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# HubSpot, Inc. (HUBS)

Q3 2018 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 Q3 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there'll be a question-and-answer session. [Operator Instructions]

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

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### Charles Tupper MacGlashing

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

Thanks, operator. Good afternoon, and welcome to HubSpot's Third Quarter 2018 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 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 the 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 and full year 2018.

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 1, 2018 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 2018 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

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

Thanks, Chuck, and good afternoon, folks. Thank you for joining us today as we review HubSpot's third quarter 2018 earnings results. Let's get right to it. Q3 was another strong quarter for HubSpot with 35% revenue growth, 4% non-GAAP operating margins, and over 52,000 customers, growing 40% from the prior year. These very strong numbers are the result of two big plays HubSpot began investing in a couple of years ago that are starting to pay off.

First is our investment in growing HubSpot from a single app company to a full suite company, dramatically increasing the value we deliver to our customer. The second is our move from a funnel to a flywheel model to operate our business. The old funnel model used customers as an output, while the flywheel model recognizes the central role customers themselves play in driving your growth through upgrades, and especially word-of-mouth. The flywheel mentality also puts a lot more emphasis on reducing friction in the customer experience. Great news is that our performance over the last few quarters gives me more confidence than ever that our investments in suite and our move towards the flywheel are paying off already, and will position us for continued growth in years to come.

Let's dig into the suite play. Back in the spring, we further expanded our offering of products with the introduction of Service Hub. This move into the service segment was particularly exciting because it gave us an even better way to add value to our customers and help them to create their own remarkable customer experiences. A typical customer often starts with just one of our hubs, usually Marketing or Sales, and then later adds a second and a third hub. A couple of years ago, about 20% of our revenue came from multiproduct customers. Since then, that percentage has doubled with over 40% of our revenue now coming from multiproduct with room to grow even much higher.

By the way, we refer to this type of hub expansion at HubSpot as east-west expansion, our first of three recent product expansion vectors. At our INBOUND event in September, we released several new and upgraded products that were a major part of our north and southward expansion. To the north, we made a massive upgrade to our Marketing Hub Enterprise, and also introduced enterprise additions of Sales and Service hubs. To the south, we made very important enhancements to our Marketing Hub Starter product, and also released a new Starter edition for Service Hub to complete the Starter suite, really, really good stuff.

Let's dig into the northern expansion of our suite, with the introduction of the robust enterprise tier, we're able to scale the customers as they grow. Now, if you go back to 2015, HubSpot was a natural fit for customers in the, let's say, 20 to 200 employee range. I'd give us an A for selling into and delighting a 50-person company back then. We nailed that segment. But things used to get a little bit tougher when customers grew in scale up to a couple thousand employees force. But now, our new Enterprise suite positions us well to delight customers with 200 employees all the way up to companies over 10 times that size.

As we highlighted at INBOUND, HubSpot with our 2,594 employees in eight offices around the world, has we recently swapped out our existing CRM, and now runs almost everything entirely on HubSpot. We use our own CRM, Marketing Hub, Sales Hub, Service Hub and a wide range of integrations plugged in. We have a lot of headroom to grow and lock step with all of our customers.

In fact, this quarter, we landed our first multiyear contract with a total contract value of over \$1 million. Now, I know some of you may be thinking Brian's finally going to the enterprise. He's moving upmarket into the enterprise, I knew it. But I'm here to tell you that's not the case. This particular deal was struck with the customer with under 2,000 employees, proving there's a whole lot of value to generate by serving the mid-market. To me, this deal is a strong signal that our northern expansion is working and as our midsize customers get their own flywheel spinning, our product can nicely scale alongside them.

We're also expanding at the southern end of the market. At INBOUND, we introduced a new Starter version of Service Hub, and made a key enhancement to Marketing Hub Starter by adding e-mail functionality. The market has responded particularly well to this new Marketing Hub Starter product. We've seen some really strong early demand. Now, this Starter tier is a big part of how we're implementing the flywheel. Friction is the enemy of any

flywheel, so we're obsessively looking for ways to remove friction from the customer buying experience. Our Starter products do just that. The majority of our Starter products are now purchased touchlessly. This is great for customers who increasingly want to self-serve, it's also great for HubSpot, because the cost of acquiring a Starter customer touchlessly is materially lower than our average customer acquisition cost, removing friction from the customer buying process is fueling our flywheel.

