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Freshworks, Inc. (FRSH)

Wolfe Research Software "March Madness" Conference

CORPORATE PARTICIPANTS

Tyler Renwick Sloat
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Alex Zukin
Analyst, Wolfe Research LLC

MANAGEMENT DISCUSSION SECTION

Alex Zukin
Analyst, Wolfe Research LLC

Good morning, everybody. Hopefully, you've got a quick break, quick coffee, did whatever you needed to do. We are extremely – I mean, I am extremely fortunate obviously, but I'm thankful that we're able to host all these great companies. I've got with me Tyler Sloat from Freshworks. Tyler, thank you so much for joining.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

Thanks for having us, [indiscernible] (00:00:21).

QUESTION AND ANSWER SECTION

Alex Zukin
Analyst, Wolfe Research LLC

Q

Hopefully, this is the last virtual conference we ever do and it's going to be all [indiscernible] (00:00:25) but listen, I've told – the audience knows this. I ask everybody the same kind of three or four questions to start just because we want a baseline and compare everybody. But the first question really is what do you – if you think about the current demand environment, how is it?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

We think it's getting – we've seen – the last couple of conferences, we had a lot of questions on pull forward, and there's anything like that that happened last year. We're not really seeing that. There is some seasonality in the business in general from quarter to quarter. But from a pull forward like of demand and like how did COVID cause things, no, we think demand is strong and it's kind of business as usual for us.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Great. Well, then I don't need to ask you the second question which is how would you characterize the impact of COVID on your demand environment. And as you're coming out of it, how do we think about the headwinds, tailwinds coming out of it on the other side?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah, that still is a legitimate question, right, because we – even for the last couple of quarters, we've been talking about compares and how numbers aren't necessarily normalized. And if we look at our fiscal 2020, kind of the end of Q1, but Q2 in particular did have a lot of COVID impact. So last year's compares look really good which makes this year's compares a little bit more difficult. And we've been pretty open about Q1 and Q2 is still going to have tougher compares because of last year's relatively easier numbers. And so that I think is like, personally as a CFO, I can't wait to kind of get past the first half of this year and then everything normalizes, you just talk about run rate numbers and be able to be just kind of straight about it without trying to add all these variables.

The other thing about COVID, I think, is just – for us in particular, just getting back into office is really important for us. And from a productivity perspective, from a culture perspective, Freshworks, the company is built around an amazing culture and it's just hard when you're working from home. So we are trying to get back in, our offices are open. We're not forcing people to get back in, but we are trying to motivate folks to do it.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Got it. Next question is about a – how – this is not super fair to ask because the company has not been public for that long, but what's the right way to think about how the business performs in a more recessionary and inflationary environment? There's obviously – you've been in a back office software company at Zuora. There's a difference between front office and back office, at least the investor perception of those lines of business in a recession. How do we think about – or how should investors think about a recessionary environment and its impact if it comes to pass on Freshworks?

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

Yeah. For us, first of all, the markets that we serve and play in are huge. And we're relatively small compared to the overall market sizes. So even though the overall markets might be impacted by kind of inflationary recessionary times, that doesn't mean we don't have an opportunity to go – continue to grow. The interesting thing about Freshworks is our products play, specifically our Freshdesk and Freshservice products, but Freshdesk in particular play from the SMB all the way up to kind of this low enterprise. And also for Freshservice where we are kind of considered the number one digital SaaS-first alternative on any service now.

So, if there is an inflationary time or recessionary time where companies are forced to think about cost and think about how can they run their business, but do it more efficiently, those tend to be opportunities where they're switching off of kind of more costly, administrative-heavy systems coming onto us. We did see some of that in COVID and industries that were really impacted that some companies had to think about kind of cost savings and things like that, but yet they didn't want to really give up all the feature functionality that they really need to run their business and that was an opportunity for a specific [indiscernible] (00:04:40) Freshservice side.

On the SMB side, we'll see, right? The long tail of SMB that if you look historically, it's always been there and companies – there is an entrepreneurial spirit to people and they start companies. But from a macro trend, that gets a lot higher if you have inflationary terms on salaries and [indiscernible] (00:05:02) supplies. We'll see if that impacts that long tail, which is we haven't quite seen it yet, but we'll continue to watch it obviously.

