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HubSpot, Inc. (HUBS)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Mike and I will be your conference operator today. At this time, I would like to welcome everyone to the HubSpot Q2 2019 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session [Operator Instructions]

I will now turn the call over to Chuck MacGlashing, Head of Investor Relations at HubSpot. You may begin your conference.

Charles Tupper MacGlashing

Senior Director of Investor Relations & Corporate Treasurer, HubSpot, Inc.

Thanks, operator. Good afternoon and welcome to HubSpot's second 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 the 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 third 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 May 7, 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 second quarter 2019 earnings press release in the Investor Relations section of our website at hubspot.com.

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

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

Thanks, Chuck. Good afternoon, folks. Thank you for joining us today as we review HubSpot's second quarter 2019 earnings results. Q2 was another strong quarter for HubSpot with 36% revenue growth in constant currency,

8% non-GAAP operating margins and 35% customer growth, bringing our total customers to nearly 65,000. Really happy with our results in the quarter.

Let's talk about how we're thinking about the world these days, the significant opportunities ahead of us and some of the investments we have made to position us to make the most of them. Over the last year, we have rolled out the biggest expansion to our product footprint in history with the introduction of a slew of new products and tiers that have filled in the gaps across our entire HubSpot suite. As we've done so, we've seen terrific cross-platform adoption. We reached nearly 25,000 multi-product customers this quarter, and our youngest product, the Service Hub, has surpassed 5,000 paying customers. Great stuff.

Expanding functionality within our own product isn't enough. We've been building a platform that enables our customers connect all of their front-office applications into HubSpot. This will enable us to truly manage and orchestrate our customers' entire end-to-end customer experience for them. Today, if you're a HubSpot customer, you have 10 integrations that we built, more than 300 integrations built by our app partners and many, many more lightweight integrations you can access through our partnerships with iPass companies.

This is starting to really work. Today, our customers on average integrate more than five different third-party applications with HubSpot. This year, we're adding fuel to the platform Fire by opening up even more API coverage and significantly increasing our investments in the overall developer experience, so our partners will be able to do more and our customers themselves will be able to do more. We're just getting started here and there's a lot of promise to increase the value we provide to our customers over time.

This platform initiative is a flywheel play, the more users we have, the more attractive it is for developers to integrate, more attractive our product is, the more users we have, and so forth and so on. That's why we recently launched email and ads in the free CRM offering. This free CRM offering is truly unique in the market and we expect it will attract lots of new users to the platform. We want HubSpot to be attainable for the growth companies of the future who want to get started on the right forward.

As I mentioned, today nearly 65,000 companies build their go-to-market model on HubSpot. We take that responsibility very seriously. So, earlier this year, we made the decision to significantly increase the number of product and engineering resources, invested in reliability, performance, security, infrastructure and usability. We set new standards for every product team to meet and funded a fully dedicated team solely focused on overseeing and testing the strength of our key infrastructure systems.

I think these investments are going to be a double win over the long haul and that they will improve our overall customer experience and enable us to deliver better, higher quality products in the future. Before I finish, I want to follow up on the 8% operating margin I started within my opening remarks.

As Kate will talk about in a second, we delivered a little more operating leverage than I would have expected or frankly hoped, because we've fallen a hair behind on our hiring. I'd say it was due to our own execution. And the good news is we made some correction in how we approach this. We're making good progress already and we're rapidly catching up. We're aiming to accelerate our hiring in the back half of this year.

That said, I'm really pleased with the progress we've been making on the suite, the platform and the go-to-market, and the gears are in motion and the opportunity in front of us is quite large.

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

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

Thanks, Brian. Let's turn to our strong second quarter financial results and our guidance for the third quarter. Second quarter revenue grew 36% year-over-year in constant currency and 33% as reported. Q2 subscription revenue grew 34% year-over-year, while services revenue grew 23% year-over-year, both on an as reported basis.

HubSpot ended Q2 with 64,836 total customers, which was up 35% year-over-year. Average subscription revenue per customer in Q2 was \$9,913, down 1% year-over-year and up slightly from Q1.

Domestic revenue grew 28%, while international revenue growth was 50% year-over-year in constant currency and 41% on an as reported basis. International revenue represented 40% of total revenue in Q2, up 3 points year-over-year.

Deferred revenue as of the end of June was \$198.1 million, a 29% increase year-over-year. Calculated billings was \$167.9 million, up 34% year-over-year, both as reported and in constant currency. The remainder of my comments will refer to non-GAAP measures.

Second quarter gross margin was 82%, up nearly 2 points year-over-year. Subscription gross margin was flat year-over-year at 86%, while services gross margin was positive again in Q2 at 7%.