Okay, so that was a quick overview of the slew of new products we announced in 2018, the biggest year of new product announcements in HubSpot history. Our R&D investments, they're really starting to pay off. One of the things I still love about working at HubSpot is it still feels like the early innings of our business. We made great progress over the last couple of years, but there's much work left to do to continue to further delight our customers and to reduce friction in our flywheel. We look forward to continuing to dig in on both these fronts in 2019.

Another area of investment for us, it's nascent but has high potential in 2019 and beyond is opening HubSpot up and lending our customers connect all of their other applications through us, moving us from an all-in-one suite eventually to more of an all-on-one platform, where customers use HubSpot to orchestrate their entire customer experience with our applications and other vendors as well.

Okay. Now, I'll turn it over to Kate to take us through our financials and our guidance.

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## Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

Thank you, Brian. Let's turn to our third quarter financial results and our guidance for the fourth quarter. As Brian highlighted, Q3 was a very strong quarter for HubSpot. We delivered strong revenue growth, over \$3 million of free cash flow, and \$5.9 million of non-GAAP operating profit. Third quarter revenue grew 35% year-over-year, driven by 35% subscription revenue growth and 39% services growth.

Constant currency revenue growth was 35% in the quarter, up 1 point over Q2 levels. The sequential increase in constant currency revenue growth is the result of the strong early traction from our 2018 product launches, and the benefit of a more seasoned sales team due to lower attrition rates throughout this year. HubSpot ended the quarter with 52,505 total customers, which was up 40% year-over-year, consistent with Q2 growth.

Average subscription revenue per customer came in at \$9,959, which was down 4% year-over-year and roughly flat with Q2 levels. As I've shared at our Investor Day in September, the largest driver of the decline in ASRPC is the significant customer growth from our relaunched Marketing Starter product. Average subscription revenue per customer in our Sales Hub and our Marketing Hub ex-Starter continue to have positive growth year-over-year.

International performance also continued to be strong in Q3 with international revenue growth of 52% year-over-year on both on as-reported basis and in constant currency. International revenue represented 38% of total revenue in Q3, up nearly 1 point from last quarter. Deferred revenue as of the end of September was \$162.6 million, a 35% increase year-over-year, while calculated billings, defined as revenue plus the change in deferred revenue, was \$140.7 million, up 32% from Q3 of last year.

Currency movements within the quarter resulted in a headwind to deferred revenue and calculated billings. Calculated billings grew 34% in constant currency, flat to Q2 constant currency billings growth.

The remainder of my comments will refer to non-GAAP measures. Third quarter gross margin was 81.7%, up 1 point sequentially and up slightly year-over-year. Subscription gross margin was 86.5%, up 1 point sequentially, and up slightly year-over-year, while services gross margin was negative 13%, up 7 points year-over-year.

Third quarter operating margin was 4.4%, down 1 point versus Q2 and up 4 points year-over-year. As a reminder, we hosted our INBOUND event in the beginning of September. If you exclude the impact of INBOUND, operating margins would have increased by 2 points sequentially, and 3 points year-over-year to 7.4%.

As Brian mentioned, we have been investing a lot in R&D, and we expect to continue to make investments that we believe will drive long-term growth for the business. At the end of the third quarter, we had 2,594 employees, up 32% year-over-year. We had another solid quarter of hiring, and as we discussed in Q2, attrition continues to be favorable, which positions us well to execute on our growth plans. CapEx, including capitalized software was \$8.3 million in the quarter. Moving on to earnings, net income was \$7.4 million or \$0.17 of earnings per diluted share.

With that, let's dive into guidance for the fourth quarter of 2018. Total revenue is expected to be in the range of \$136.5 million to \$137.5 million. Non-GAAP operating income is expected to be between \$11.5 million to \$12.5 million. Non-GAAP diluted net income per share is expected to be between \$0.29 to \$0.31. This assumes approximately 43.2 million fully diluted shares outstanding.