Alex Zukin
Analyst, Wolfe Research LLC
Q

Given the European and international business percentage for Freshworks, what's the right way, I get the question all the time right about the impact – the demand environment in Europe, the impacts to companies that have a lot of European exposure and national exposure. What's the right way for investors to process that that lends both from a growth and risk standpoint for the business in light of what's happening in the world?

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

Yeah. First, I think it's actually a unique attribute of Freshworks that we are very much global. And if you look at our ARR base, these are rough numbers, but it's kind of 40-40-20 in terms of North America, kind of EMEA and then rest of world. But when you look at our currency exposure, we're just over 60% USD and then the next two biggest are euro and GBP. We do have some FX exposure. In fact, we talked about Q1 that we're going to have like a 1% FX impact to a negative in terms of revenue and for the year in terms of that exposure. When that does, the dollar has gotten stronger against the pound and the euro.

That being said, we don't have a lot of exposure in Russia and Ukraine. We do have customers in Russia and they were mainly through partners – actually all through partners. And so there's a little bit of exposure that [ph] isn't material (00:06:40). We're trying to figure out what to do there along with all the other companies, especially as you can't – if they're on credit card, which a lot of them are, they can't pay, right? But in terms of broader Europe, we're watching it. We don't see it yet. But I wouldn't be shocked if something happens in terms of some pressure there because you just think about even supply chain and folks going out. And I think people get nervous, right? And so we haven't seen it yet, but we are going to watch it.

Alex Zukin
Analyst, Wolfe Research LLC
Q

When would you anticipate other companies starting to talk about those types of issues? Is that like a Q1 guide? Is that a Q2 event? Is that even later in the year, like how do you – not so much for just Freshworks, but just like industry-wide?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah, I think it depends on their business, right, in terms of sales cycles, but I would assume that companies are going to exit Q1. They're going to have visibility in the pipeline, so they'll have a sense of what Q2 is and they'll see how that pipeline mix is distributed globally and geographically. And if they see weakness in pipe, it's an indicator that clearly especially geographic weakness indicator that there might be some softness and absent everything else, meaning like new competitors coming in or something like that, you have to attribute some of these things, some more macro conditions.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Makes sense. Let's talk about – you're recently, although not as recent, but you had an IPO, obviously, you had a lot of conversations with investors both through that process, through earnings, through conferences now. What do you feel is the most misunderstood aspect of the Freshworks story from an investor standpoint?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

First of all, I don't think we have a lot of awareness yet, and we do need to work on it and that's in general brand awareness, but also some investor awareness. But the unique attribute for us is that we have three main product lines, two of them at scale now, each over $100 million in ARR, one over $200 million, one over $100 million is what we said at the IPO, plain and massive markets. But uniquely, these products were initially built for the end user and really thinking about the SMB. And then as we've added feature functionality, we've been able to go in and close much larger companies because our products are not relevant for them [indiscernible] (00:09:05) they have. But this sales motion we figured out is how to go attack that long tail of SMB, do it efficiently and really stay true to kind of that efficient model, very little implementation. You see the product, it should meet your needs, you just start using it. And that's kind of the holy grail of SaaS in my mind. Like how can you build a product that's just going to work and meet the needs of your customer? We don't try to do everything. We don't have [indiscernible] (00:09:35) all of our products. But as we continue to innovate, we add while staying true to that DNA of serving the end user. And then over time, our products are competitive with the most established players out there.

