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# HubSpot, Inc. (HUBS)

Q3 2019 Earnings Call

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*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

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*Chief Financial Officer, HubSpot, Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Ladies and gentlemen, thank you for standing by. And welcome to the HubSpot Q3 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speakers today, Chuck MacGlashing, Head of Investor Relations. Thank you. Please go ahead.

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### Charles Tupper MacGlashing

*Head of Investor Relations, Corporate Treasury, HubSpot, Inc.*

Thanks, operator. Good afternoon and welcome to HubSpot's third quarter earnings conference call. Today, we'll be discussing the results announced in the press release that was issued after the market closed.

With me on the call this afternoon is Brian Halligan, our Chief Executive Officer and Chairman; and Kate Bueker, our Chief Financial Officer.

Before we start, I'd like to draw your attention to our Safe Harbor statement included in today's press release. During this call, we'll make statements related to our business that may be considered forward looking within the meaning of Section 27A of the Securities Exchange Act of 1933 as amended and Section 21E of the Securities Exchange Act of 1934 as amended.

All statements, other than statements of historical fact, are forward-looking statements, including statements regarding management's expectations of future, financial and operational performance and operational expenditures, expected growth and business outlook, including our financial guidance for the fourth fiscal quarter of 2019.

Forward-looking statements reflect our views only as of today, and except as required by law, we undertake no obligation to update or revise these forward-looking statements. Please refer to the cautionary language in today's press release and to our Form 10-Q, which was filed with the SEC on August 6, 2019, for a discussion of the risks and uncertainties that could cause actual results to differ materially from expectations.

During the course of today's call, we'll refer to certain non-GAAP financial measures as defined by Regulation G. The GAAP financial measure most directly comparable to each non-GAAP financial measure used or discussed and a reconciliation of the differences between each non-GAAP financial measure and the comparable GAAP financial measure can be found within our third quarter 2019 earnings press release in the Investor Relations section of our website at [hubspot.com](http://hubspot.com).

Now, it's my pleasure to turn over the call to HubSpot's CEO and Chairman, Brian Halligan.

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### Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

Thanks, Chuck. Good afternoon, folks. Thank you for joining us today as we review HubSpot's third quarter 2019 earnings results. Q3 was another good quarter for HubSpot with 33% revenue growth in constant currency, 6% non-GAAP operating margins and 31% customer growth, bringing our total customers to nearly 69,000.

In addition, we improved some of the operating efficiency over the last few months, including reaccelerating hiring. I want to tell a little bit about how we see HubSpot these days. 2018, we had a lot of products and filled out the suite. This move from a marketing application company to a suite is paying off as our customers are branching out and allowing us to create more value for them over time.

We have over 25,000 multi-hub customers now. This year, we're running a project we call Mainsail on the product side where we ramped up investment in engineering to make sure our suite was more reliable, more secure, faster and easier to use, the big initiative of ours this year and we're starting to see some benefits from it. Our customers put a lot of trust in HubSpot. As the system that runs their front-office, we want to reward that trust with an awesome suite of applications for them.

Over the next couple of years, I expect that suite will get better and better and will ultimately have a couple of additional hubs added to it. What makes our suite stand out in the marketplace is it's consumer-grade on the front-end and enterprise-grade on the back end. But HubSpot can't live on suites alone. The reality is that a typical mid-market customer leans heavily on our applications, but also has about 40 other SaaS applications in their business. Our goal is to enable our customers to create a disruptive customer experience for their customers by orchestrating all those applications in their go-to-market. We want to move from a suite company to a platform company.

To that end, yesterday, we're announced the acquisition of PieSync. The way I think PieSync is this is a synchronization engine that keeps system A perfectly in sync with system B. This is a very hard technical work to build these systems and they're a world-class at it. The acquisition overnight gives us the ability to keep HubSpot synchronized with over 200 third-party applications. Ultimately, we want all that data inside of HubSpot from which can trigger workflows, advanced reporting and create the delightfully disruptive end-to-end customer experiences.

With that, I'll hand it over to Kate.

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## Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

Thanks, Brian.

Let's turn to our third quarter financial results and our guidance for the fourth quarter. Third quarter revenue grew 33% year-over-year in constant currency and 32% as reported. Q3 subscription revenues grew 33% year-over-year, while services revenue grew 3% year-over-year, both on an as reported basis.

HubSpot ended Q3 with 68,803 total customers, which was up 31% year-over-year. Average subscription revenue per customer in Q3 was \$9,992, up slightly, both sequentially and year-over-year.

Domestic revenue grew 26%, while international revenue growth was 46% year-over-year in constant currency and 41% on an as reported basis. International revenue represented 40% of total revenue in Q3, up 3 points year-over-year.

Deferred revenue as of the end of September was \$204 million, a 25% increase year-over-year. Calculated billings was \$179 million, up 27% year-over-year on an as reported basis and 30% in constant currency. The remainder of my comments will refer to non-GAAP measures.

Third quarter gross margin was 82%, up about 0.5 point year-over-year. Subscription gross margin was 86%, while services gross margins were negative 7%. Third quarter operating margin was 6.1%, up 2 points from Q3 of last year. Our Q3 operating margin benefited from lower than expected hiring during the first half of the year, although the margin benefit in Q3 was lower than in earlier quarters of 2019.

