Think about IVR driving automation in the call center and things like that, right?

So from 2018, we have been helping customers in the Freshdesk, Freshchat business to drive more automation. And that's always a business driver. So what we have with GenAI and Freddy Self-service and bots is the opportunity to bring a natural language conversational automation of customer service and some of the largest B2C companies are using our Freddy AI today for customer service automation.

So we actually believe in this and it will actually help us – help Freshworks be a beneficiary in driving better automation, and along with a seamless transfer to a live agent when the actual customer query goes beyond a simple, automatable question. So I think overall you have to look at it as how do we use – how do businesses use automation as the first line of defense and then seamlessly hand over to a human and then handle all the complex workflows. We think we have the best omni-channel customer service product in the industry today and we would be a big beneficiary of that.

Scott Berg
Analyst, Needham & Co. LLC

Q

Got it. Helpful. And then, from a – a follow-up, Dennis, you mentioned you have a new field sales leader starting. You've obviously helped enact a number of changes to the organization since you came. But with this individual, are there a lot of moving parts that are going to be occurring here in terms of what your go-to-market strategy looks like in 2024? Is this going to be more of an opportunity to make some subtle adjustments? Thank you.

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

A

Well, I would say, this is more of an opportunity to make subtle adjustments. We announced in Q4 that we made a change to separate our inbound business from our field business apps to create more focus on both that SMB, primarily inbound business from field. Field, we've done quite well over the last year. We have some opportunity in that SMB inbound business. And that's why, we brought Mika in. I think today's announcement with Abe is really the next step in creating focus on those two businesses as distinct. It's very different, going out, negotiating big deals with large industrial customers, and on the other hand, managing a funnel that's generating thousands of leads every single week. So we want to bring focus to both of those businesses. And that's why, we made the change.

Scott Berg
Analyst, Needham & Co. LLC

Q

Very helpful. Thank you, and congrats again on the next quarter.

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

A

Thank you.

Operator: Thank you. One moment for the next question. And our next question is coming from Pinjalim Bora of JPMorgan. Your line is open.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Hello. Great. Thank you for the question. Good to hear about the improvement in the CX expansion side. I wanted to ask you if you can go a little bit deeper. Are you seeing seat starts to grow and kind of accelerate there? Or is that expansion characteristic largely driven by the customer service suite, or maybe the pricing changes around bots?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey, Pinjalim. This is Tyler. We actually – in the quarter, we had strong expansion. We called out CX – it's a mix of all of the above. But we did have seat expansion specifically on that mid-market enterprise, which is driving a lot of it. Some of it was pull-forward early renewals from Q1 with expansion, which I always see as a good sign that they're coming – a customer coming up in renewal and they're going to actually increase their ARR and renew early with us. And so that was encouraging. CX has seen pressure on agents for a couple of years. We've been calling that out. And so we thought it was a really good quarter of execution on that side.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Okay. Understood. Tyler, another one for you. The guidance, can you maybe unpack some of the assumptions on the guidance? What are you thinking from a net retention perspective for the whole year on the logo perspective? Are you thinking about macro to be kind of the same? What should we think about from a pricing leverage point of view in that guidance? Anything you can add will help.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. So I'll take that in a couple of different pieces. On guidance, you mentioned net dollar retention. We have been calling 105%, and we really did think it was going to hit 105% in Q4, and we had called that earlier in the year. And kind of coming into Q2, Q3, one of the reasons that we didn't get down to 105% is because we were doing really, really well on churn.

In hitting our number for Q4, it was really a combination of churn still getting better as well as expansion kicking in a little bit. And now we're saying, hey, we're going to be at 106% in Q1. And we do think that's going to be the number. But, previously, we thought we'd stabilize at 105%. And now we think we're going to stabilize at 106%. And it really is just a reflection of the health of the customer base.