And for the full year of 2018, total revenue is expected to be in the range of \$505.5 million to \$506.5 million, up from our previous guidance of \$496.8 million to \$498.8 million. Non-GAAP operating profit is expected to be between \$29.5 million to \$30.5 million, up from our previous guidance of \$24.3 million to \$26.3 million.

Non-GAAP diluted net income per share is expected to be between \$0.80 and \$0.82. This assumes approximately 42.3 million fully diluted shares outstanding. We expect full year free cash flow to be between \$39 million and \$40 million. As you adjust your models, keep in mind the following. Currency movements created a 4 point positive impact on reported revenue growth in both Q1 and Q2 of 2018, and was roughly neutral in Q3. At current spot rates, we expect a foreign exchange headwind of 1 point to 2 points to revenue growth in Q4.

In the quarter, we saw a 3 point benefit to non-GAAP operating margin from our adoption of the ASC 606 revenue recognition standard. While we anticipate a similar benefit to Q4 non-GAAP operating margin, the benefit from capitalizing sales commissions over a longer period of time under ASC 606 will diminish thereafter. We expect CapEx as a percentage of revenue for 2018 to be in the 6% to 7% range, which is 1 point to 2 points below our historic average. We expect CapEx will return to historical levels next year, primarily as a result of a couple of international facility projects.

To close, we delivered another strong quarter of operational and financial performance, and believe we are well positioned for a strong finish to 2018.

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

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## Brian Patrick Halligan

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

Thanks, Kate. One of the things that's critical to scaling a company in today's day and age is attracting and retaining great talent. This is an area we've invested tremendously in over time. We won numerous awards in this front over the years, but I was particularly pleased to see last quarter we were named the Number 1 Place To Work For Employee Happiness in the U.S. by comparably, thrilled about that.

Another area of continued investment in focus is making HubSpot as diverse and inclusive a workplace as possible. I was happy to see that Fortune Magazine just rated us as the 18th Best Place To Work in the U.S. for Women. We have more work to do on diversity and inclusion, but pleased to see some recognition on that front.

With that in mind, I want to close by thanking all the HubSpotters as well as our customers, partners and investors. Operator, can we please open the call for some questions?

## 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

Oh, great. Thanks, guys, for taking my question. Congratulations on the nice quarter. I wanted to ask about just early traction with the Enterprise edition, particularly from Marketing. I know it's early, but any color you can provide on how just the general pipeline and interest has been trending there?

Brian Patrick Halligan

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

A

Hey, Brad. It's Brian. I'll take this one. It's going very well. The Marketing Enterprise in particular, the big upgrade actually happened on November 1, where we released a whole slew of new really compelling functionality. What I think this does for us is it positions us very well with the company between, let's say, 200 and 2,000 employees to win a deal. It also positions us well as customers who signed up maybe when they had 50 employees, as they scale, so we will be able to keep them longer and scale along with them. So early, early returns are good, the demand is good. As you know, we're raising the price of that product. I haven't really heard any pushback on it. It seems like that was a good move, so feeling great about the early traction on Marketing Enterprise.

Brad Sills

*Analyst, Bank of America Merrill Lynch*

Q

Great. Thanks. And one more, if I may, please, Brian.

Brian Patrick Halligan

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

A

Sure.

Brad Sills

*Analyst, Bank of America Merrill Lynch*

Q

Any color on the addition of sales into the Marketing base? I know in the past you've made comments that sales – customers are adding Marketing, but the other way around is an area where you've been focusing on potentially improving. Any commentary there would be helpful please. Thank you.

Brian Patrick Halligan

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

A

Yes, I think it's actually going really well also. We're seeing lots of customers come in, starting with Marketing and buying Sales; and lots of customer come in, starting with Sales and buying Marketing. I guess that there was a surprise as the number of customers who come in and bought the whole suite upfront. That's ticked up – that's exceeded my expectations and really happy with that. So, going well on that front.

Brad Sills

*Analyst, Bank of America Merrill Lynch*

Q

Great. Thanks, Brian.

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

Samad Samana

*Analyst, Jefferies*

Q

Hi. Good afternoon, and great quarter. Thanks for taking my questions. Maybe one to start with, on the \$1 million [ph] TCB (18:32) deal, I'm sure that's going to stand out for a lot of people. Brian, can you double check maybe on some more characteristics about that customer? Maybe what products did they take? What duration of that deal different than typical HubSpot deal with a customer of that size? And what convinced them maybe to commit that much to the company [indiscernible] (18:54)? And then, I have a couple of follow-ups.