At the end of the third quarter, we had 3,204 employees, up 24% year-over-year, a 4 point increase in growth from last quarter. We continue to believe that the operational changes and additional investments we made over the last couple of quarters have put us in a position to be back on our original hiring plan by the end of the year.

Net income in the third quarter was \$15.1 million or \$0.32 per diluted share. CapEx including capitalized software development costs was \$13 million or 7.5% of revenue in the quarter. The build-out of our Dublin facility is progressing well and we expect CapEx as a percentage of revenue to be at the high-end of our 7% to 8% range for 2019.

Finally, our cash, cash equivalents and marketable securities totaled just over \$1 billion at the end of September. With that, let's dive into guidance for the fourth quarter and full year of 2019.

For the fourth quarter, revenue is expected to be in the range of \$180.3 million to \$181.3 million. Non-GAAP operating income is expected to be between \$17.1 million and \$18.1 million. Non-GAAP diluted net income per share is expected to be between \$0.40 and \$0.42. This assumes approximately 47 million fully diluted shares outstanding. And for the full year of 2019, total revenue is expected to be in the range of \$669 million to \$670 million.

Non-GAAP operating profit is expected to be between \$54.5 million and \$55.5 million. Non-GAAP diluted net income per share is expected to be between \$1.44 and \$1.46. This assumes approximately 47 million fully diluted shares outstanding. We now expect free cash flow to be between \$63 million and \$64 million for the full year.

As you adjust your models, keep in mind the following. At current spot rates, currency has an incremental \$1 million head wind to Q4 revenue relative to our prior forecast. We're now expecting currency to represent a 2 point negative impact to as reported revenue growth in Q4.

Our acquisition of PieSync will add minimal revenue in Q4, but will have a slightly more meaningful impact to operating expenses in the quarter. This impact has been incorporated into our guidance. As we discussed at our recent Analyst Day, we expect our increased hiring and continued R&D investments, now combined with the incremental expense from PieSync, to pressure operating margins in the short-term, but to position HubSpot for a more durable growth rate into the future.

With that, I'll hand the call back over to Brian for his closing remarks.

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## Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

Thanks, Kate. I want to close by thanking our customers, our partners, our investors and all the HubSpotters around the globe for helping us with our mission to help millions of organizations grow better.

Finally, I'd like to welcome the team at PieSync, who are a key piece of the puzzle as we expand from a suite company to a major platform player.

Operator, can we please open the call for a few questions.

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## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Your first question comes from Brad Sills from Bank of America Merrill Lynch.

**Brad Sills**

*Analyst, Bank of America Merrill Lynch*

Q

Hey, guys. Thanks for taking my question. Wanted to ask about the hiring, the comments that you made earlier. I guess the question is where are you focusing on hiring? Where was the shortfall? Where is the emphasis in terms of the sales organization that you're hiring for?

**Kate Bueker**

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. Thanks, Brad. It's Kate. I'll take this. So I think as we shared on our Q2 call that hiring shortfall in the first half of the year was actually pretty much across the board. We made a ton of progress against the hiring in Q3 and again in October and most of the groups are actually caught up. It's important I think to remember that, first, you got to get the people on board, but then it'll take them a little bit of time to ramp up and become productive. But there's a little bit of lag effect, but we're certainly making progress and we're pleased about it.

**Brad Sills**

*Analyst, Bank of America Merrill Lynch*

Q

That's great. Thanks. And then one more, if I may. One of the things we hear from the channel is that larger deals are coming into the pipeline, still within your target range of 200 to 2,000 employees. But towards the upper end of that with some of the work you've done on Enterprise additions, the revamp last year, my question is, is there a different go-to-market here? Is it a pivot at all in kind of the go-to-market as you go after these larger deals? Is there something about them that is more complex such that maybe the go-to-market becomes different?

**Brian Patrick Halligan**

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Small tweaks versus big changes, I would say. If you – Brad, if you kind of step back and look at HubSpot, we've got three segments: a small business segment, a mid-market segment and a corporate segment. In that corporate segment, we're being thoughtful about the ratios between sales reps and systems engineers, between the ratios of number of accounts per sales rep, of how we deal with security requests, how we do deal with legal request, and we're investing a lot in the product.

Like, the product improved a lot on that Enterprise layer over the last couple of years, but I would say over the next 12 months, I would look for kind of a step function improvement in that product. We've made a ton of progress, but there's going to be a lot more progress going to be made over the next 12 months. There is a bunch of things – I talked to the customers all the time. There's a bunch of a relatively well-known things they want done. And if you like, we got more our arms around it and are kind of marching toward them. So feeling pretty good about that over the next 12 months.

Brad Sills

*Analyst, Bank of America Merrill Lynch*



Great. Thanks, Brian.

**Operator:** Your next question comes from Mark Murphy from JPMorgan.

Mark R. Murphy

*Analyst, JPMorgan Securities LLC*



Yes. Thank you, Brian. I wanted to ask you about the evolution of the low-touch model for HubSpot. I think a couple of quarters back, you had said that 50% of net new business is coming from a free user upgrading into a paid version. I'm curious just, first, how did that compare the most recent quarter or where is that trending? And then second, where do you see that heading into future state of the business if you succeed with the evolution to a low-touch model?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*



Yeah, Mark, really good question. Just overall, I think the freemium models work. We decided about three, four years ago that as we move from an app company to a suite company that we wanted to attack the market with a lower touch, lower friction, easier way to try and easier way to buy, similar to the way a lot of these B2C companies do it, similar to the way a lot of companies new B2B companies like the Zooms and the Slacks do it.