On the other areas of guidance on revenue, it's our best estimate based on what we see today and – that kind of 18%, 19% growth. And then, billings for the year, we expect to actually track that. We did call out that Q1, just the way that renewals are kind of falling. And also, I just mentioned that we had some early renewals into Q4 that pulled some billings from Q1 into Q4, that number is going to be a little bit – calculated billings, we expect to be a little bit lower in Q1. But really, it's just around timing. And for the year, we actually expect it to track revenue for the full year at 18% to 19%.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Understood. Thank you so much.

Operator: Thank you. One moment for the next question. And our next question will be coming from Elizabeth Porter of Morgan Stanley. Your line is open.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thank you so much. First, I just wanted to ask on the AI monetization impacts. You have some of the usage-based revenue from bots coming in and the Copilot seat add-ons. And I believe Freddy Insights, you mentioned is coming later this year. So what kind of attach or penetration rates are you assuming? Or is this more of an upside driver to guidance? Thanks.

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

A

So thanks for the question. So first of all, I think in terms of adoption so far, we have thousands of customers that have adopted in – opted into the beta programs for Freddy Self-serve (sic) [Freddy Self-service] (00:34:34), for insights and for Copilot. And not only have they opted in, but the usage rates amongst those customers is quite high. So we track things like active usage and so forth. We recently put those programs into GA, so you can purchase insights – or sorry, you can purchase Copilot and Self-serve (sic) [Self-service] (00:34:56) today on our website if you're a new customer. And then, we're moving all the beta customers into paid programs over the next month or so. So we'll start to see the monetization flow through.

But for now, we're very much focused on adoption. We're very much focused on the value that those products are providing to our customers. That's a good leading indicator for us.

In terms of how we're thinking about it for the full year, we haven't baked in meaningful upside to the year from AI because we wanted to see how things play out before putting anything into our number.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC
Q

Great. And then, just as a follow-up. I wanted to hit on margin. You had some really impressive expansion over the last year. Looking ahead, guidance implies more minimal expansion, despite still some of that solid top line growth. So first, how should we think about the leverage in any incremental areas of investment in fiscal 2024? And then, second, should we just be thinking more about some back-end-loaded linearity to hit your fiscal 2026 targets? Thanks.

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

Yeah. So thanks, Elizabeth. This is Tyler. We did make some huge improvements last year. Some of those improvements were kind of one-time. And I think we've been pretty consistent. I don't kind of expect the same kind of stair-step improvement coming into fiscal 2024 here. We are still very, very focused on efficiency, but we also think that there's some areas to invest.

On the R&D side, it really is going to continue to invest in innovation. And we think that's a big advantage that we have. And on the sales and marketing side, we are going to continue to lean in where we see opportunity specifically in field and hiring there where we see appropriate. So we have built in some areas of investment, but while also focusing on driving margin or driving more dollars to the bottom line and driving more cash.

Elizabeth Porter
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thank you.

Operator: Thank you. One moment for the next question. And our next question will be coming from Brent Bracelin of Piper Sandler. Your line is open.

Hannah Rudoff
Analyst, Piper Sandler & Co.
Q

Hi, guys. This is Hannah Rudoff on for Brent today. Thanks for taking my questions. It's really encouraging to see that record 50,000 net adds this past quarter. I guess, what do you attribute that to? I imagine a lot of it is ITSM, but some of it was probably driven by that new CS Suite as well. So wondering if you could just talk about the dynamics you witnessed in that cohort.

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

Yeah, you're correct. A lot of it's driven by ITSM, but we're seeing some promising results for CSS. One of the companies that I talked about in the prepared remarks, CarltonOne, that's a new CSS customer. They're a loyalty company up in Canada. Klöckner, one of the larger steel companies in Europe, that's a new ITSM customer. Tata, also another customer we talked about earlier, that's another ITSM customer.

I think it's not just something that we've done in the last quarter, but the investment that we've made in the product over the last couple of years, where we've built out an enterprise-grade ITSM suite, added on ITOM, ITAM, and then, more recently, ESM with Freshservice for Business Teams. That really has driven growth of that product.