Alex Zukin
Analyst, Wolfe Research LLC

Q

As you think about the most exciting stack – stack ranking, the most exciting growth drivers for the business over the course of the next 6 to 12 months, where would you – what's that order?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Really two-fold. I think number one, our Freshservice product, we're pretty open about it, which is our ITSM product, selling into the CIO organization. It's done really well. And again, the competitive dynamics in that space is really ServiceNow servicing the large mega enterprise and then a lot of legacy players, I mean old school software and then players like Atlassian kind of coming up at the bottom. We are kind of right in that kind of high mid-market, low enterprise space and I think considered the preferred vendor there. And that's a great opportunity and we're going to continue to go capture that. Little bit longer term is this Customer 360 vision that we've talked about a lot that is really that journey from us providing our customers the visibility into their customers' journey from marketing to sales to support. And we've talked about our Freshmarketer and Freshsales products that are now built on our unified customer record and that how we are bringing on components of our Freshdesk product, which is support to be able to provide that 360 vision. Longer term that is what we are really investing because we think that's what customers are really going to need and that they're going to see a lot of value in that. And so that is what a lot of our innovation investments are being made around.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Okay. On the Freshservice side specifically, you mentioned last year cost pressures, making companies make some switches from more expensive solutions, as you look at your pipeline over the course of the next 6 to 12 months, like what percentage of those are flips from other large SaaS providers? Do you see that becoming like more of an impactful part of the growth curve or is it still just very opportunistic, the majority is either legacy displacement greenfield or even upselling to your current customer [indiscernible] (00:12:15)?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

I don't know if there's one that outweighs the other, and we're definitely seeing companies migrate off of ServiceNow and put us in. I'd say probably legacy software migrations are bigger percentage. And then for the mid-market customers, and these are customers that we classify between 250 and 5,000 employees, oftentimes it's the first real ITSM solution they're buying, where they were handling that through some kind of [ph] probably remunerate (00:12:47) simple ticketing system internally and that's more internal IT ticketing than a broader ITSM, then they hired [ph] VP of IT (00:12:56), they hired CIO as they grow and then they need more capability. So, we were possibly the first real ITSM solution they put in.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Got it. When you think about – so we talked – you mentioned Atlassian. Where are you seeing them come up? Jira Service Manager – and Service Management is becoming more impactful is from a [ph] talk track (00:13:23) perspective for them. Where are you seeing them? How is that changing or impacting the market dynamics or competitive dynamics at play?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah, I mean, so they're going to be a decent competitor, I think, but they bought a couple of solutions, right, and they kind of stitched them together. I think where we're seeing them is if they're already in the engineering groups and they're using – those groups are using Jira and they get them to use Jira Service Management, which is more on the DevOps side, then they're coming in from the DevOps side into IT as opposed to IT and then moving over. For us, one of the things we announced in November was increased ITOM capabilities, which was kind of unified response management between IT and DevOps and things like that that we believe customers need fully integrated solutions that are going to be kind of easy to use, but they don't have to put in a bunch of different things to help them respond internally and work for eventually their end customers. And that's the stuff that we're actually investing in there. But Atlassian is a great company, right? And I think they're still playing kind of on the mid-market side, and they're attacking it that way and coming up from the SMB, but there'll be a competitor in the space.

Alex Zukin
Analyst, Wolfe Research LLC

Q

If you think about your R&D dollars, you mentioned the size of the businesses. I think we have a rough sense of their growth rates within the company. As you think about between front office, front-facing CDP, messaging, there's a lot of investments and opportunity there. In IT, yeah, you've seen ServiceNow invest more meaningfully in observability, in desktop – not desktop, in observability and in DevOps, whereas Atlassian, you've seen them start talking more about even collaborative work management, particularly inside of the IT down or DevOps perspective, and they also have to deploy the monitoring tools to compete alerting. What do you feel, like, do you go the alerting route, the collaboration route, the observability route, like the umbrella of innovation required in that segment to compete? There is two questions basically, which way – where do you tilt there and how much R&D as a percentage of the total is going towards that vector?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. So, there is – I guess, two questions there is. So, first, I will answer to the second piece on how we think about R&D investment across the products, right? We kind of come into the year just like everything else, but we have distinct business units and those groups have product and engineering groups and then obviously they have needs. We also have a platform group that is developing components that are utilized across all the different products. And so that helps the products innovate faster to the extent that they can utilize the platform group. And we don't have to duplicate efforts across all the different product lines.

We also think about investment for future products. And so we have to protect that, right, order our products for next year and five years from now and even a little bit after that. And those ones we do protect, those investments, and then we kind of carve out what else is capable in terms of what we can afford because we do have targets of spend on R&D against – we run it against ARR or subscription revenue as a proxy and make those investments there. And so that's how we think about R&D spend across all the different products.