And I think it's really paying off. I don't have the exact number on my finger tip, but I think it's around 60% now originate through that freemium channels. So it's starting to really work. I also just like kind of strategically, like I look at the main competitors in our space and they've got a very heavy price and a very heavy UI and a very heavy go-to-market. We have a very light price, we have a very light UI and a very light go-to-market. We want to get them while they're early and scale with them over time. So feeling good about that decision, the progress we're making. We have a long way to go on it, like, we're not at kind of Dropbox, Atlassian level, Ninja premium warriors, but we're making a lot of progress.

Mark R. Murphy

*Analyst, JPMorgan Securities LLC*



Okay. Thank you for clarifying. And Kate, just as a quick follow-up. It feels like you're facing a few minor temporary headwinds. And it looks like based on this, you're getting through them in very good shape. And I wanted to ask when you consider some of these factors like being behind on hiring; there is a lack of a real major new hub that you're launching here in the second half. I think you're kind of lapping the effects of the price increase a year ago. For how long do you think that these conditions are going to persist? And if you had to make a guess, just when do you think all of that normalizes?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*



Well, I think you can come and work at HubSpot IR, and [indiscernible] (00:15:59) the challenges that we're facing at any point in time now. I think you're characterizing [indiscernible] (00:16:05)

Mark R. Murphy

*Analyst, JPMorgan Securities LLC*



I could never measure up to Chuck.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

He sets the high bar. That is absolutely, for sure. Look, I think that we have made a bunch of operational changes where that we think will have the impact of turning the ship around here. As you are alluding to, I think the sort of time to realize that is something that we'll probably talk about on the next earnings call.

Mark R. Murphy

*Analyst, JPMorgan Securities LLC*

Q

Okay, very good. Thank you.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Yeah. Thank you.

**Operator:** Your next question comes from Samad Samana from Jefferies.

Samad Samana

*Analyst, Jefferies LLC*

Q

Hi. Good evening and thanks for taking my questions. First one maybe Brian for you on PieSync. How should we think about the business model there? And from a strategic perspective, I think at INBOUND at the Analyst Day, the company talked app market places and that being something that could potentially be monetized. How should we think about PieSync fitting into that overall strategy, both short-term and long-term?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Sure. How are you doing, Samad?

Samad Samana

*Analyst, Jefferies LLC*

Q

Great. How are you doing?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Let's talk about PieSync. I'm doing great. I'm super excited about PieSync. We have been looking at deals for a while. We're super picky about the deals we do. We're looking for companies with a great culture fit, with great technology, with a reasonable financial decision to make, and [ph] will really fit (00:17:25) with our customers and PieSync fits the bill. So I'm super psyched about that team and they're kind of a key piece of the puzzle, frankly, going forward.

I look at HubSpot, we've moved for an app to a suite. And when you use the HubSpot suite, HubSpot itself does a great job of managing all the data created through HubSpot, does a great job of triggering workflows off of that data, using that data in those workflows to really personalize that end-to-end experience, but it's all based on HubSpot stuff. The reality that we're seeing is, whether we like it or not, companies use lots of different applications, lots and lots of applications.



A typical mid-market company will use 40 different SaaS applications these days. Many of which will touch the customer, many of which will involve the go-to-market. And so what we want to do is, we want to move to a world where we manage all of the data, whether created in a HubSpot app or not, trigger workflows off of all of that stuff, and create a disruptive, really personalized experience for our customers' customers.

In PieSync is kind of the key piece of that puzzle. Today, if you look at HubSpot, through synchronization where I've got data in a third-party system, data inside of HubSpot and they're perfectly in sync in real-time. We only really do that, Mark, (sic) [Samad] (00:18:37) with Salesforce – Samad, with Salesforce and Shopify. The PieSync guys do that for 200 different applications. So overnight we have much richer integrations that are really, really slick. So I'm psyched about PieSync. It's going to be really slick. That team is going to continue to work on that stuff and be a key, key engine for us going forward.

Samad Samana

*Analyst, Jefferies LLC*

Q

That's really helpful. Thank you. And then, Kate, maybe one for you, I was just looking at the net adds number, it was down slightly quarter-over-quarter. And then, thinking about that in the context of last quarter, it was down slightly quarter-over-quarter from 1Q, the prior quarter. So I guess, normally, you get bump heading into – heading out of INBOUND. How should we maybe think about any – either changes to the funnel or if there's anything that's happening that's leading to net adds going down quarter-over-quarter when it normally would be up seasonally?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. I guess when I look at that, I think the net adds for Q3 are actually pretty stable quarter-over-quarter, I think around – in and around that 4,000 mark. We had a little bit of a headwind this quarter because we introduced free email in June and that had a modest impact on our Marketing Starter additions, which has been benefit of a fuel to the engine of our new customer adds. But we're actually overall pretty happy with that, sort of that 4000-ish level of customer additions.

Samad Samana

*Analyst, Jefferies LLC*

Q

Okay, great. Thanks for taking my questions, guys.