Second quarter operating margin was 8.4%, up 3 points from Q2 of last year. While we're pleased with the operating leverage that we delivered, our margin expansion benefited from lower than expected hiring in the first half of the year.

At the end of the second quarter, we had 2,924 employees, up 20% year-over-year. We have made operational changes and additional investments that we believe will help reaccelerate hiring in Q3 and Q4, but will also result in less operating margin expansion than we delivered in the first half of 2019.

Net income in the second quarter was \$17.6 million or \$0.37 per diluted share. CapEx including capitalized software development costs was \$10.3 million or 6.3% of revenue in the quarter. As we noted on our last call, we expect CapEx to be heavily weighted to Q3 and Q4 as a result of the build-out of our new Dublin facility in the second half of the year. We still expect CapEx as a percentage of revenue to be 7% to 8% in 2019. Finally, our cash, cash investments and marketable securities totaled \$994 million at the end of June.

With that, let's dive into guidance for the third quarter of 2019. Total revenue is expected to be in the range of \$168 million to \$169 million. Non-GAAP operating income is expected to be between \$8 million and \$9 million. Non-GAAP diluted net income per share is expected to be between \$0.22 and \$0.24. This assumes approximately 48 million fully diluted shares outstanding.

And for the full year of 2019, total revenue is expected to be in the range of \$663 million to \$665 million. Non-GAAP operating profit is expected to be between \$54 million and \$55 million. Non-GAAP diluted net income per share is expected to be between \$1.39 and \$1.41. This assumes approximately 47.1 million fully diluted shares outstanding. We now expect free cash flow to be between \$62 million and \$63 million for the full year.

As you adjust your models, keep in mind the following. At current spot rates, currency would have a 1 to 2 point negative impact to as reported revenue growth in Q3 and a 1 point negative impact to revenue growth in Q4. This

equates to a \$1 million to \$2 million increased headwind to as reported revenue growth relative to our prior forecast.

As a reminder, we'll be holding our 2019 INBOUND event in September and anticipate it will have 3 points of negative impact to third quarter operating margins. In addition, we would expect free cash flow to be slightly positive in the third quarter, given the timing of INBOUND related payments. We expect the fourth quarter to be a strong quarter for free cash flow.

To close, the second quarter was another strong quarter for HubSpot. We look forward to seeing you at our Analyst Day at INBOUND on September 4.

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

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

Thanks, Kate. Our suite product play is delivering a ton of value for customers. Our platform flywheel play is gaining serious momentum among integration partners and our expanding user base. And our investment in the core products is setting us up for the solid scalable infrastructure to deliver an even better customer experience now and in the years ahead.

Okay. I want to close by thanking our customers, our partners, our investors and all of the HubSpotters around the globe for helping us with their mission to help millions of organizations grow better. I hope to see you all at Analyst Day in just a few weeks.

Operator, can we please open up the calls for few questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Bhavan Suri from William Blair.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Hey guys. It's actually Arjun Bhatia on for Bhavan. Thanks for taking our questions. So it's been a couple of quarters since you've built out the full suite, including the new Enterprise tier subscriptions. I was just hoping you'd be able to touch on the customer upgrade activity you've been seeing since that Enterprise tier was fully built out. Should we be thinking of this more as a new landing point for a customers or is this very much an upsell that happens that happens over time?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Good question I'll take this. So this is Brian. You're right. Last year, we really did make some nice improvement in the Enterprise tier products in HubSpot Enterprise Marketing, Sales and Service. We had kind of a step function, lots more good work being done in Enterprise later this year and next year. I'm really quite excited about the potential there.

I would say the Enterprise product so far is a little bit of both. We're seeing a decent amount of upgrade activity out of the Pro customers and a decent amount of new. Nothing surprised me either way. I don't know if you have anything to add on that.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

No, both things continue to be sort of good feeders into the Enterprise SKU. It's probably 60, 40 new customer on balance.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Okay.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Okay, very helpful. Thanks. And then just kind of on that – following up on that point a little bit. It seems like there's two kind of counterbalancing forces here on sales cycles. So on the one side, it's the freemium offering that presumably increases – or [ph] fastens (00:13:56) the sales cycles here, and then the Enterprise tier on the other end. Just as if we zoom out a little bit, how – what kind of impact are you seeing overall on sales cycles with these – with both of these offerings in the market now?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I think you hit the nail on the head. We've got lots of customers coming in on shorter cycles on their new Starter tier – improved Starter tier and some customers coming in on slightly longer cycles with the Enterprise product,

particularly if they're going to buy the Enterprise suite. So I think you actually hit the nail on the head with your question. And it's balancing out that it hasn't changed much over the long haul, but the standard deviation is a bit higher.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Got it. All right. Thanks for taking my questions.