For Freshdesk, a lot of the investments are around what we think are the modern capabilities, but also the things that we're doing around the unified customer record, importing a lot of those capabilities onto that so that we can deliver this Customer 360 view. Modern capabilities are a lot around messaging and bots, which we think kind of what we would describe with our customers who are taking on our omni-channel capabilities that the next generation of consumers aren't really picking up the phone and they're not doing email. They're communicating with their vendors in a completely different way. And we saw that years ago. We started it and – but you have to continue to innovate there.

You were asking about Freshservice in particular, where there, there's additional ITOM capabilities, which is the operations management, which includes alert management, incident response, things like that. There's ITOM capabilities, which is asset management capability that allows your IT group to understand all the assets in the portfolio. But then there's also ESM capabilities, enterprise service management, which is the deployment of the ITSM solution for other functions within the company. And typically, those would start with like HR functions or other G&A functions where there is kind of some ticketing process like LEGOs oftentimes in that.

And there is some need for almost like an internal verticalization of the product to allow for really clean deployments in some of these functions. And so we're focused on that as well. So I think in Freshservice, there's a bunch of different directions that we're focused on and continue to innovate in and there's a lot of places that product can go.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Perfect. I want to make sure that the audience gets the chance to kind of queue in here. Guys, please queue in and ask questions. I will ask them going forward. If I think about the roadmap from a CDP perspective, it's built in to your product at kind of a foundational level. What's the vision and the focus around CDP? Clearly it's important in the sense that it's definitely available to all your customers inside of the product. But how do you monetize that? Is that a product that in the future you could make as a standalone product? What's the right way to think about it?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. That's actually a good question. So we can clarify. Our CDP vision right now is kind of more like out of the box CDP that's built into the products that our customers would be able to realize the value of having that internal CDP because the products just work together. And there's the seamless sharing of data across the different products.

The longer-term vision is not that we're necessarily selling it, but that we would be able to open up components of that CDP so that you could import data or you could connect data from other systems, right, because that – when you talk about a Customer 360 view, as G likes to say, the best we ever going to have is maybe a Customer 270 or something like that. There's going to be other systems that are going to have data that you're going to want to be able to kind of coordinate across other data to be able to really get that 360 view of your customer. And so we understand that and we want to be able to build our products and our internal CDP with the capability to ingest that data or at least make it seamless to a customer who could see it all.

The main difference is that you don't have to buy that CDP, right, and that's where a lot of companies are coming up and they are CDP companies, but you have to essentially stitch all your different products together across this hub. And we want our CDP to have a seamless capability for our customers and then they can just pull in data on their own.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Perfect. Again, I'm going to ask the audience, please put in questions. I will ask them. If you put them in at the end of the call, a lot harder to ask them, so please ask them. Let's go to a question about investments in margins. You saw, obviously, some pushback in the space from companies that were kind of investing behind what the opportunities they saw increasingly lay out like what is the investment profile, what is the thought process around margins, around efficiency? How should that work out over the course of both the next year, but beyond? And what are the governors that you use that are going to judge or give you the signal to either push on the accelerator or push on the brakes, particularly as the geopolitical and macro environment evolves?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Yeah. I mean, clearly, there's been a shift in investor appetite for kind of high growth, high burn, and maybe it has something to do with interest rates going up or whatnot and DCFs prolonging. But I just think it's overall just a shift, which I should have mentioned earlier when you ask, okay, what is misunderstood about Freshworks and anything that's unique about us, is that one thing, in addition to us having these three product lines and servicing the SMB kind of all the way up, but the [indiscernible] (00:23:00), we already do it efficiently and we've been able to get to our scale and growth rate and innovation kind of rate with those three products, but do it efficiently that we produced cash last year. And we came into this year on our call and we said we are going to burn a little bit this year, but that little bit was about $25 million and we have over $1 billion in the bank.

And the reason we're burning a little bit is absorbing full year of public company costs and then also everything else being equal, we're assuming that we're going back to pre-COVID levels of travel and facilities. A lot of investors don't realize that this was almost, say, a hall pass, but kind of for the last two years for a lot of companies. And if you have any enterprise sales motion or any kind of multi-geolocation strategy, travel can be relatively significant. And so, we already see it coming back. We have a lot of folks traveling, especially for us, it's from India back and forth, and things like that. And so that's why we're going to burn a little bit.