**Operator:** Your next question comes from Alex Zukin from RBC Capital Markets. Alex Zukin, your line is open.

Alex Zukin

*Analyst, RBC Capital Markets LLC*

Q

Hey, guys. Sorry, I was on mute. Really quick, just quick two for me on PieSync, is there an intention to sell the solution similar to where Salesforce with sell of Mulesoft without really any other solutions from HubSpot. So that business the starting point for a new HubSpot customer could just be integrations with other apps and over time actually selling HubSpot solution. Is there any element in that?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

I think you'll see over the short-term, we're going to leave it in our marketplace and people can continue to buy PieSync and happily go on their way. Over time, you'll see that PieSync functionality be built into our core

products, may underpin a new hub down the road. So that's kind of how we think about it. It's the synchronization engine that will live inside of HubSpot, that will take data from other applications and make sure they're synched into HubSpot. And then, inside of HubSpot, we'll trigger workflows off of it and we'll do personalization off of it and enable them to create really disruptive experiences on top of it.

Alex Zukin

*Analyst, RBC Capital Markets LLC*

Q

Perfect, and then maybe just another one around, any kind of observations around macro that you saw in the quarter or anything about sales cycles, particularly as you now have multiple solutions that you're selling together. Is that – could – is there anything around delays or just the lengthening of sales cycles that you've seen at all or any kind of macro weakness that you can comment on? And if not, that's great, too.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

We're watching that carefully, like, I read the New York Times, Wall Street Journal and whatnot every day, and people are predicting a recession to come. And I do believe it'll eventually come, but we have not seen signs of it. Sales cycle seems similar, haven't been elongated, consistent demand environment over the last several quarters.

Alex Zukin

*Analyst, RBC Capital Markets LLC*

Q

Perfect Thank you, guys.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Yeah.

**Operator:** Your next question comes from Chris Merwin from Goldman Sachs.

Christopher Merwin

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Thanks for taking my questions. I wanted to ask a bit about the new hubs being added to the platform. I know there's probably not too much you can say now. But in terms of some of the capability that your customers are asking for, anything you can share there? And should we be thinking about you sort of staying in the customer facing area for solutions or could we see a shift into some brand new areas?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

I wouldn't imagine in the short-term, you'd see us going to any back office function. I guess a couple comments on that. When I look at our existing product line, we've got three hubs today. They're all very solid. They'll never been done. I mean, we'll always be working on them and there's lots and lots of room to improve on them. So you're going to see nice advancements in those three hubs, particularly the Enterprise layer of those three hubs, over the next year or two years. It's going to be really nice.

We made a lot of investments in then freemium and Starter layer, continuing to invest there, but a really kind of a heavier emphasis on that Enterprise layer. There will be a heavy investment in platform where we open up the

application, we open up more footprint for our APIs, we make those APIs more consistent, make them easier to use and better supported. And so that'll enable third parties to come in and build really nice integrations to HubSpot. PieSync will accelerate all of that stuff, that'll be really good.

And then, I think you'll see over the next couple of years, a couple more hubs we'll be able to layer in. And when we think about the opportunity for us, it's really around helping our customers create kind of a disruptive experience in their own industry. How do we build an awesome go-to-market that really transforms the experience for their customers? So if you can imagine, there's lots and lots of touch points along that journey, lots and lots of application areas. There's much more room for us, we think, to maneuver in the front office before we would even consider the back office.

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Christopher Merwin

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay, that's great. Thanks. And then maybe just one for Kate. Looks like average revenue per customer returned to positive territory for the first time I think in a while. So are you seeing more success in cross-sell or upselling that'll move around quarter-to-quarter based on a number of factors? But just curious any trends that you'd call out there?

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Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. I mean it was nice to see it tick up a little bit. Frankly, we continue to see the product mix as the main driver and we expect that we will see ASRPC continue to bounce around from quarter- to-quarter but we were like you pleased with the upward progress.

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Christopher Merwin

*Analyst, Goldman Sachs & Co. LLC*

Q

All right. Thank you.

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**Operator:** Your next question comes from Stan Zlotzky from Morgan Stanley.

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Stan Zlotzky

*Analyst, Morgan Stanley & Co. LLC*

Q

Perfect. Thank you, guys. And my apologies in advance for any background noise. So, maybe two quick questions from me, one, just putting a finer point on the macro. Just specifically looking outside of the US, what did you guys see in the quarter in Q3 and how are you thinking about Q4? And then just on PieSync, when you guys approached the acquisition decision, how did you think about the buy, build back and forth versus potentially integrating more tightly with one of the big integration software vendors that are already out there? That's it from me thank you.

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Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

You want to take Europe and I'll take PieSync.

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Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah, I think Brian talked at a high level around the macro situation and I think that what he – his comments echo true for both domestic and internationally. We did not see sort of a slowdown in demand internationally. We had a great quarter outside the US and haven't seen any signs of slowing.

**Brian Patrick Halligan**

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

And I would just say, like HubSpot, I feel like we had a really solid quarter here, 33% growth is really solid. If it could have been higher, and the reason it wasn't higher, it wasn't macro. I think the reason it wasn't higher was more execution on our side earlier in the year. Hiring, we fell behind hiring, that's just rippling through.

The other thing is just we had an outage back in March and that outage, that was kind of a big deal. Like, we talked to a lot of customers about it, really impacted them, and we take our responsibility very seriously. We want to be good stewards of their go-to-market and that outage really hurt us personally. And so we really went to work on that.