Operator: Your next question comes from the line of Chris Merwin from Goldman Sachs.

Christopher Merwin

Analyst, Goldman Sachs & Co. LLC

Q

Thanks very much. I wanted to ask about international. Looks like that was up, I think, 50% on an organic basis in the quarter, which was a very strong acceleration from last quarter. So maybe you could just talk a bit about what is inflected in those markets? Some other vendors actually have called out challenges there. So just curious what you're seeing in the quarter on the demand front. Thank you.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. So why don't I just start with a clarification on the growth rates. So international was up 50% year-over-year in constant currency. That's basically flat from last quarter. Last quarter, it was up 42% and – as reported. In this quarter, it's up 41% as reported.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Yeah. I think international is going really well and I think it's a result of a lot of investments we've made over the last several years, big investment into Dublin. There's been crank along. We've opened a bunch of other offices. We translated the – not only the product but the whole experience in the five different languages. And I just think we're getting a nice return on it. I've heard a bit about some softness from other vendors in the demand environment. We haven't seen that so far.

Christopher Merwin

Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. And if I could just sneak in one more. Just as it relates to CRM, could you talk a bit about which type of customers are taking the products so far? Is it more the kind of SMB or is it more in your Enterprise segment? And is it proving to be helpful in terms of driving higher retention as customers build in more integrations there?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Yeah, definitely. I would characterize it as when we first came out with our – spreading out of Marketing into a full CRM offering, the little tiny companies were buying it. But as time goes on, those products are getting a lot stronger and lots of small startups are buying it, but decent midsize companies are starting to buy it as well. Feeling really good about our offering these days.

Christopher Merwin

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thank you.

Operator: Your next question comes from the line of Stan Zlotsky from Morgan Stanley.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Hey guys. Good afternoon and thank you for taking my questions. Really impressive quarter. Maybe just a couple of details from me. How did net revenue retention trend in the quarter?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah, so I'll take that. Revenue retention in Q2 was just under 100%. We typically see a bit of a step-up from Q1 to Q2 where – as part of the normal seasonality, we saw that again this year.

As you know, and we've said probably every quarter, retention numbers bounces around a little bit from one quarter to the next. They continue to do that, but we think over the long-term, we are comfortable in retention levels around the 100%.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I would give the same kind of answer as on the Sales question earlier. It's hovering – bounce around, right around that 100%, like it has for a while, standard deviation's is a little higher. You've got Starter products which are a little lower and then you've got Enterprise growth suite customers that are a little higher. We're pretty comfortable where it is.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Okay, perfect. And then maybe just a high-level question. We saw a blog post intra-quarter about Hunter moving on as a head of sales. Maybe just kind of fill us in on the opportunity that he's going after and how you guys are thinking about the transition of that role going forward? Thank you.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Sure, really, actually quite happy for Hunter. He did a great job for us over five, six years there. And he's taken a new gig – Hunter's lived in Toronto. So he was commuting to Boston and that was quiet a grind for him. So what's cool about this new gig is, one, it's a CEO gig and I'm happy for him and proud that he's the CEO, and it's going to be great. And two, he's able to live in Toronto and be around his family. So super, super happy for him. I am the Interim Chief Customer Officer for HubSpot. So I've got Hunter's old job, and Marketing and Sales and Service reporting in to me, really enjoying it. And don't plan to have this job forever. [ph] I've hired (00:18:54) an executive search firm to do a search for Chief Customer Officer for HubSpot. That's going pretty well. Starting to interview people. I think we'll get a really good person to backfill him. We have a great brand. We're a great place to work. I'm very confident we can find somebody great. But I will say I'm going to be patient on it and try to find the right person. We've got a great team in place today. So I think I've got the ability to be patient, but so far, so good on being the Interim CCO and replacement of Hunter and what not.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Okay perfect. Thank you so much, guys.

Q

Operator: Your next question comes from the line of Ken Wong from Guggenheim Securities.

Ken Wong

Analyst, Guggenheim Securities LLC

Hey. Thanks a lot for taking my question guys. I wanted to ask about ASRPC. That obviously ticked up Q-over-Q. Just wondering if you can help us flush out how much of this was maybe attach related, some of this was SKU mix, any color there would be great.

Q

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

Yes. So it was nice to see that we had a quarter of ASRPC where we're sort of flat to up Q1 to Q2. I think the primary driver of ASRPC for us continues to be product mix. So, as Sales and Marketing and Marketing Starter customers become a bigger and bigger component, they're sort of a headwind to ASRPC. On the same – on the opposite side of the coin, we have a growing number of multi-product customers, a growing number of Enterprise customers. They're sort of the tailwind of that. And so on balance, this is where we came out for the quarter. So, again, it will continue to move around, but we were pleased with the result in Q2.