But in terms of strategy, my thought process, which you asked about, I think, first of all, cash. I was like, okay, free cash flow is really important, operating cash flow is really important. And let's get to a point where we are sustainably generating cash. And we said from Q4 on, we are going to be cash flow positive. Then second is about operating margin and producing profits and that will come later, but it's not going to be way down the line, first, let's get to a sustainable cash flow machine and then think about operating profits.

When we think about decision criteria, which you asked about, I think we have our controls on the four main components: it's your margins, it's your G&A, it's your R&D, and your sales and marketing.

On our gross margins, we're already at a point where I think is pretty good, where we're low-80s, I think was 83% last quarter. And, I mean, it's going to bounce between 80% to 83%, let's call it. But that's – as a SaaS company, that's already I would consider really, really good. And maybe you get a couple of hundred basis points in improvement over time there.

G&A is a little bit high for us. We're absorbing costs on going public [indiscernible] (00:25:22) and building the infrastructure, but you get economies of scale and then that will go to kind of high-single digits.

Then so it's really R&D and sales and marketing. On the R&D side, we are innovating and I think that's really important and we have the capability because we have access to more efficient human capital to be able to produce more products and really quality products than probably our peer set who's kind of a standard Silicon Valley company. We're going to keep doing that. But those – that spend will also come down as a percentage of total revenue and we're kind of in that mid- to high-20s now and over time, that will be high teens. So then it's all about sales and marketing.

And so we look at the efficiency of sales and marketing all the time. We can break it down between our different product lines and also within kind of our SMB motion, which is 250 and below customers that we serve, employee customers that we serve and we do that solely out of India and then our field motion. And those efficiencies, if it looks like it's still running efficient, we'll continue to throw dollars into that motion, just makes sense. But we don't do it kind of willy-nilly [ph] and grow at (00:26:39) any cost, we've already demonstrated that because, as I said, we produce [ph] cash costs (00:26:44). And so we will continue to run with that efficiency and that discipline.

Alex Zukin
Analyst, Wolfe Research LLC

Q

I want to ask you a more pointed question. You talked about one competitive set and that was ServiceNow and Atlassian. We haven't talked about the other competitive set, which is Zendesk. Zendesk involved in a lot of rumor milling, whether it's with M&A, whether it's with activism. Well, that's not rumor milling, that's actually happening.

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

[ph] It's public (00:27:14), I think, yeah.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Let's talk about the puts and takes for your business, for your pipeline, for your brand, for your marketing. I know that we don't – investors overly fixate on narratives and competition, but this is one where for a long, long time you were viewed at least for investors and Zendesk as kind of like the disruptive price competitor, lower end of the market. They were more, I don't know, developer friendly, savvy, that is presumably changed and this is going to also ultimately migrate into a longer term question about pricing and your ability to take price over time in your customer base. But, first, let's just focus in on how do investors – like, how good of it – how good of a thing is it for Freshworks for the situation that Zendesk is currently at?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

It's not a bad thing, I'll tell you that. So when we look at the kind of higher mid-market and enterprise space in customer support, it's Zendesk and Salesforce. And so one thing I can say Zendesk is still there, right? They're still in the deals, they're still competing. So whatever's happening at the corporate layer, there's their sales motions that are still out there, which is great. We are comfortable competing with them in that space now. And we're not necessarily competing on price. It is competition on feature functionality.

One thing that we saw, I think, before they did was this shift towards omni-channel communications, investments in AI, ML bots, and capabilities to handle conversations – conversational messenger over social media. And we've been investing in that and we'll continue to do so.

In that mid-market enterprise space, there's a lot of customers who still want legacy just support, right? Traditional email, telephony, things like that, which is fine, too, because we have those things. So, we're definitely just still competing with them. And we're still seeing them in deals and they're still there.

Then are they going to have other problems around confusion and disruption at the corporate layer, which then leads down to attrition and also other stuff? Probably, but we can't count on any of that, right? We just need to go do what we do and go compete. What are the differences? They're not really playing in that long tail of SMB. And even those – the companies at the higher end of SMB, which is those 250 employee business companies, and we are, right, and that's one thing that our desk solution is all inbound for us. And we're going to continue to go attack that market because we think it's really important that a lot of those companies grow up and become large organizations.