And so I talked about this in my prepared remarks, but we put this initiative in place called Mainsail. And Mainsail has been really, really important for us. It's an initiative where basically starting in April, we put all of the team- all of the development teams, about 100 of the them, into this Mainsail initiative. And they could work on security, reliability, speed and ease of use. And really, for six months, we didn't push out any new features, never mind a new hub. And so we took this initiative very, very seriously. And I think the results of that is no new hubs at INBOUND and no big splashy releases at INBOUND. You guys were at INBOUND. I think we could have been growing [ph] 1, 2, 3 point (00:27:36) faster if we had done that.

The good news is that initiative was kind of one step back. I think that'll generate two steps forward for us. So I think it was a right move. We're starting to see some nice signs of life where NPS is ticking up a little bit because of it and you can imagine that because the app is faster and easier to use. The customer dollar retention and revenue retention numbers are looking really solid. And just now over the last month, we are starting to crank out new products. So the teams are out of the Mainsail and have really satisfied the criteria around security, reliability, speed and ease of use. They're starting to build new stuff. So I personally am looking forward to 2020. I think we've have learned our lessons on execution and I think we're going to have a really good year next year, so feeling good.

So any like macro, I don't think it's macro, I think it's sort of self-induced, some of the mistakes we made in the first half that we're dealing with now. And I think we've learned from them and I think next year we're going to have a really good year.

**Charles Tupper MacGlashing**

*Head of Investor Relations, Corporate Treasury, HubSpot, Inc.*

A

I think his follow-up was the buy versus build.

**Brian Patrick Halligan**

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Yeah, I forgot. PieSync, yes, we've been looking at deals a lot and we've been looking at this space a lot. And we considered building it and we considered partnering it with, we're already partnering with PieSync. We decided to buy because we think this idea of really having the synchronization is core to HubSpot.

We want to these synchronizations to be very bespoke to HubSpot. We don't want it to be sort of a third-party system that sits off on the side and is kind of a traffic cop, kind of like previous caller asked about Mulesoft. We wanted to be tied in the HubSpot and really control it. And then we looked at building, it is really complicated hard stuff. Like, we have teams internally that build the Shopify integration and the Salesforce integration. They are large teams and it's complicated. And these PieSync folks are really deep and geeked out about synchronization. They're world-class [ph] and it's (00:29:30) very hard problem. So it was a near ideal buy. The other reason I really like this PieSync buy is it's a little bit under the covers. We pride ourselves in having like a consumer-grade UI and experience for our customers. The usability is really good and this is a nice, like, under the covers, it's a synchronization engine, so it doesn't sort of impact our Pristine UI. So I like that deal a lot.

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Stan Zlotzky

*Analyst, Morgan Stanley & Co. LLC*

Perfect Thank you so much.

Q

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**Operator:** Your next question comes from Tom Roderick from Stifel.

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Thomas Michael Roderick

*Analyst, Stifel, Nicolaus & Co., Inc.*

Yeah, hi, thank you for taking my questions. So, Brian, I wanted to go back to an answer you gave just a little bit ago and kind of see if I could put a finer point on how this all plays out a little bit. So if we go back to the second quarter, I think there was concern over the outage and you guys quite frankly put up a tremendous quarter in the bookings, reaccelerated and everyone said things are fine, right? But you guys were quick to point out, we need to hire more and we need more capacity. So now perhaps the stock's reacting a little bit to the billings decelerating. But it seems like you put more of that capacity in place. So perhaps you can kind of just draw an arrow to what happens next and how we ought to think about the trajectory of billings from where we're at now, given that you've caught up a little bit on the hiring and perhaps the execution is back on track?

Q

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Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

I would just say on the hiring, yeah, we're kind of disappointed in ourselves. We grew hiring 20% in Q1 and 20% in Q2. It was well below what we should have done, but I do give credit to the recruiting team here. They really got their act together. They grew 24% in Q3 and it's going to be north of that in Q4. A little bit of the problem with that is just the timing thing. Like, I used to work for an enterprise software company called Parametric Technology in the old days. And in the old days, it was very quarterly-driven, and what you did in the quarter is what showed up. And that's certainly not what happens today. It ripples through. And so I think you're seeing with Q3 and Q4 having solid quarters, but I think as those reps come onboard and those reps are fully productive and the teams around them are fully productive, I think we'll be in a really good shape.

A

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Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

And I guess just to add a little color on the billing side of things. I think billings is a relatively complicated metric for us and not always the most indicative of forward growth. Yeah, I think Q3 had, again, a set of factors, some FX factors that make billing a bit challenging. So at the end of the quarter, you would note that the year was particularly weak. And so we both revalued the deferred revenue on the balance sheet, which created a headwind from an FX perspective, and we also had a revenue headwind. So the difference between as-reported billings and constant currency billings was 3 points for the quarter, which is relatively substantial.

A

The other thing that I would say is that product mix plays a part here in billings. And when you think about the commentary that Brian sort of laid out around where we've been having success this year, it really has been at the lower end of the product portfolio and those tend to have shorter payment terms, so lower billings associated with the transaction.

In addition, we've been pretty relatively stronger in Sales and Service Hub, which also have – tend to have relatively lower upfront billings than our historical Marketing Hub. And then finally, I think we are, frankly, just up against a really, really hard compare from last year where we launched a ton of new product in Q4. And so I think it's a bunch of things on billings for Q3.

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**Brian Patrick Halligan**

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Really, good points.

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**Thomas Michael Roderick**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay, really helpful. Thank you. A quick follow-up, just in thinking about the ASRPC numbers, so nice to see that go up, and thinking about the upper end of the mid-market, we've heard Adobe express that Marketo perhaps has focused less on the mid-market. Does that leave an opportunity for you? Are you already benefiting from that? Is that part of the ASRPC strength? Would love to hear how you think about that as Adobe pulls Marketo upstream a little bit.

