

HubSpot

**March 02, 2020
07:55 PM EST**

- Stan Zlotsky: All right, everybody. Good afternoon and thank you for joining us today. So my name is Stan Zlotsky from the Morgan Stanley Software Research Team. And with us this afternoon, we have the pleasure of hosting Kate and Chuck from HubSpot. Kate, Chuck, how are you guys?
- Kathryn Bueker: Good, thanks, hi.
- Stan Zlotsky: Thank you so much for having us. Thank you for joining us, rather. So before we get started, very quick, please note that all important disclosures, including personal holdings disclosures and Morgan Stanley disclosures, appear on the Morgan Stanley public website at www.morganstanley.com/disclosures or at the registration desk.
- So guys, we're asking all the companies this wonderful question, but I realize you only, you reported earnings just 2 weeks ago. How are you thinking about the impact of the coronavirus? You do have the international exposure, and it's one of your faster-growing businesses. But I'm guessing you're monitoring the situation?
- Kathryn Bueker: Yes, that's absolutely right. This is obviously, first and foremost, a human crisis, and so we're obviously aware of that. But from a business perspective, you're right on. We announced earnings 2 weeks ago. At the time there was no global impact or on demand to note, and we did say that on the call. We're obviously actively monitoring the situation. We're a little bit cautious in the actions that we're taking internally. We have partnered an upcoming that we had decided to do remote. But frankly, the company has been a very remote-first culture for a long time, and so our team really knows how to get stuff done from anywhere. And so we are business as usual, actively working, and near term, really still very much accomplishing the business.
- That said, if this does turn into a recession, our customers, like everyone's customers, will feel the impact. But we feel like we're well positioned financially to weather that.
- Stan Zlotsky: Does the fact the you guys have this SMB exposure rather than a lot of software companies, big enterprise exposures, big supply chains that stretch globally, is it fair to

say that maybe you guys are almost a little bit less sensitive, a little bit more insulated because of the SMB exposure?

Charles MacGlashing: I think we've heard the case be made, and I think we're hopeful that that's ultimately the case. I think the reality is that we've been in an economic bull market for the better part of the last 10 to 12 years. I don't think there have been very many examples of seeing significant pull-backs macroeconomically and what that means to models and spending levels.

That said, one thing that gives me confidence in our model and I feel like will allow us to hold up better than, say, the way that we were positioned 5 years ago is if you think back to HubSpot at our IPO, our business with 10,000 customers, single application, three different flavors, and it was a piece of software to the extent that if you went into a recession, it would be quite easy to cancel. And if you fast-forward to today, and 40% of our business is now on multiple products. And in most cases, we're the underlying CRM for those multi-product customers. And so in those cases, those customers are running their entire front office on HubSpot. And so I think it will take a pretty significant pull-back in spending levels and a pretty difficult economic environment to rip that out entirely. So we'll have to see.

Stan Zlotzky: Right, that makes a lot of sense. And Chuck, you actually transitioned very nicely. If we go back to the days of IPO of HubSpot, back then you were just a single-product company. Although it's a great product, the marketing automation product, but it was still just one product. Today you have this entire suite that addresses the front office of an SMB. When you think about where the suite of these products is going in 2020 and beyond, how are you thinking about your product roadmap for the broader suite?

Kathryn Bueker: Yes, why don't I start and you can dive in. I think there are a number of places where you're going to see product innovation in the near term or over the next few years. There's still work to be done in each of the Hubs that we do have. So Marketing Hub, which is the one that's been around since the IPO, we would argue is the most mature of all the Hubs. But there's a lot of innovation over the last couple years has been at that freemium tier, so the lower end of the market.

There's a lot of work to be done, still, that sort of more up-market tier in the Marketing Hub. You saw as we launched the Marketing Hub enterprise product in January. That's the start of that. On the Sales Hub, I think there's work to be done, certainly, up-market. There's work to be done at the starter level as well. And the Service Hub is really a Version 1.0 of that product. We think there's some core functionality up and down the stack that we have a line of sight to and we're executing against.

That said, we do have ideas, and we've said consistently we have lots of ideas for new Hubs. And over the next couple of years, you will see us introduce one or more Hubs. And so I think it's going to be a combination of things.

Stan Zlotzky: Got it. You mentioned that there's still a lot of work from the product perspective to really build out the enterprise pieces of your Sales Hub and Service Hub, and frankly, even the Marketing Hub. How far up-market do you want to take those capabilities?