A

Ken Wong

Analyst, Guggenheim Securities LLC

Yeah.

Q

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

Kind of same thing, it bounced around the same level, standard deviation's gone up, kind of the same story in all three things.

A

Ken Wong

Analyst, Guggenheim Securities LLC

Got it. And then, you mentioned with email now part of CRM expect to attract a lot of new customers. Can you talk about what you've seen so far and should we be expecting a similar monetization path and timeline from this particular cohort of customers?

Q

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

I think it's going to go really well. If you roll the clock back a year, we added email to Starter SKU. And that's done good thing for the business, really happy with that. This year, we're rolling it into our free CRM along with ads into the free CRM. So that free offering is powerful. There's two things I like about that, Ken. The first is it really helps our kind of platform flywheel. The more users of our product and more companies using and actively using it, the more developers are going to want to integrate their offering into HubSpot and so forth and so on. It's really positive reinforcing move there. So I think that will tick up.

A

The second thing I really like about that is what we – what I have in my head about HubSpot is we want to catch them early. It's Dharmesh and I and an intern starting HubSpot basically out of a conference room in business school and eventually now we've got 3,000 employees. We actually want to get companies like Dharmesh and I and an intern working out of a conference room. So this is a really easy way to get them early and grow with them. So, it's early, but positive signs so far.

Ken Wong

Analyst, Guggenheim Securities LLC

Q

Great. Thanks for the color guys.

Operator: Your next question comes from the line of Kirk Materne from Evercore.

Kirk Materne

Analyst, Evercore Group LLC

Q

Thanks very much and I'll echo the congrats on the quarter. Brian, in your prepared remarks, you mentioned sort of serious momentum around some of your integration partners and I was wondering if you could just add a little color there. How that may be impacted customer acquisition this quarter, just general feedback as you've continue to sort of broaden and expand this platform play. I'm just kind of curious if you can maybe give us a sense of the relationships with integration partners today versus maybe a year ago, just put some context around it. Thanks.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Sure, that's a great question, Kirk. Thanks. I think of HubSpot as we're kind of in the middle of this ecosystem that's around us and you guys all know about our Marketing agency program has gone really well over time. It's 40% of our business. We're starting to sign up lots and lots of non-marketing agency, more sales CRM, IT type implementers there. And so that's a very healthy nice part of our ecosystem.

The application partner ecosystem is much, much newer, but is super promising. We've got over 300 third-party application software companies that have built integrations into HubSpot as well as a lot of these kind of neutral iPass companies who have built rich integrations to HubSpot. And what that does is a couple of things. It enables our customers to use our product to craft their go-to-market, but also use all the other applications they use, and any other application they can possibly think of and pull all those things together to craft their really compelling go-to-market model and that they run really that whole go-to-market model on HubSpot. So I think that's very important. As we look into the future, HubSpot's going to shift really from an applications company to much more of a platform company.

So, really, really happy with the progress on that stuff, and I think it'll increase. There's a lot of investment going into this, for example, inside of our product organization, more and more of the footprint of our product will be opened up into an open API that third-party companies can integrate into. It's a little bit limited now, but that's been increasing quite a bit, so there's just more opportunities for innovation that are going to happen over time. Our marketplace will get better over time. This thing is going to be a really interesting next vector in HubSpot's growth that I'm really excited about

Kirk Materne

Analyst, Evercore Group LLC

Q

Super. Thanks, Brian.

Operator: Your next question comes from the line of Brad Sills from Bank of America Merrill Lynch.

Brad Sills

Analyst, Bank of America Merrill Lynch

Q

Hey guys, great. Thanks for taking my question. Wanted to ask if you could comment on activity you've seen in that kind of next tier up market within your target range with Enterprise investments you've made in the Enterprise features in last year's INBOUND, that 500 to 2,000 employee size company, I think, you're going after more aggressively. So any commentary on activity in that segment of the market would be helpful, please.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Hey, Brad. I'll take it. It's Brian. It's going well. The way we segment our business is two to 25 employees small business, 25 to 200 is kind of mid market and then 200 to 2000, we call that corporate, we actually don't call it Enterprise internally. And the new products are doing a better job of matching the requirements of that market. And I feel like we're just getting started in there. Last year, we announced a bunch of new functionalities in that Enterprise product suite. There is a lot more stuff we're working on that I think is going to be really solid in there over the next 12 months. So, feeling good about it overall.