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**Brian Patrick Halligan**

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

That's a good question. I did look at the Adobe earnings results yesterday. I thought that was interesting. I think the mid-market is it's really where to be. That's kind of where we live. There's a set of competitors down in the small business, everyone from Wix to Constant Contact down there. And then, there's a bunch of Enterprise competitors, like Adobe's up there and lots of other ones. And there is a big wide space in between and HubSpot fills it really nicely. And what we want to do is you're a startup, and you get five people, and you get them going, like Dharmesh and I were in the early days, bam, come on our freemium version. And then, as you grow, move to Starter and Pro and Enterprise. I kind of think of HubSpot over the last couple of – over the last year, we've really pushed down, that freemium's gotten better, the Starter is getting better. I think there's room to kind of push up as well and elbow a little down and a little up. I like this mid-market a lot. I think there's a big, big opportunity for us.

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**Thomas Michael Roderick**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Thank you both. That was great. Appreciate it.

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**Operator:** Your next question comes from Kirk Materne from Evercore.

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**Peter Levine**

*Analyst, Evercore Group LLC*

Q

Great, thanks. This is Peter Levine in for Kirk. So just two quick questions. As you think about the newer channel initiative that you kind of highlighted during your Analyst Day and on prior calls, just anything notable from contributions changes from these partners that you've seen from outside of the traditional agency group? And

then, Kate, can you kind of give us any metrics or quantify what partner contributions year-to-date look like year-over-year?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. I guess, I'll just start, the partner contribution is very steady. So partner continues to contribute about 40% of revenue for the quarter.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Overall, I think it's going great. The partner team's doing a nice job this year. They made some nice enhancements to the partner program and INBOUND that did a couple of things. One, they created a new layer for partners to achieve, like a really ultra-high layer for them to get to, which partners – the good partners really liked. They also created some new incentives to cross-sell. We're piloting some stuff there. It's going pretty well. I'm really happy about that. And then there's a bunch of plays in motion now around operational improvements and technology improvements. Some of which will drop on Partner Day, which we have in March that I think the partners will really like. So feeling good about that partner program, feeling good about the changes we're making, feeling good about the idea of the best Marketing partners picking up Sales and Service and really [ph] enabling (00:36:09) an experienced disruption play, feeling really good about the ability of us to pick up new types of partners. We're doing that really well and turning them into bigger and better partners. So, yeah, feeling good about that.

Peter Levine

*Analyst, Evercore Group LLC*

Q

Great. And then you highlighted, you're not really seeing any macro issues internationally. Now, it's 40% of revenue. So I mean maybe you can help us understand customers internationally, are they purchasing differently than customers here in the US? I mean, are you seeing more growth stack customers? Are they adopting multiple hubs at once? Just any dynamics there that you see would be interesting. Thanks.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

It's remarkably consistent across geographies in terms of all those ratios you might look at. We're seeing really Europe's done – doing great, Australia's doing great, and then the newer markets are coming online, and we're thinking that can be a nice growth drivers for us. So we've seen some of the other companies out there saying there's some softness in certain markets. And I'm sure there's an executional issues. I don't know how much of it is execution versus how much of it is the market itself. In any given pocket, you might have some executional issues, so it's hard to say.

Peter Levine

*Analyst, Evercore Group LLC*

Q

Thank you.

**Operator:** Your next question comes from Ken Wong from Guggenheim Securities.

Ken Wong

*Analyst, Guggenheim Securities LLC*

Q

Great. Thanks for taking my question. Maybe first one for Kate, as I look at the guidance, historically, your sequential growth is closer to high-single digits. You guys are looking to grow it in the mid-single-digit for Q4. Besides FX, anything we should be aware of that might be causing that headwind?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Nothing's changed in our overall guidance framework. You know as we sat down and looked at guidance for our Q4 and the full year, I think we talked about the fact that really we're catching up on hiring, but there's going to be a period of ramp for the new hires. We talked about the fact that there's an incremental foreign exchange headwind into Q4. And frankly, we just have some tough comps in the back half of the year. So I think we feel good about guidance. We always try to do better, but we think that we feel good about what we put out there.

Ken Wong

*Analyst, Guggenheim Securities LLC*

Q

Got it. And then, I believe you guys recently made some changes to onboarding to focus more on customer goals. Can you talk about what those tweaks were and perhaps any benefits you're seeing or we should potentially expect from this initiative?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Sure. You've been doing your homework. We just rolled that out. I believe we rolled that out yesterday.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yesterday.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

It's a little early to know if it's going to work. It's just trying to get a little bit more focused on what the – we've been a little bit generic. So you're a customer, we sign you up on Marketing Hub Pro. We kind of run you through the same program, no matter what company you are. In some companies, they're saying, hey, I want to really get good at automation. I have a big database. And other companies, they're saying, hey, I want to really up my advertising game. And other companies say, hey, I want to get really good at content marketing. So just trying to get a little bit better at understanding what the customer pain is, figuring out what their priorities are and mapping into it. It's a little bit of a solution-oriented implementation and I think it's going to have a nice impact. I think we'll see some improvement in customer dollar retention and revenue retention as well as word-of-mouth.

Ken Wong

*Analyst, Guggenheim Securities LLC*

Q

Great. Thanks a lot.