- Kathryn Bueker: Why don't I start and you add? We have said consistently that we have a target market from 2 to 2,000 employees. And what has happened historically is that our marketing or sales or service customers get to a certain number of employees and they upgrade. And we want them to stay with us longer. We are not foundationally changing that target market. We want to get our customers early, we want to grow with them, and we just want to grow with them longer.
- Stan Zlotsky: Got it.
- Charles MacGlashing: I think Brian likes to joke that our customers tend to graduate from us in high school and he wants to keep them through graduate school or maybe get their Ph.D. or something like that, so a little bit longer.
- Stan Zlotsky: I think that's a really good goal. And Kate, you mentioned the freemium model within HubSpot, and that's really worked very well. So last year you added email. It was one of the features that you added into your free CRM tier. Maybe walk us through what was the reasoning and the thinking behind adding such powerful functionality into essentially the free version of the product?
- Kathryn Bueker: Yes, so if you just take a step back, the whole purpose of the freemium model is to really broaden the funnel for potential new customers, so it is a foundational lead gen engine into the business. And as such, you want to make sure that there's real value in the products that you are launching and maintaining in that free tier. And we found that the addition of email into that free product, the marketing free product, was a critical missing component, and so we added it so that the product really had real value.
- Charles MacGlashing: And I think we've had a history, too, Stan, of dropping features and functionality into the high end of the portfolio and then letting that trickle down into professional starter and into the free layers. Another example we give is A/B testing was something that was only traditionally available within Marketing Hub Enterprise, and that's something that we've brought down into Marketing Hub Professional. And I think you should look for us to continue to do that.
- Stan Zlotsky: To trickle down.
- Charles MacGlashing: Right-sizing the value that we're providing within the additions, but to Kate's point, solidifying the low end and making sure that we're providing a ton of value to bring lots of leads up and through that we can ultimately upsell and cross-sell core versions of the product.
- Stan Zlotsky: And when you introduce these types of--the email marketing is, like I say, a pretty important functionality to do. Do you see any kind of upticks in the conversion rates that you recognize as a result of really getting so many leads into the pipeline on this powerful new product, and then subsequently graduation of them from free products to paid products? Have you seen any upticks in that conversion rate?
- Kathryn Bueker: So what we're really looking for, actually, by introducing free email into the free product, is a broadening of the free user base. And we did see some very positive traction as it relates to that. I think the conversion rates from free into the paid tiers have, frankly,

stayed pretty consistent. Those are the levers that our growth team is playing with. There are a number of things that they can move around with respect to moving features, as Chuck talked about--moving limits, et cetera. And they have goals in mind around one volume of leads coming into any point in the funnel and to the conversion rates from there.

Stan Zlotzky: Got it. Maybe changing gears slightly, the latest product that was added to the broader HubSpot platform is Service Hub. When you think about the trajectory that Service Hub could have as it matures, would it resemble something like what we saw with the Sales Hub? Or it's also possible that it could be slightly slower just because of, given the reseller community and the partner community that you have in your core marketing product and how they would be--would they be able to make the jump, so to speak, to also sell service?

Charles MacGlashing: I think I'll take that first part and you can add some color around the partner stuff. So I think the simple answer is that we expect the Service Hub trajectory to be quite strong. It has been since its adoption. It's ahead of the Sales Hub curve, which is, quite frankly, what you would expect, given that we have more sales reps that are selling it, more partners that are selling it, more opportunities to cross-sell it across a larger install base. But we've been quite happy with the overall trajectory of that.

One thing I would say is that with our focus on Project Mainsail in 2019 and shoring up the foundation of the application, we did slow new feature and functionality development across the entire portfolio, and Service Hub had an impact to their product roadmap as well. I think we're quite excited about the teams transitioning beyond Project Mainsail and getting back to new feature and functionality development for Marketing Hub, for Sales Hub and Service Hub. And I think that it has the ability to be a big piece of business for us over the next 3 to 5 years. I don't know if you want to talk about changes to partner channel.

Kathryn Bueker: Yes, so we announced some changes to our partner program in January. If you think about the history of the company and you lay out the history of the company as really being founded as a marketing product, our partner channel was very much aligned with that marketing product orientation. So most of, if not all of, our partners were marketing agencies who naturally used the product and were natural resellers and servicers of the product, not unlike accountants are for Intuit, for example.

And as we've moved from a single Hub marketing to sales and service, some of those partners--really, that top 20%--have come with us on that journey. They have recognized that the world is changing to one where really, it's the customer experience and not just the marketing experience that is important. And they have been--they are successful in selling and also servicing our customers across the suite.

That said, our partner program was a much less natural fit for the traditional CRM integrators, for sales coaches, et cetera. And we had a bit of a pilot program running for sales partners specifically over the last year to 18 months. And we've had some success there. And what that program really did was lower the entry bar for partnership with HubSpot and focused on a different set of certifications and qualifications. And so we

have relaunched the partner program in January to include the best of those breeds, so it's a much more flexible program in terms of entry point and requirements.