Brad Sills

Analyst, Bank of America Merrill Lynch

Q

That's great. Thanks. And then, with the investments you've been making in the platform, do you see an opportunity to kind of go bigger here with potentially more emphasis on a marketplace or an App Store kind of a full-scale program there?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I think over the long haul, I think that's in our sight. Right now, we're not – right now, we're just trying to decrease the friction for a third-party company who wants to build an integration or be part of our ecosystem, we want to make it really easy for them to do that. So we don't want to put up barriers to that. But over time, I think our thinking will shift there and it will become in and of itself a line of business over time. But we don't want to hamper the innovation that's going on now.

Brad Sills

Analyst, Bank of America Merrill Lynch

Q

Great. Thanks, Brian.

Operator: Your next question comes from the line of James Rutherford from Stephens, Inc.

James Rutherford

Analyst, Stephens, Inc.

Q

Hey, thanks for taking the questions. A couple for me, the first really on the Growth Stack. I think you mentioned that you're now at nearly 25,000 Growth Stack customers. And I recall that number was south of 20,000 just two quarters ago. So just curious what are the main drivers of that growth in the stack and is this an inflection in the bundling of service? Thank you.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. So I think maybe it snuck up on you because we basically have decided that we would give you milestone updates, but not report it out at one quarter to the next. It's been a continued evolution where we see more and more customers adopting the full platform. I would say we have been pleased to see that actually lots of those customers are actually buying HubSpot upfront and that's the majority of the new multi-product customers.

James Rutherford

Analyst, Stephens, Inc.

Q

Okay, that's helpful. And then a second one on the product itself. I know you're coming off a big period of product innovation and INBOUND last year, all the new product tiers, hubs that you announced. It seems like you kind of have your bases covered in terms of the current product and there is also incremental improvements you will continue to make.

But I'm just curious what's the next phase of the product? You've commented about being able to launch more hubs, but perhaps what's your interest level in commerce or payments or something along kind of those lines over the long term?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I'll take that one. I would just say, well, first of all, you're right. Last year was a big product year. We really filled out our product grid. Really proud of it. I think we executed quite well. None of those products will ever be done, that's kind of how we think about product. They can always be better and they're continually being improved. They're being improved right now while we're on the call.

In terms of new opportunities, I think of it as kind of two ways. There is this suite that we're building, and we have three hubs today. You can imagine in – over the long haul, next, call it, two, three years, there will be more hubs. There's – you mentioned a couple of potential opportunities, but there's several potential opportunities in our head for us to create new hubs that will deliver more value to our customers and enable them to grow better, so more opportunity there. And then the second thread we can pull on is more on this platform side. Not monetizing that today, but you can think over the next two, three years, the nice opportunity as we continue to grow HubSpot for us to monetize that.

And so the way I think about HubSpot, it's still very much the early innings, like this product and our business is going well, but we feel like we've got a much bigger, more interesting business in us over the long haul.

James Rutherford

Analyst, Stephens, Inc.

Q

Thanks and congrats on the quarter.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Thank you.

Operator: Your next question comes from the line of Jennifer Lowe from UBS.

Jennifer Lowe

Analyst, UBS Securities LLC

Q

Great, thank you. Maybe just to extend on that product vision. If you look at what's some of – I think a lot of companies have sort of come away around the HubSpot way of thinking, trying to have more of a unified view of the customer. You have that from day one. But one of the big talking point from a lot of those providers is this concept of a customer data platform and being able to pull in multiple data sources, create that one unified view to go-to-market with. You've got that with the suite and the third-party integrations with platform. But is that sort of enough to be equivalent to what maybe as Zendesk is thinking about with their Sunshine platform or do you think there's more that you can do on that unified customer data profile side?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I think Zendesk and HubSpot and a lot of people are coming to the same conclusion at the same time is what you really want as a customer is to create an absolutely delightful end-to-end experience for your customer. Just having a good product these days isn't enough. You have to create a great, great experience for your customers. And to do that is actually quite tricky today, particularly if you have a whole bunch of different databases, a whole bunch of different applications and that stuff doesn't talk to each other. The more and more we've been predicting this for a while, we think people will pick like a core hub. And Salesforce is a hub obviously, HubSpot is a potential hub. And inside of that hub will be a CDP where you will store all that data from all those different applications and they'll be able to report out on that data in really interesting ways.

So that's the value prop we see emerging over time for HubSpot. That is a good way to think about our platform initiative is really heading in that direction.

Jennifer Lowe

Analyst, UBS Securities LLC

Q

Okay, great. Thank you.

Operator: Your next question comes from the line of Michael Turrin from Deutsche Bank.

Michael Turrin

Analyst, Deutsche Bank Securities, Inc.