And then, with CSS, our customers have a best-in-class, fully integrated product that covers both conversational and traditional ticketing, enhanced by AI. And that's something that really is unique in the marketplace, where if I'm an agent in a single pane of glass, I can ingest and see comments from my customer coming in through WhatsApp, coming in through SMS, or email, or phone and respond, and that has had a lot of positive acceptance in the market so far.

Hannah Rudoff Q

Analyst, Piper Sandler & Co.

Great. Super helpful. And then, Dennis, what do you feel still needs to be done to continue to execute on this upmarket motion that you're on right now? And is it just execution? Or is there more that you still need to do?

Dennis M. Woodside A

President & Director, Freshworks, Inc.

We're going to be making a meaningful investment in partners and partnerships. We announced a couple weeks ago a partnership with AWS, where they're bringing us into new deals. We're working with them on deals. One of our largest deals with a large apparel maker this year was assisted by AWS. Our customers are able to retire AWS commitments in terms of credits that they've committed to spend over multiple years by buying our software, so that makes the buying process much easier for them; and for us, it speeds the time to sale. So that's an example of a large partner that we think can help us accelerate growth over time. I think just also getting better and better at execution. We had our best quarter ever in North America.

Not surprisingly, about six months ago, we brought in Will Anastas, who's leading our North America sales effort. So we're seeing the benefit of some of the big hires that we've made in the last year as well. And we think that will continue with Abe coming in. Abe is a tried and true field general. And I think he's going to up our game even more as we go to market.

Hannah Rudoff Q

Analyst, Piper Sandler & Co.

Great to hear. Thank you so much.

Operator: Thank you. One moment for the next question. And our next question is going to be coming from Brian Peterson of Raymond James. Your line is open.

Brian Peterson Q

Analyst, Raymond James & Associates, Inc.

Hey, guys. Thanks for taking my question. So I wanted to follow up on the seat dynamic [indiscernible] (00:40:43). You've also mentioned that your overall seat [indiscernible] (00:40:47) has been under pressure for a little bit. Do you think we're through that? [indiscernible] (00:40:51) can expand going forward? Curious to get your thoughts there.

Tyler Renwick Sloat A

Chief Financial Officer, Freshworks, Inc.

Hey, Brian. This is Tyler. You're breaking up a little bit. But I think you're asking about kind of seat degradation or just expansion pressure and whether it's over or not. Now, we actually – we saw really good expansion in Q4. And you're right, we've been talking about kind of agent addition having kind of lower amounts over the last, call it, year-and-a-half. That has not recovered from what it was several years ago and we don't expect it to actually recover right away. There was good sings in Q4. But we're not planning on that just coming back. Because, at the same time, also, SMB did see some pressure and continuing to see pressure. And that's one of the reasons for the lower net adds at the very long tail of SMB, specifically CX, we saw some logo churn there.

In general, what we've been talking about is focusing on figuring out how to expand with our customer base outside of seat addition. If seat addition and agent addition comes back to the levels it was a couple of years ago, that'd be fantastic. But we are very focused on introducing new products, introducing new feature functionality, moving customers up the addition stack and things like that, as well as getting them to use more across other divisions.

And so, that's what our focus is right now. It's not all the way back, but we did have a good expansion quarter.

Brian Peterson
Analyst, Raymond James & Associates, Inc.

Q

That's good to hear. And maybe a follow-up [indiscernible] (00:42:22). Just on the field sales teams, any opinion on how you're thinking about the pace of [indiscernible] (00:42:29) hiring for 2024? And any comments that you can make on [indiscernible] (00:42:32). Thanks, guys.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

I think you're asking about the pace of hiring in field, is what I heard. We have been hiring in the field, and specifically in areas that we think there's opportunity and we think there's areas to definitely lean in. We're going to continue to do that. Our regional leaders are in place and have been for a while. So Abe's coming in, and he's taking that over, and he's going to work through. And part of the plan is to continue to hire and build up quota capacity, because we think there's big opportunity there.