Stan Zlotzky: Great. So moving on through the Hubs, the Sales Hub. That's been a very strong-performing area for you guys and a big contributor to your overall top line growth. Overall, as we move forward, how do you think about continuing to differentiate the Sales Hub among this very crowded landscape of CRM tools, CRM SFA kind of tools?

Charles MacGlashing: I think the good and the bad is that it's been quite crowded for some time, really for the last 10 or 15 years. And the way that we've found a way to differentiate and build a decent-sized business that's growing quite fast is through really a leading-edge consumer experience. It's through integrating it organically with our Marketing Hub and our Service Hub so that you're giving sales reps all of that context that comes with an end-to-end customer experience.

And then more recently, I think it's with the investments that we've made into our ecosystem and taking this leading-edge CRM that we basically give away and wrapping hundreds of third-party applications that can plug and play with it to make it even more powerful. So I think it's really those three things that have made it as successful as it is. And I suppose, back to the point that Kate made earlier on in the conversation, it should be no surprise that those are the areas that we're looking to invest, continue to invest quite aggressively in over the next couple of years to continue to drive growth.

Stan Zlotzky: Well, Chuck, you brought up the platform, and I think that's a great segue. That's been a big focus area for you guys, and you've really been building out the platform strategy to have this kind of, almost like an ecosystem of apps. How are you guys thinking about that into 2020 and 2021? And how does the PieSync acquisition fit into that broader strategy?

Charles MacGlashing: We're really excited about the opportunity. And truth be told, if we were sitting here 5 years ago having this conversation, what you probably would have heard from me was that HubSpot wanted to be this all-in-one platform. What that meant to us at that period of time was we wanted to be everything to everybody. We wanted to do marketing, sales, service, and everything that's out to the left and the right of it.

The growing realization over the last couple of years has been the proliferation of applications within an SMB company has grown more quickly than we could ever invest to keep up with. The average 50-person company SMB has 30 to 40 applications in their environment. And so I would say in the 2018--'17 to '18 timeframe--we began to transition, sort of open up the platform in a way to expose our APIs, do a better job of investing into the documentation so that folks could build atop our platform. And what you've seen as a result is quick, strong growth in terms of the applications that can plug and play with HubSpot today. I think there's over 350 applications today that can plug and play. We have over 1 million cumulative downloads or installs of applications into the CRMs that our customers use. And then on average, I think it's six to seven applications per customer that's getting integrated on top of the HubSpot CRM for an average customer. And so we're investing aggressively to get to a point where it's not just hundreds of applications that plug and play, but thousands that plug and play nicely with HubSpot. And while not a 2020 opportunity, to the extent that we get the value equation right, we feel like there's the possibility to monetize this over time.

- Stan Zlotsky: And how would that--almost like this app ecosystem be monetized hypothetically? Would it be almost like a take rate off of the sales percentage?
- Kathryn Bueker: We are early days in those conversations. That's certainly one option and one that many people pursue. On the PieSync side, it's important to point out one of the core advantages of having this ecosystem and all of the apps actually plug and play together is that you have one central place where all data is stored. And that's often a very, very hard problem to make sure that you get the data one place and then you keep it in sync. And what PieSync has is the technology that makes sure that the data stays consistent, or synced up, across two applications in a bidirectional way, which as the financial leader, I hear is a very hard and challenging engineering problem. And so what that has allowed us to do is really open up the platform to other technical partners, where we can sync their data very easily in and out of HubSpot.
- Stan Zlotsky: That makes sense. Kate, you do a great job of explaining R&D technology compared to my CFO.
- Kathryn Bueker: Thank you. I'll take it as a compliment.
- Stan Zlotsky: So maybe getting into something that will be much more in your wheelhouse, international investments. It's about 40% of your revenue now is international and a very well, very rapidly growing area of the business. How do you think about your international, moving forward? It certainly feels like it's an underpenetrated opportunity. But as far as balancing where the incremental investment dollars are flowing, whether it should be going internationally or in the US, how do you think about all these opportunities?
- Kathryn Bueker: We certainly look at unit economics as the primary way to judge where we're going to put investment. We do think there's a lot of opportunity to grow domestically. We think there's a lot of opportunity to grow internationally. On the international front, we have a set of markets that we've been operating in for a decent amount of time that have a core critical mass. We have a whole set of markets for whom we're really just starting to get the flywheel spinning, actually, to get to critical mass and really get the engine running. So we will continue to make investments in both of those areas.
- Stan Zlotsky: Got it. Maybe just taking a step back, there's been an increasing--at least in software--there's really been an increasing number of SMB-focused vendors. Because if you think about it very holistically, 10 years ago before SaaS really proliferated, or maybe 15 years ago, it was really hard for--
- Kathryn Bueker: We're all getting old now (inaudible).
- Stan Zlotsky: Yes, adding on a couple of fives.
- Kathryn Bueker: Twenty-five years ago.
- Stan Zlotsky: Before we get too depressed, so there's really a lot of SMBs attacking--I'm sorry--a lot of software vendors attacking the SMB market. How do you as a customer--as a company--