In that space, there's a litany of competitors, right? A lot of smaller companies coming up just focused on say, bots, or messaging or things like that. And we have to continue to innovate and it's probably healthier for us to see that because that's the future and being able to have visibility into a lot of that, which I think a lot of players don't see it in, say, Salesforce and Zendesk and then they can't shift and innovate fast enough, and over time, they might be left out.

And so, long story short, we're still seeing them. We're still competing with them. We're comfortable competing price. We are not necessarily that much more inexpensive and on the SMB side we're definitely probably more expensive than a lot of the smaller competitors. But we have the opportunity to be a little bit disruptive in price and we've never tried to be the high price or high cost alternative.

And then secondarily, we're still at a situation where the majority of our customers don't really have any implementation costs. They're kind of doing it themselves or using one of our quick starts and a lot of our online capabilities and when you look at total cost of ownership, that really puts us at an advantage and our customers recognize that.

Alex Zukin
Analyst, Wolfe Research LLC

Q

You mentioned you haven't necessarily seen – you're still seeing them in deals. Have you seen any sales attrition? Have you taken reps over from their – has their – have you seen any kind of disruption start to percolate and, again, give you that incremental added edge in a sales cycle or that incremental added opportunity to, I don't know, close the business faster or even go into their account base?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

Well, we're always trying to do that. I can't say there's been a mass exodus. Can I say we have folks from Zendesk and some great folks? We do. And I think there's opportunity to hire there. I'm sure they'd try to hire some of our great folks too, right. But I don't think it's falling apart. I just think that there's just a lot of noise and I'm assuming they're doing a lot of things internally to try to quell that. But I don't envy it, that's for sure.

Alex Zukin
Analyst, Wolfe Research LLC

Q

With respect to – you mentioned being free cash flow breakeven or even positive exiting this year, when we think about either capital, or allocation of capital, whether it's to M&A, which the company has done historically at a decent pace and with a great track record of integration or buybacks or any other – or just need to raise more capital to finance the growth of the business itself.

When you think about your approach to capital allocation, particularly in an environment where private markets, at least in the later stage side, are starting to compress a little bit, there's a lot of probably pretty decent quality assets. There's a lot of great R&D that's been funded, let's say, over the course of the last few years at exorbitant crazy valuations that are quickly fueling the force of gravity. How does a company like yours look at that, evaluate that and just start building it into the strategic direction of the company?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

I don't think anything's changed for us. M&A has – it's not core to our strategy around growing or innovating. That being said, we've looked at M&A as an area that if we can accelerate innovation or bring on teams, we'll absolutely look at it and we've been pretty open about that. They've tended to be smaller deals and doing just that accelerating innovation, bringing on teams, not necessarily revenue. And I don't think that's going to change. That being said, if stuff comes up, we'll continue to look at it. We are in a really good position.

As I mentioned, with over $1 billion in the bank and effectively cash flow neutral, that puts us in a healthy place. And for that, our capital allocation is not to go buy stuff, but we would be opportunistic. I do think in the private space, even still, valuations are probably crazy, but it just takes a little bit of time for all that to adjust. I think as public market valuations reset, then it trickles down as funding happens, you see VCs using that to their advantage and then that flows through and over time you do see things that could be attractive.

But, again, for us, it's not – that's not core to the strategy. It's just something that we would continue to look at. And if we think we can accelerate innovation or bring on some incredible teams and talent, we would do it.

Alex Zukin
Analyst, Wolfe Research LLC

Q

With respect – one of the things that I remember learning at least when I covered Zendesk and I want to ask you about HubSpot as well, is just contract structure, as well as billing terms. Just remind us, because I find that particularly in times of a little bit more macro uncertainty, contract structure, whether it's monthly or annual or quarterly, and what kind of terms you can give customers that are struggling in one way or another become important elements for investors to fully understand and then act. Where are you kind of similar/different than either your peers or interesting or not interesting, and more conservative structures that you have in place that actually promote outperformance or durability in times of distress?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

On the SMB side, we're still allowing for customers to buy monthly and it's often on credit card or some other payment method. The idea is that they would pay for that right, so the pricing for monthly is higher than it would be for annual. In advance, we now have about 60% of the businesses paying us annually. We have very few contracts that are multi-year and it's just not kind of in our sales motion or even the way we engage with customers as such, right, our contract asset and that kind of stuff is not really material or meaningful for us.