Q

Hey, great. Thanks. Good afternoon. You have a sizable customer base these days, which extends across geos, products, yet the profile of the financials remains remarkably consistent. Just wondering if you can talk more around what it is that helps sustain that profile. I know the product vision we talked about a bit here. But is there anything else you can add in terms of your observations there as the business continues to scale?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. I think Brian had said the word sort of we have balance at the high end and balance at the low end probably three or four times during this call. I think the overarching customer profile stays the same for us because we're innovating sort of on both ends of the spectrum and there's a balance that's sort of continuing to manifest itself within the overall customer base. I don't know if you have a different [indiscernible] (00:32:25)

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I didn't understand the question.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

Okay.

A

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

I didn't understand the question.

A

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

Maybe we missed your question. Do you want to rephrase?

A

Michael Turrin

Analyst, Deutsche Bank Securities, Inc.

No, no, no, that right. I mean, I think, look, we see businesses with longer [ph] tails (00:32:38) of customers that have challenges delivering this consistent of results from a financial perspective. And so obviously, the way we're looking at the business is different than what Brian might be looking at, but that's just kind of the observation that I was curious to kind of tease out more commentary around.

Q

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

Okay, as JD Sherman, our chief executive officer, would say, it's very simple, executive leadership. No, I am really kidding. I think one of the things that's sustained us well over time is we just don't sit still, I mean, we don't sit still for half a second here. We feel – we have in our heads a vision for what we could deliver in terms of value for our customer that is far beyond what we're doing today. And we do feel like we're very much in the early innings. And we're chipping away at it and we're making progress in it, but we're super, super, super focused on delighting our customers. And I think at the end of the day, when we are focused on delighting the customers, the customers are rewarding us and I think the investors see it in the results. I also think we've got very good financial management. Our Head of Investor Relations has his act together. Our CFO has her act together. I think we are halfway decent at planning, I think we have good financial controls in here as well.

A

Michael Turrin

Analyst, Deutsche Bank Securities, Inc.

That's great. Just a quick one if I can. In terms of the commentary around hiring, is there anything else you can add in terms of key focus areas there? Does that present any obstacles we should be aware of in terms of near-term initiatives or just anything else you can add there?

Q

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

I'm glad you asked about that. The core issue we had was really a recruiting capacity issue. We just didn't have the number of recruiters we needed to hit our goals. It's a pure execution issue on our side and kind of took our eye off the ball on it. So, anyway, we didn't execute well on that. I would say, our eye is very much on the ball for that – for the last several weeks, actually the last couple of months, so the recurring capacities way up. The good news is attrition has been pretty solid, we're still a very good place to work and I think we will be for a long, long

A

period of time and so the employees and they stay and they seem to enjoy it and tell their friend. So overall I feel like we're making – kind of like if we didn't execute well, but I feel like we've made great progress over the last few weeks. I think it'll be a blip on the recruiting radar over the long haul. And I think we are on a good path.

Michael Turrin

Analyst, Deutsche Bank Securities, Inc.

Q

Okay, great. Thank you.

Operator: Your next question comes from the line of Terry Tillman from SunTrust.

Terry Tillman

Analyst, SunTrust Robinson Humphrey

Q

Hey, good afternoon. Can you hear me okay?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Yeah. Sure, can, Terry.

Terry Tillman

Analyst, SunTrust Robinson Humphrey

Q

Yeah. Thanks. So I guess the first question as it relates to just the platform integrations, Brian, have you all seen any kind of statistics in terms of retention patterns or greater propensity to buy more products from customers that have those five integrations on average? That's the first question.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Yeah. Like a lot of platform vendors, the more integrations you have, the more value you get out of the products, the stickier are, the more committed you are. And so as we make more integrations available and better quality ones, I think that will be a tailwind that will offset some of the headwind that we get on the Starter products in terms of retention. So yes, very much so, you're exactly right about that.

Terry Tillman

Analyst, SunTrust Robinson Humphrey

Q

Okay. And then on the Service Hub, maybe an update in terms of just another quarter into it, the size of the average customer you're saying, and just maybe how that's comparing to the same timeframe when you had brought up Sales Hub. Thank you and congrats.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Feeling great about Service Hub. Yeah, I was – I'm delighted we're up to 5,000 customers on it. One of the things I look at and you pointed this out in your question is we – I look at sort of a year into the Sales Hub initiative [ph] what were the revenue as well as (00:36:33) the growth rates versus a year into the Service Hub initiative what that look like. And Service Hub is flapping. Sales Hub, it is really doing quite well.