decide which SMB segments you focus on? Because there could almost be like subsegments. I know you guys talk about the 20 to 10, but what about even maybe below 20? Is that not an attractive area or is there something specific about potentially not-- something about that segment that you're not interested in? Is it the economics or something like that?

Kathryn Bueker: You want me to start? No, I think there's been competition at the low end of the market for a very long time. I think the reason that we focus on that 2 to 2,000 is that we want our customers who have real growth aspirations, and we want to get them early, and then we want to grow with them. And we believe that 2%, as low of a limit as it is, does provide at least a bar that correlates to growth aspirations.

Stan Zlotzky: Got it, got it, okay. I'm going to throw out one and then we'll see if there are any questions in the audience. Net revenue retention. You guys, since going IPO, have done an outstanding job of really driving that number. I think back at IPO, it was somewhere in the mid-80s, and now it's essentially at 100. How should we think about net revenue retention moving forward? Do you need to continue to bring out brand-new Hubs to drive that number and actually--well, maybe not drive it up--but continue to stay in that number above 100? Or is this like the new normal is the 100 level?

Kathryn Bueker: I can--go ahead. Go ahead, I will.

Charles MacGlashing: Okay, I haven't spoken for a minute.

Kathryn Bueker: Yes, go ahead. I'll dive in.

Charles MacGlashing: New products help, as evidenced by the back half of '18, and changing pricing can help as well. But to your point, as the products get better, there are opportunities to move it up over time, and you've seen that since our IPO, where it was in the mid-90s and we've consistently moved it up over time, although there are quarters where it can move around. Ultimately, it just comes down to the strength of the products and the opportunity within the install base. And I don't see any reason why 100% isn't sustainable. And to the extent that there are opportunities to take it higher, we, of course, will endeavor to achieve that.

Stan Zlotzky: Got it. All right, well, let's see if there are any questions in the audience. No? All right. Easy enough. I'll keep right on rolling. So getting into some financial numbers, some financial questions, your 2020 guidance calls for about mid-20s type of revenue growth, and you just provided that guidance 2 weeks ago. If we were--as we sit here today and we look at these numbers, if we were to see upside to those numbers, where would that come from? Would it come from a faster pace of customer acquisition, better retention numbers, maybe revenue per customer expansion? How should we think about those different levers?

Charles MacGlashing: I think it's really hard to say here. Is it March 2?

Kathryn Bueker: Two weeks later.

Charles MacGlashing: Yes, 2 weeks into giving guidance at this point. Stan, you've been covering us for long enough to know that from time to time, the business can mix more up-market; from time

to time, it can mix more down-market. And to the extent that it heads in one direction or the other, you can see outsized growth in customers or ASP and, of course, to the point we were just talking about, there are retention implications as well. And so my personal hope, to the extent that the demand environment holds up and we execute at the level that I think that we can, is that you would see upside across all of that. But it's really hard to dimension, quarter to quarter and year to year, because you just don't necessarily know where the demand is going to come from. I don't know if you'd add anything to that.

Kathryn Bueker:

Nope.

Stan Zlotsky:

So maybe just one last one from my end. I feel like no Q&A is complete without a question on margins. So margins for this year: inasmuch as last year you fell behind on hiring a little bit, and then you caught up very quickly. Are you almost, in a way, compensating on the other end, where you're over-hiring now, as in, like, you're trying to hire faster than you would so as not to fall behind? And as a result, maybe is that putting some pressure on the margins heading into 2020?

Kathryn Bueker:

No. So we have said consistently that we wanted to build a business that was making the right long-term decisions. The right long-term decision, in our view, for 2020 was to have a normal course year of hiring, where you hired a reasonable number of people across each of the quarters. But what that meant was, given the significant ramp in hiring in the back half of the year, was that the margins were going to be pressured, particularly in the front half of the year. And in addition to the overall guidance for the year, we also shared that the majority of the margin pressure was focused in the first half of the year, where we saw for 3 points of margin pressure, where the back half of the year will be more like margin-neutral.

Stan Zlotsky:

Okay, all right. Well, I think this is a great place for us to stop. Kate, Chuck, thank you so much for your time today.

Kathryn Bueker:

Thank you.

Charles MacGlashing:

Thank you. Thanks for having us.