**Operator:** Your next question comes from Richard Davis from Canaccord.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Richard.



Luke Morison

*Analyst, Canaccord Genuity LLC*

Hey guys. This is Luke on for Richard.

Q

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

Hi Luke.

A

Luke Morison

*Analyst, Canaccord Genuity LLC*

So I just want to dig back in on – how's it going?

Q

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

Good.

A

Luke Morison

*Analyst, Canaccord Genuity LLC*

Good. So I just want to dig a bit back on your channel strategy. Would you say the focus there is primarily on growing the number of partners you have and has that focus shifted over time as you emphasize and hone your higher value add partners to make them more successful? Or how – I guess how do you balance those two things and how's that strategy evolved over time?

Q

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

There's a couple of things going on in the partner program. One thing that's going on, it's trying to make our best partners better. For example, we just put in place an advanced certification program for our best partners to really go deep in our CRM, really go deep in our API so they can do larger and larger CRM implementations. I think we're certified about 10 of those recently.

A

So going deeper with our best partners. At the same time, we have initiatives going on. We're trying to sign up partners that aren't just Marketing partners. We're signing up a lot of CRM implementation companies, sales consulting companies, companies like that, and there's a lot of them coming in and they're starting to do pretty well. So we've been talking about that for a year or two now and it's really starting to work quite well. And next year, we're going to kind of institutionalize that and make it a real legit program. And so feeling good about it.

Luke Morison

*Analyst, Canaccord Genuity LLC*

Perfect. Thanks.

Q

**Operator:** Your next question comes from Arjun Bhatia from William Blair.

Arjun Bhatia

*Analyst, William Blair & Co. LLC*

Q

Hey guys. Thanks for taking my question. Just maybe wanted to touch on Service Hub. I was hoping if you could – I was hoping you'd be able to give us an update here, particularly on kind of the changes that you've been seeing in new customer interest versus kind of cross-sell to the existing base. And I think in Q1 next year, Desk.com is supposed to be sunset. Just curious if you're seeing any kind of pickup in the interest from new customers there that are looking to migrate over to your offering now?

**Brian Patrick Halligan**

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

I'd say it's steady as she goes with Service Hub. Like the Sales Hub, we released a few years before it. We're never done with these things and they start kind of a little light. And then, over time, we add a lot more functionality and power to it. And that's we're in process of doing that with Service Hub. There was really nothing new that happened while we were in Mainsail between, call it, April and September, but since September, it's really picked up, in particular, for Service Hub, and there are two things just came out that I think are really hot.

As a service organization, you want to monitor incoming chat, incoming social media, incoming emails, incoming phone calls from folks who have service issues, a lot of people want to do that via Facebook Messenger. So we just added the ability a couple of weeks ago for people to use Facebook Messenger as the channel, and people are psyched about that.

The second thing, we just came out with, and I'm really excited about, is around the knowledge base. So more and more of our customers, they don't want to get a phone call from a customer per se or an email or a chat with them, what they really want is to enable their customer to self-serve via Google and then go through a knowledge base on their site.

And we just added the ability for folks to have a knowledge base that really matches the rest of their site. One of the many cool things about HubSpot is underneath the covers. There's a content management system and we expose big pieces of that content management system through the knowledge base inside of Service Hub so they can create a really beautiful nice experience that matches their website, matches their blog, matches their landing pages. So that product's getting better. It's going to continue to get better over the next – forever, it's going to get better, but lots and lots of investments, and it's going well.

**Arjun Bhatia**

*Analyst, William Blair & Co. LLC*

Q

Great. Thanks. And maybe one for Kate. Kate, I noticed Professional Services saw kind of a big step-down in the quarter. Is there anything to point out there that might be causing that? I know Brian alluded to maybe adding more implementation partners. Just wondering if that's kind of contributing to the results there.

**Kate Bueker**

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. No, I would not point there. I think we generally view the services business as an enabler of the software business. And it's relatively small as a percentage of overall revenue. And so, call it, modest changes can have big swings in the growth rates associated with that business. I think product mix is one of the things that's really driving the slowing of the services revenue growth this quarter. And as I talked about before, it's that Sales Hub and Service Hub that are really strong in terms of new business this quarter and those tend to have lower attach rates and similar services packages. And that's, frankly, the biggest contributor to the slowdown there.

Arjun Bhatia

*Analyst, William Blair & Co. LLC*



Great, very helpful. Thanks for taking my questions.

**Operator:** Your next question comes from Brian Peterson from Raymond James.

Brian Peterson

*Analyst, Raymond James & Associates, Inc.*



Hi, thanks for taking the question. So, Brian, I think you hit on this a little bit earlier, but there's a lot of product innovation over the last few years. In commentary on going from a suite to a platform, I think Sales and Service get a lot of attention there. I'm just curious what role do you think the CMS offering plays in that effort?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*



CMS is going well. We did something big with the CMS that didn't get a lot of coverage, but we – typically, we bundled the CMS with the Marketing product and you couldn't buy the CMS without buying the Marketing product. We decoupled those things at INBOUND last year and the growth rate's been nice with that product. And as we come out of the Mainsail and people are building new functionality, I think you'll see that thing really get better and grow next year. I'm excited about that.

I'm excited about the idea, too. Like, what we really want to do is help our customers create awesome experiences. And I think part of that is having an awesome website and an awesome experience for your customers come through. They'll be able to build custom stuff and make it really great. So that's an area to keep your eye on.