Having said that, the way we build products is we get something good in the market and we try to make it better and better and better, so there's a long way to go on that thing. And it improves every day and I think it's – I think it'll potentially be a nice big business for us.

Operator: Your next question comes from the line of Samad Samana from Jefferies.

Samad Samana

Analyst, Jefferies LLC

Q

Hi Good afternoon and thanks for taking my questions. Kate, maybe one for you, as you thought about the updated guidance, how did you factor in the hiring plan shifting from 1H to 2H, and how should we think about that in terms of productivity ramping or the overall kind of productivity of the company as we start to think even beyond 2019? I know it's a little bit early. And then just a follow-up question from there.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yep, sure. So I think as you know, like, there's a lot that goes into our thinking on guidance. Well, we haven't changed the framework at all, but as we work through guidance for this quarter and update for the full year, I think the biggest piece actually was FX. In my comments I noted that we had an incremental headwind from FX in the back half of the year. It's obviously a lot more volatile than we've seen. So that was a big factor, but we certainly would have also incorporated sort of any impact from the slow hiring in the first half and what we've told you for the full year.

Samad Samana

Analyst, Jefferies LLC

Q

Great. And then, Brian, if I could, on Service Hub, the 5,000 paying customers, I'm curious how many of those are standalone that are either just using Service Hub on its own versus how many are part of Growth Stack deployments. And then maybe in that vein, not to get three questions into one, but I'm curious if you're seeing customers that are starting with Sales and Service as a package and then moving into Marketing or if Marketing is usually attached to either one of those when they're a multi-product customer? Thanks.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

It's a good question, Samad. Most of the business is cross-sell. Service Hub being purchased upfront with Sales or upfront with Marketing or all three, or Service Hub being tack on to a customer who has got one or two of those hubs. We are starting to see some net new customers coming in on Service Hub. And as that product improves over time, I think you'll see more and more of that. That happens a lot on the Sales Hub product, really proud of the progress on that and the way that that we cross-sell it as well as it's a magnet to pull in new customers. So I think that will develop over time.

Samad Samana

Analyst, Jefferies LLC

Q

Great. Thanks for taking my questions and congrats on the quarter.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Thanks, Samad.

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

Alex Henderson

Analyst, Needham & Co. LLC

Q

Hi. This is Alex on for Ryan. I just would like to know, given the constant changing dynamic in the UK regarding Brexit, has this impacted purchasing decisions or spending trends? As we get closer to the 31st deadline also, what sort of major impact have you built in for FX for the percentile Brexit? And then, can you remind me of the exposure you have there?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I'll take the first half.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yep.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

We haven't seen anything yet, Alex. I checked in once in a while with that team, but the demand environment hasn't changed a whole lot. Yeah.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. We've obviously seen a lot of movement in the currency over the last period of time and we tried to take that into account as we put forward our guidance. GDP denominated revenue is, call it, mid- to high single-digit percentage of overall revenue.

Alex Henderson

Analyst, Needham & Co. LLC

Q

Great, thank you.

Operator: Your next question comes from the line of Tom Roderick from Stifel.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey guys. Thanks for taking my question. So I guess what I'd like to do is go all the way back to the headlines here, which is getting at the point that your billings and subscription revenue both reaccelerated on reported levels and on constant currency level, so fantastic job on both of those. I guess what I was hoping to get at in a little bit more detail is, if there's anything you'd call out to highlight what was clearly some better than expected execution and coming off of last quarter where you kind of – you were very open and candid about some of the challenges with the outage. It would just be helpful to understand were there any sort of one-time depressors last quarter or one-time positive beneficiaries this quarter that would sort of alter the level of how do you think about the natural run rate of the business?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

No, I'd say not really. I think, Q2, we're pleased with the performance on the top line. I think, frankly, we continue to the way the SaaS economics work to benefit from really strong performance in sort of Q4, Q1. So nothing really to call out there.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. And then, maybe I'll just sort of follow-on with that – with the comment that you had on the hiring. Anything behind the hiring and the timing of some of the new hires that might impact the way we think about billings growth or new sales efforts in the second half of the year? Do you feel like that may be perhaps puts you behind where you wanted to be on sales capacity? Or is that just much more a comment on, hey, just be aware, we're going to ramp up the hiring and that'll impact the way you think about margins and really not a comment on sales capacity our productivity?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

I think that's a good question. The hiring we're behind kind of across the board, not just in sales, but we are here behind on sales hiring. I don't know what impact it'll have. [ph] It'll probably (00:42:24) have a slight headwind on the second half of this year, but I wouldn't think it would be huge.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay, great. Brian, real last quick one for you. One of the things we heard from some of your partners and customers is that the content management system seems to [ph] be coming (00:42:43) a very popular add-on. Can you just sort of talk about that in particular as one of the add-ons that seems to be catching some traction and the impact it's having on the overall stack approach?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Sure. We did something with that last year where we decoupled it from the Marketing Hub. For a long, long time, you had to buy the Marketing Hub with the content management system. Now you can use the content management system standalone and connect it to your free CRM or the Sales product.