And so, when you're looking at our deferred revenue base, you have a mix of kind of monthly and then maybe a few quarterly semi-annual, and then the rest may be in annual pace. And for that, I don't think we're really going to change that. I think, as we're engaging with that mid-market enterprise, we do want most of them to be on annual contracts. What then happens though as you're upsell motion and we have a really healthy upsell motion, those don't end up being annual payments, right. And this does flow through to our billings, which adds a bunch of billings nuances where that, as customers are buying, they're then buying stub periods, right.

So, they're adding agents and you're already in on an annual contract, you're not buying on an annual payment. You are buying for three months or four months or whatever it is to get to that co-termed event. And so for us, upsell is core to the strategy, because we want to land with what you need. And then as you grow, you add agents and then you hopefully buy other products, but that would provide billing nuances for us.

Alex Zukin
Analyst, Wolfe Research LLC

Q

Last two questions. I'll try to squeeze them in. HubSpot, obviously, is making a bigger push on the service hub, rebranded, more innovation re-launched. Where do you see HubSpot coming up either today or where would you anticipate them coming up if at all? And then, as I think about the vector or algorithm of pricing on that dollar base, that expansion or NRR, is it more seats or is it more SKUs?

Tyler Renwick Sloat
Chief Financial Officer, Freshworks, Inc.

A

On HubSpot, I mean, they're going to be our top competitor on the sales – Freshmarketer and Freshsales products. We do not see them on Support right now. And I think as we say, our Freshsales and Freshmarketer are pretty new products for us, we don't really talk about the numbers, I'm guessing they say the same thing on Support. They – but we're not seeing them there right now. But maybe we will, I don't know, but not right now. I'm assuming their play is very similar to ours, right. We kind of established in Support, it's over $200 million product for us and we moved up to sales and marketing. They obviously start with marketing and they are not moving down. And so, they will eventually be there and we should be in their backyard as well.

Our net dollar expansion this past quarter, I thought we did pretty well. In fact, we look at FX, we really just moved down 100 basis points. And when we went public, had a lot to do with what I talked about earlier. This compares to the prior COVID where we said, hey, it's really not going to stay at this 118 basis points level. It's going to go down to 110 basis points to low teens. The reality is just hasn't come down as fast as I thought, because we've been doing really well on the churn side. And as we said in our last – on our year end call, we had record attrition rate – positive churn rates for the company, specifically, Freshdesk.

So, I think what we're – and what we said is that we used to be as a company kind of low-20s, high teens in terms of churn rates, and now we're squarely in the high teens. I think for – so you're kind of asking, how do – what do we think about net dollar retention, what could it get to and what's going to be the driver? I think, for us, once we get to normal compares, then that is going to be that low teens that we've talked about.

And then how do we get to that 115 basis points rate everything else being equal is, okay, if we can continue to make improvements on churn and if we can get from high teens to mid-teens on gross churn that kind of gets our net dollar retention to mid-teens. Then how does it get from kind of mid-teens to kind of that 120 basis points rate. Our expansion motion on agents is already pretty consistent and really healthy, so it has to really come from cross-sell motion.

And that cross-sell motion, there's no natural cross-sell between our Freshservice and Freshdesk product, two completely different buyers. Although we are starting to see customers buy both, but the big drivers got to be from the Freshmarketer, Freshsales product all through to Freshdesk and their cross-sell motion of those and that will come with the unified customer record and a lot of the work we're doing on the Customer 360 there. It's in the future still, but that is in my mind how we would eventually get that up and we would have to see an uptick in that cross-sell.

Alex Zukin

Analyst, Wolfe Research LLC

Perfect. We've run a little long, but I want to give you a chance to take a break and I want to thank everybody for joining us. Again, expect the survey in your inbox. It's important for management and it's important for us. It takes 30 seconds. I will say it every time on every fireside, just to reiterate the importance. But thank you, everybody.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

Alex, thanks man. Appreciate it.

Alex Zukin

Analyst, Wolfe Research LLC

Thanks, Tyler.