Brian Patrick Halligan

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

A

Oh. Hey, Samad. How are you?

Samad Samana

*Analyst, Jefferies*

Q

I'm good. [indiscernible] (18:59)

Brian Patrick Halligan

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

A

I was very happy about that. I kind of put it in the – it's kind of neat thing that happen, but I'm not going to start having sort of a checklist on my desk of a number of million dollar deals. We're not going to start reporting the number of million dollar deals. It's not going to be a focus of ours.

I thought it was just an interesting proof point to show that, yes, these new enterprise products we came out with are really good, and they delivered a ton of value. The company that made the purchase – purchased Marketing Enterprise that actually wasn't a full suite deal. There's been lots of nice full suite deals, but that was a Marketing Enterprise deal. I don't think we would have won that deal, had we not come out with all that new functionality at INBOUND that we're about to release. So, the new features are really working for us.

The company itself is only about 400 employees. So I think this deal is a nice sign that even in the mid-market, we are delivering a tremendous amount of value for these customers, and there'll likely be a lot more of these in the future, but we're sticking with our SMB focus. We're not moving into the enterprise. I don't think I would really over focus on the number of million dollar deals at HubSpot.

But the product works. The new features are working. People are getting value from it. The sales cycle on that deal are relatively short, and what was interesting about that sale – I was actually involved with that sale – was a



lot of it was self-service, kind of what I talked about on stage at INBOUND. They gave the product a good try on their own. They used our API quite a bit in the trial and really got quite comfortable with it, and then our sales org kicked in and did a fantastic job.

Now, one note I would give you on that, Samad, is that it's a million-dollar deal, but it's a four-year deal. This isn't a one year deal. I want to make sure we don't get over our skis on \$1 million deals at HubSpot.

Samad Samana  
*Analyst, Jefferies*

Q

Great. And maybe just one follow-up on Customer Hub, we're now about six months into that release. Maybe just [indiscernible] (21:03) the ramp comparing to Sales Hub, and is it – maybe help us understand how that sales motion is going [indiscernible] (21:10) the product with all the bundled suite price changing, et cetera. And that's it for me. Thanks again.

Brian Patrick Halligan  
*Co-founder, Chief Executive Officer & Director, HubSpot, Inc.*

A

Yeah. Just to make sure everyone's got the vernacular, it's called Service Hub, not Customer Hub. And just to refresh folks, we came out with Service Hub Pro edition back in the spring, and then in INBOUND, we came out with the Starter and the Enterprise edition. So far, it's gone really, really well. It's ramping faster, whatever we are five months in, ramping a lot faster than the Sales product did four or five months in.

The product's improving a lot. A lot of people are buying it. I mean it's still early, kind of like the Sales product, it's mostly – if I think of SMB, small and medium-sized businesses, it's more S than M right now. I suspect six, nine, 12 months from now, it will be a lot more M, but right now, it's more S. But really good reception so far. We're selling quite well. People seem to like what we're up to, and I feel like we've got another hit product on our hand. Yeah, feeling really good about it.

**Operator:** And your next question comes from Mark Murphy from JPMorgan.

Mark R. Murphy  
*Analyst, JPMorgan Securities LLC*

Q

Yes. Thank you. And I'll add my congrats. Kate, I wanted to ask you regarding the calculated billings growth, where you said – I think you came in at 34% in constant currency, very consistent, very healthy. But is there any adjustment to be made there for the increasing mix of HubSpot sales bookings, which I think pull through a shorter duration of a couple months versus only six or seven months for Marketing, so is there any – even though it's something subtle, is there any upward adjustment to be made in that number?

Kate Bueker  
*Chief Financial Officer, HubSpot, Inc.*

A

Yeah, sure. I think billings is, I would characterize as a relatively misunderstood metric in our business. I think if you look at the composition of the calculated billings, 90% of calculated billings is revenue. And so, it's going to take a big swing in the months upfront or what we sell in order to move that away from revenue growth over time, when you're looking at it on a constant currency basis. So, yes, we do see it slightly smaller duration for deals on the Sales Hub, but that's really not moving the needle tremendously in calculated billings growth.