Brian Peterson

*Analyst, Raymond James & Associates, Inc.*



Got it, and maybe just one related to PieSync. I'm curious, if you look across your customer base, any sense of how many of those customers have a solution similar to that or have deployed PieSync today versus potential white space? Thank you.

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*



Yeah. PieSync, I think we have a lot of customers that are using PieSync. I forgot the exact number, but I saw the graph and it was very steep, up until the right. So it's a fan favorite of the HubSpot crew. And the thing – one of the things we really liked about PieSync, if you go to G2 Crowd and look up PieSync, it's ridiculously highly rated by all their users. It's just people love that application. So I'm feeling good about PieSync, and the team there is really good. Those people are really good at building something that's really hard, and that's a good place to acquire.

**Operator:** Your next question comes from Ryan MacDonald from Needham & Company.

Alex Narum

*Analyst, Needham & Co. LLC*



Hi. This is Alex Narum on for Ryan. I'd just like to know, could you give us an update on the search for the new customer officer? What qualities, particularly as you continue the sales organization towards the \$1 billion revenue target, are you looking for in that type of candidate?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

The search is going very well. We're making good progress. We've been thrilled with the quality of candidates we have been seeing. And I imagine we'd be able to announce something shortly on that. We're making good progress on it. And the person we're looking for, we want certainly to be a nice culture fit inside of HubSpot to have experience in building a high-growth SaaS business, and hopefully, someone who has the experience of building these light-touch sales models. Those are some of the things we're looking for. We've seen some great candidates. I'm super confident we're going to nail someone terrific.

Alex Narum

*Analyst, Needham & Co. LLC*

Q

Okay. And then also, how did net revenue retention trend during the quarter?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. So, net revenue retention was over 100% in Q3.

Alex Narum

*Analyst, Needham & Co. LLC*

Q

Okay. Thank you.

**Operator:** Your next question comes from Jennifer Lowe from UBS.

Rakesh Kumar

*Analyst, UBS Securities LLC*

Q

Hi. This is Rakesh Kumar sitting in for Jen Lowe. Thanks for taking my questions. You talked about introduction of Starter products leading to some cannibalization of Pro and Enterprise SKUs. I was hoping to see if you can share any metrics around customers upgrading to higher priced SKUs as they mature?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

I don't think we've talked about that, but recently, we've started to put some attention on – like, we're spending a lot of time figuring how to take a total stranger and get them into our CRM and get them actively using our CRM and inviting their colleagues in and then getting that free CRM user into a Starter tier. And then it's mostly been of a higher touch way of a PQL, we call it. There's a paywall in there that they will trip over that will get them into the Pro product. We're getting better at that and we're getting better at automating some of that stuff. So, that's something where we've gotten better at just over the last couple of months. And I think it's an area we can improve and really grow up.

Rakesh Kumar

*Analyst, UBS Securities LLC*

Q

And I have a follow-up, so without going specifically into next year guidance, when do you expect to be done with this project Mainsail and how should that impact operating leverage in 2020 and beyond?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Yeah, good question. Mainsail is a permanent project where we want the base line of HubSpot around security or reliability, speed, and ease of use. So just be a baseline that we want everyone to get this kind of table stakes on there. And as our teams get through those table stakes, then they can start building new and exciting features for our customers. More than half our teams are out of that already. That's why we're starting to see the pace of innovation pick up. And I would imagine six months from now, pretty much all those teams will be out of that mode, but we're still going to have that baseline and really want the products to be more secure, more reliable, faster and easier.

**Operator:** And your next question comes from Derrick Wood from Cowen and Company.

Q

Great. Thanks. It's [ph] Andrew (00:50:22) on for Derrick. Most of mine were taken, but any change in the competitive environment on Marketing? And maybe any color on the mix of greenfield versus replacements?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

No major changes. It's a competitive environment. We compete with some big companies like Salesforce and Adobe that are well-funded and innovate and capital isn't super-efficient. So we need to stay on our toes and keep innovating and delight our customers, kind of how I look at it. But no major shifts, have been pretty consistent over the last, let's say, a year.

Q

Great. That's it from me actually. Thanks.

**Operator:** And your next question comes from Eric Lemus from SunTrust Robinson Humphrey.

Eric Lemus

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Hey guys. Thanks for taking the question. I wanted to follow up on the question around buy versus build. When we think about the M&A strategy moving forward, should we think about some more tuck-in acquisitions more so for technology and people versus acquisitions that could lead to a brand new hub?

Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

A

I mean, first of all, we want to digest the PieSync deal. I think the purchase process went well. We learned a lot. I think it was relatively well executed on both sides. I'm pleased with the way the teams performed on that. We continue – we're continuing to look. We have a team that looks at deals. And I think you'll see us continue to be fussy about the teams we'll acquire. The culture's got to be a nice fit, the technology has got to be a legit,

financially it's got to make sense and it's got to be technology that will delight our customers. So if we factor all that in, we find deals we'll do them. We'd maybe be open to a new hub, we'd maybe be open to tuck-ins. We're going to keep open-minded on that.

**Operator:** And that was our last question at this time. I will turn the call back over to the speakers for closing comments.

## Brian Patrick Halligan

*Cofounder, Chief Executive Officer & Director, HubSpot, Inc.*

Great. Thanks, everyone, for joining today and talk to you soon.

**Operator:** Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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