Brian Peterson
Analyst, Raymond James & Associates, Inc.

Q

Excellent.

Operator: Thank you. One moment for the next question. And our next question is coming from Alex Zukin of Wolfe Research. Your line is open.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Hey, guys. Thanks for taking the question and congrats on a solid quarter. Maybe just the first one. Dennis or Tyler, can you maybe just talk about the macro exiting Q4 like – and entering the year. Has it changed? Has it gotten better? Is it different by geography in terms of what you're seeing? And to what extent do you feel like this was you guys executing meaningfully better versus the macro changing to the positive? And then, I got a quick a follow-up.

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

A

Sure. So I think the trends we saw in Q4 were consistent with trends we saw earlier in the year, and that is, that in enterprise and mid-market, we continued to see really solid traction. You see it in the 50,000 add number. And part of that is because vendors are consolidating spend. They're looking for platforms that can do much more for them. They're looking to bring AI into their operations, their workflows, their help desks, and we can do that. And they're excited about the AI road map and what we already have out there in beta and now in GA. So, all those things help there.

I think on SMB, SMB overall is a bit more challenged. I think the market – what we're hearing from our customers is the market is under a little bit more pressure if you're a smaller business. But there are also things we can do better. And that's, again, going back to driving product-led growth to the next level, aligning marketing more tightly with our SMB efforts, all those things we think will pay off for us. So, we think SMB is potentially a source of upside for us going forward, but what we saw in Q4 was consistent with prior quarters where that was the part of the business that was not growing quite as quickly as what we saw in the larger customer cohort.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Perfect. And then maybe just to follow up for G. You've gotten the AI question a couple of times. But maybe just what are you seeing in terms of early adoption or learnings from either – are you seeing more in SMB versus in mid-market enterprise or vice versa, faster versus slower? And what monetization motions, because you have a number of different ones that you're doing in the field, which one of those are working the best early on and that you see potentially kind of getting escape velocity later in the year?

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

A

Yeah. So, I would answer it in two parts. When you look at Freddy Self-service, that is seeing – like, we are seeing success with the larger B2C companies, because B2C companies have, like, fewer use cases that are scaling across millions of customers so it's right for automation. But if you look at our Copilot, that is seeing traction because it's helping agents get more productive. That we are seeing, like, excitement and adoption across thousands of customers across customer sizes or segments, SMB, as well as mid-market.

So again, where will we get escape velocity? I'm hopeful we'll get it in both, but we'll wait to see, it's still early days. And so, we will continue to put our heads down and execute, and deliver more value for our customers and get escape velocity through both.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Perfect. Thank you, guys.

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

A

Thank you.

Operator: Thank you. One moment for the next question. And our next question will be coming from Ryan MacWilliams of Barclays. Your line is open.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

Hey. Thanks for taking the question. And I just want to know your focus on upmarket customers. So, it makes sense that much smaller customers below $5,000 are turning into customer service segment. But any reason why those customers are leaving now? Are they just looking for cheaper alternatives or is it some change in the competitive landscape?

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

A

Yeah, I wouldn't say that they're necessarily looking for cheaper alternatives. I think we have a natural – there's natural churn as businesses, frankly, fail or shrink. And in SMB, you see quite a bit of that. I think we also have had customers who come in and try the product, find it doesn't fit for whatever reason, what they're looking for. Maybe they're too small. And so, I wouldn't say there's any one competitor that we find those customers migrating to, if that's your question.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

Excellent. And then, just for Tyler, pleased to see net retention come in better than expected. What are some of the things you would need to see to, like, call a trough? And do you think for Fresh to get back to 110% NRR, we would need to just see a step up in macro? That's, like, what we're waiting for here.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey, Ryan. So, I think in terms of a trough, right now, we called 106% for Q1. We were previously calling 105%. We do think 106% is kind of, from what we can see today, is a low point now, where I think we'll hit it, and then possibly stabilize from there. And getting it back up to 110%, I think it's a combination of a couple of things. We're still going to make progress on churn that we had said, hey, when we were public, we were kind of low 20s, total kind of gross churn, and now we're mid-teens. And I think we can continue to make subtle progress there, but it's going to be kind of like maybe 100 basis point, 200 basis point over a longer period of time. So, it really is going to be up to the expansion motion. And we've got a lot of initiatives there that are in play. We kind of called out what some of those are. In our Investor Day, we actually called out six things that we're working on.