Mark R. Murphy

*Analyst, JPMorgan Securities LLC*

Q

Okay. And then a quick follow-up, maybe for Brian. Was there any actual impact from the pricing changes? I think, as you had mentioned, the price of Marketing Enterprise went to \$3,200 a month, starting just a few days ago. Did that have any tangible impact on the tone of business either in Q3 or in the month of October?

Brian Patrick Halligan

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

A

A minimal pull forward, but like Kate said, in a SaaS business the way we're set up, it's not a big swing in the numbers. You're going to see, but it helped a little bit but it's not life-changing.

Mark R. Murphy

*Analyst, JPMorgan Securities LLC*

Q

Thank you.

**Operator:** Your next 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 my questions. Just wanted to touch on the Growth suite a little bit. I know it's been introduced relatively recently here, but what can you share on the initial traction you're seeing from the Growth suite and how much of a role that play in the quarter?

And I just wanted to get an understanding of, are customers actually landing at – with the Growth suite or are you still seeing a single hub customer maybe transition over time into the multiproduct, and all three product suite?

Brian Patrick Halligan

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

A

Yeah. Good question, Arjun. I'll take that. I guess my reaction to that is we come out with the Growth suite offering at INBOUND, so first week in September. So, in terms of the impact on the quarter itself, very, very minimal. Having said that, we got a nice uptake on it, people are quite interested in. And I think what's going on in the world is, more and more companies are going to kind of pick a platform and buy applications in that platform vendor and glue other applications in around it.

And I kind of think it's like the way you would buy in their G Suite or Outlook or you're an Apple person or an Android person, and it's a bit of an all-in-one play. And we want to incent people to buy that way. We think that's the right way to buy. If you buy it altogether from HubSpot, and then you glue all these other third-party applications, then that works so well with HubSpot, boy, it's really, really nice platform to enable our customers to create a very nice end-to-end experience for their customers. So, I guess at a high level, it's going pretty well. It's had a nice uptick on it, and I think that will continue to go well. I think that's the way, over the long-haul, people end up buying this type of software.

Arjun Bhatia

*Analyst, William Blair & Co. LLC*

Q

Great. That's helpful. And then, maybe just a follow-up, on the customer count, it looks like customer count went up about 4,500 net new customers sequentially. It was certainly higher than we're seeing. Just wanted to see if

there was any impact from INBOUND there or if there's anything else that's driving that change to be higher than it's been over the past few quarters here.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. I think that the largest contributor there is the uptake in the new Marketing Starter product.

Arjun Bhatia

*Analyst, William Blair & Co. LLC*

Q

Okay. Great. That's helpful. Thanks for taking my questions.

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

Stan Zlotzky

*Analyst, Morgan Stanley & Co. LLC*

Q

Hey, guys. Good afternoon. And thank you for taking my questions. Wanted to [ph] gain (27:03) on the U.S. versus international growth. I mean international is certainly growing at very, very rapid clip. When you were thinking about the investments in international versus driving growth in the U.S., how are you thinking of balancing those two priorities? And then, I have a quick follow-up.

Brian Patrick Halligan

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

A

You want to take that?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. Why don't you start and I'll add in?

Brian Patrick Halligan

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

A

Sure. I'm feeling good about the growth on both sides. International is growing very, very fast, and I think that's the result of the investments we've made. We got going in international a few years ago. We made big, big investments in opening new offices and hiring people as well as big investments in translating the product, translating – offering the product and the sales and the service in different languages. And I think those investments have largely worked and we're getting a nice return on those investments.

So, we expect to invest in both where we get better returns, we invest a little faster in international. But we've been investing in both. We feel like it still early days for HubSpot, lots and lots of opportunity both domestically and international.

Want to add anything to that?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

No.

Stan Zlotsky

*Analyst, Morgan Stanley & Co. LLC*

Q

Got it. And then, a quick question for Kate. I'm not sure – I'm jumping between calls, but did I miss the net revenue retention rate? And where – how it trended in the quarter?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

You did not miss it. But you want to start and I'll add on?