So that has done well. That product's gotten a lot better over the last year. I'm proud of that development team. That's one of the – it's one of those cases where they have been grinding on it. It's not like one Hail Mary Pass, but just making that product – every day that product gets a little better. So nice progress on that. And I was surprised you asked about that. You've been doing your homework, but it is going well.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Wonderful. Thank you, guys. Great job.

Operator: Your next question comes from the line of Brian Peterson from Raymond James.

Q

Hi guys. [ph] Kevin (00:43:44) here on for Brian. Thanks for taking my call. Just a quick one for me. You previously talked about looking to drive more of a self-serve touchless motion, particularly across the Starter products. Can you remind me how you are seeing that trend as a mix of your new customer adds, and maybe where you see the potential for that going forward?

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Yeah. I think it's going pretty well. Like, over time, what we want to do is kind of tilt our go-to-market where on the Enterprise or corporate side a little bit of a heavier touch. And on the Starter side, we want to make that lighter and lighter touch over time. So we're starting to see. The number we track is the percentage of our customers and revenues that comes in where they started with a freemium offering, and that's gone quite well. Really pleased with the progress on that. And the freemium model is definitely working for us. I am glad we switched and I think we're going to get nice returns over the long haul on that.

Charles Tupper MacGlashing

Senior Director of Investor Relations & Corporate Treasurer, HubSpot, Inc.

A

Yeah, Kevin, and just to put a number around that. One of the numbers that we shared historically is that about two-thirds, a little over 60% of our net new business is coming through where the customer that starts on our free product and then ultimately purchases a paid product. And that's held up quite well in that sub-60% plus range.

Q

Understood. Thanks.

Operator: Your next question comes from the line of Mark Murphy from JPMorgan.

Pinjalim Bora

Analyst, JPMorgan Securities LLC

Q

Hi. Thanks for taking our question. This is Pinjalim on behalf of Mark, congrats on the quarter. I wanted to ask you about the partner ecosystem. You obviously have a pretty robust ecosystem in inbound marketing, with thousands of agencies, and some of your partners have added sales. And then – but with the recent additional services, I guess, how important is it for HubSpot that these partners support of the three product hubs so that they can evangelize the flywheel, et cetera and – versus selling separately.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

A

Sure. You are right, this partnership is going well for us. It's still about 40% of revenue and very pleased with the performance in there. It's going great. That partner channel is going to get some love over the next 12 months and some nice enhancements we're going to make to that channel that will – that I think our existing partners will really like. And I think it will make it very attractive, more attractive to new types of agencies. But – and what we're seeing sort of underneath if you unpack it, is our existing agency partners, we've got thousands of them, most of them started [ph] with us they are (00:46:17) marketing agencies earlier, search engine optimization or social media website development. And many of them have embraced the flywheel and embraced sales and services

and particularly the ones that are growing with us and are tiered. They're doing a really nice job of spreading out and selling the whole product line. Many of the smaller ones are kind of sticking in with Marketing and we're okay with that. At the same time, we started a new channel program to attract sales consultants, IT consultant implementers, not Accenture ones that are in the kind of Fortune 500 land, but sort of smaller mid-market ones. And that is I would just look at the numbers on that, maybe before I walked in the room and that has picked up nicely. So I am pleased with the partner program, I am pleased that we have this nice ecosystem. I think of HubSpot is a much more resilient adding a lot more value to the community and to the customers because we have this giant ecosystem around. I am really pleased with the progress on it.

Pinjalim Bora

Analyst, JPMorgan Securities LLC

Q

Okay, thanks for that. Can you – just to put a finer point on the sales hiring. Could you talk about your head count plans for the year? I mean directionally maybe if you don't want to give numbers. Should we see a growth higher than 2018 where you ended 2019?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

I'm not sure that I heard the last part of the question, but we obviously aren't going to comment specifically on sales hiring. But I think we share every quarter our ending head count and we do expect that we would see a reacceleration in head count growth in the back half of the year.

Operator: And that was our last question at this time. I will now turn the call over to Brian Halligan, CEO and Chairman of HubSpot for closing remarks.

Brian Patrick Halligan

Co-founder, Chief Executive Officer & Director, HubSpot, Inc.

Yeah, we'll see you all in a couple of weeks in INBOUND, looking forward to it.

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

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