The sixth one was kind of, hey, if macro comes back. And that would be a no-brainer. I think we would just get to ride that wave organically. We're not counting on that. And we don't expect that to happen overnight. And so we are very, very focused on other ways to grow with the customer base outside of that. And we do think that eventually we can bring it back up to 110% based on that, but it's going to take a little bit of time.

Ryan MacWilliams
Analyst, Barclays Capital, Inc.

Q

That's great. Appreciate the color. Thanks, guys.

Operator: Thank you. One moment for the next question. And our next question is coming from Pat Walravens of JMP Securities. Your line is open.

Austin Cole
Analyst, JMP Securities LLC

Q

Hi. This is Austin Cole on for Pat. Appreciate you guys taking the question. So I just wanted to kind of piggyback on the answer given to the incremental kind of an operating efficiency guidance implied. And looking at the flip side of that on the top line, with all the kind of unlocks that you guys are discussing, and the better than expected expansion, improving churn, why might it not be, at this point, prudent to say that this business could grow 20% next year? Thank you.

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

A

Well, our guide is to a little bit below that, we do build up that guide based on what we see right now. And what we've said is we have a lot of initiatives in play. And those specifically six things that we called out in our Investor Day that we said, hey, these are going to be upside to what is close to 20% growth rate. But they have to play out, right. And these aren't things that are going to happen overnight. Kind of like the AI monetization that we talk about that we said in Q4 is like, hopefully we can come out in the middle of the year and give an update on what the early signs of monetization there are. I just, we're very, very excited about the initiatives and what the longer term results could be from those, but they're just going to take some time to play out and thus we can't build them in yet.

Austin Cole
Analyst, JMP Securities LLC

Q

All right, thanks a lot.

Operator: Thank you, one moment for the next question. Our next question will be coming from Brent Thill of Jefferies. Your line is open.

Brent Thill
Analyst, Jefferies LLC

Q

Tyler, everyone appreciates the margin you guys gave us last year, but a 50 basis point increase this year, I think many are scratching their heads. So, just to push back a little bit, at your run rate, $600 million, I think everyone's questioning, where all these investments are going? Is this 80% of the field, 20% of the product, 50% field, 50% product? How would you characterize that? Because the natural margin trajectory should be, in my view, a lot better. And again, respect what you gave us last year. So maybe it's just that's it, you just gave us a big margin bump. But just trying to...

[indiscernible] (00:52:15)

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Q

No, totally get it, Brent. If you look at last year, we did get some onetime benefits, right. And so, if you look at, R&D stayed flat for the whole year, year-over-year compare, and then sales and marketing slightly higher, but really only $10 million higher when you look at kind of 2023 to 2022.

And we had said, hey, don't expect that same type of efficiencies driving into next year, especially as we kind of, last year going into sales and marketing, we really reshuffled a lot of stuff at the beginning of the year and let things settle. And now we feel like they're settled, and it's going to be time to lean in a little bit, and make some investments. We don't want the impression that we're moving away from thinking about efficiency. We are very focused on getting to the Rule of 40 by 2025, which we called out, and specifically free cash flow margin and growth. If you look at what we're guiding to, we're just under 16% on free cash flow margin for the year, and about 18%, 19% on revenue.

And so, I feel like that's a pretty good path or trajectory to get us to what we said we're going to be doing. And we're not going to lose sight of that. And we're going to obviously be as efficient as possible while we're growing. But we do think that if we have the opportunity to grow a little bit faster, we're going to take that opportunity and we have to invest first to be able to do that.

Brent Thill
Analyst, Jefferies LLC

Q

Okay, thank you.

Operator: Thank you, one moment for the next question. And our next question will be coming from Taylor McGinnis of UBS. Your line is open.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Yeah, hi. Thanks for taking my question. So, if I look at the high end of the FY 2024 revenue guide, it's only a point below the 4Q exit rev growth rate. So, it implies some stability in top line growth. So, can you talk about what gives you comfort that this outlook still embeds a level of conservatism or any change in the guidance framework? I think even despite the pull-forward, you're expecting billings growth to remain more stable too. So, maybe you can just comment on what you're seeing in the macro or what your assumptions are for ITSM versus CS growth that's supporting that outlook. Thanks.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Hey Taylor. This is Tyler. On the guidance, I think we've tried to get to a cadence that you guys will recognize. We are guiding to what we see. And it's not like we're trying to be overly conservative. We are trying to call it as we see it. And then we will obviously update that every single quarter. For the year, we do think in terms of the growth rate stabilization, we do think we're at a point right now where, okay, expansion, things like that, we don't expect those rates to get worse. We just talked about net dollar retention that we thought it was going to be 105%. We're actually calling 106% as kind of the bottom now. And we think we have pretty good view of the business as it is in front of us. We, again, I'm going to point to some of the initiatives we're working on and how we're going to grow faster. We just need to let these things play out, and we'll actually build those in as we start to see returns on them. It's just too early to be able to do that. But in general, we feel really good about the business and we're coming off a really good quarter and we're pretty positive.

Taylor McGinnis
Analyst, UBS Securities LLC

Q

Great. Thanks so much.

Operator: Thank you. And the final question for today will be coming from David Hynes of Canaccord. Your line is open.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Hey, guys. Thanks for taking the question. I'm going to pile on with another AI question. I don't know if it's for Dennis or G, but look, the value prop, the customer examples you're giving us, the early adoption seems very apparent. For the folks that aren't moving forward yet, is it a matter of organizational readiness? Are there price sensitivities in the market? I guess I'm particularly curious on the latter, just given, some of the more advanced AI features are yet to come to market. How sensitive are buyers to price at this point? Any color there would be helpful.

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

A

Yeah. So, this is Dennis. So, so far, as I said earlier, there's like thousands of customers have opted into the beta. So, I think to one degree or another, all of our customers have some level of interest. Now, some of those customers are going to be a little more cautious if they have become reliant on a human-driven interaction, or let's say they have a very high-value customer on the other end, and they prefer to have a human involved, then they're going to be less likely to adopt Freddy Self Serve (sic) [Freddy Self-service] (00:57:03). But they may adopt our Copilot product.

So I think it's just a matter of time before all of these opt into some trial of sort. And then it's a question of whether or not they see value in the product. And if they do, that's when we get into a nice discussion about, well, what is the investment that they're going to be making in AI? Are they going to provision all their agents or some of their agents? And how does that work? So that's a huge opportunity for us this year. And we're seeing with some of the resolution rates, the improvement in call quality, and customer interaction, and customer resolution, we're seeing a lot of value come from these AI products. And customers are recognizing that value.

So we're going to have to see how it all plays out. But I'm pretty optimistic that this is a huge opportunity for us that's going to really materialize over the course of the year.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Yeah. Okay. That's helpful color. And then, Tyler, maybe a follow-up for you. I think it's been asked a couple of different ways, but you have this $1 billion target out there for 2026. It implies some future acceleration in growth. Do we need to see the macro improve to hit that, or do you think you can get there with the go-to-market enhancements, the enterprise push, AI, new products, all the stuff that you're doing today? Can you get there in the current environment?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah, our plan is to be able to get there in the current environment. That's not based on macro coming back.

David Hynes
Analyst, Canaccord Genuity LLC

Q

Perfect. All right, guys. Thank you.

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

A

Thank you.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Thanks, everybody.

Operator: This concludes today's conference call. Everyone may disconnect.