Brian Patrick Halligan

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

A

Well, we had a little argument about this actually, Stan, because we had our best revenue retention quarter ever, but Kate reminded me that this metric would bounce around a little bit, and with all the product and packaging changes, they can go up and down over time. But we had a very, very solid revenue retention quarter, best quarter ever, and I'm personally very excited about that.

Stan Zlotsky

*Analyst, Morgan Stanley & Co. LLC*

Q

Okay. Is it fair to say that was above 100%?

Brian Patrick Halligan

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

A

Yeah, yes. It was over 100%.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

It was over 100%. And I would just add that when you look at the drivers of sort of the slight uptick in revenue retention over Q2, it's really the upgrade motion from the new Enterprise products that we're seeing drives that up a little bit.

Stan Zlotsky

*Analyst, Morgan Stanley & Co. LLC*

Q

Got it. Perfect. Thank you, guys.

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

Richard Davis

*Analyst, Canaccord Genuity, Inc.*

Q

Hey. Thanks very much. Maybe kind of on that topic, because I mean, we always ask for more, but I was thinking about on the churn side, and if you think about good Inbound programs, they take consistency. And the question I have is really how to imagine, if I adopt Inbound, there's this moment in time, I don't know if that's six months or 12 months where I'm kind of like, darn it, it's not – I don't feel like I see a lot of traction yet. And that moment is when you'd get churn and stuff like that. Is there a way and are there tools and strategies or actions that you could take to get people through that dark moment? And I don't know if it's – again, if it's three months or 12 months, but you must see that to some degree, I would think, at least that's what we've heard from talking to people. Thanks.

Brian Patrick Halligan

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

A

Yeah. I mean, there's a whole slew of things we've worked on to improve the value we deliver to our customers over time. First is, just investing in the product to make it better and more relevant. Second is just trying to stay very modern, so as social media network change, as search engine optimization change, as sales technique changes, keeping up with those and pulling our customers into it, pulling them into enabling them to create a better customer experience end-to-end for them.

And then, we moved our packaging around a little bit. What we try to do on packaging is, for a while, we thought, oh, let's just do much longer payment terms on these folks, but we don't actually want to lock people in for a long time. We want to make it easier for them to buy and then offer a lot of value to them.

So, we do all kinds of things, I would say, and are very, very focused as a company on delighting these customers and making sure they're getting as much value as possible. Now, if I think about it like over the course of HubSpot, when we first started the company, Richard, we were really just helping people get more visitors to their site, and then we helped them get more leads to their database, and then we helped sell more leads, and then we're helping them delight those customers like the value prop and the value we deliver to customers has dramatically expanded over time. And as a result of that, you've seen that retention rate come up over time.

Richard Davis

*Analyst, Canaccord Genuity, Inc.*

Q

Got it. Thanks very much.

**Operator:** Your next question comes from Alex Zukin from Piper Jaffray.

Taylor J. Reiners

*Analyst, Piper Jaffray & Co.*

Q

Hi. This is Taylor Reiners on for Alex. I wanted to double click on the Growth suite bundle. When we think about that being about a 25% discount relative to list price for purchasing of products individually, how does that compare to kind of typical discounts for individual products? And then, do you see that driving up on subscription revenue per customer over time as more [ph] Hub (32:09) product adoptions start to – continues to trend higher? Thanks.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yes. I mean I'll take the pieces. I think that the idea in designing the Growth re-packaging was to get some benefit for buying the whole thing. And so that is typically a bit more of a discount than you would get on a regular product. I think there are other ways that you can get discounts, including sort of signing up for longer commitments, et cetera.

As it relates to ASRPC, yes, certainly adoption of the Enterprise product in Growth suite should be a positive impact on that. But as we've talked about historically over the last couple of quarters here, we have a bunch of competing factors that are going to move that number around. And we talked about in my recorded remarks that or my written remarks that the biggest driver of ASRPC in this quarter was actually at the low end of the product SKU with the impact of the big customer additions for Marketing Starter.

Taylor J. Reiners

*Analyst, Piper Jaffray & Co.*

Got it. Thanks, and congrats on a good quarter.

Q

Brian Patrick Halligan

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

Thanks, Taylor.

A

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

Jennifer Swanson Lowe

*Analyst, UBS Securities LLC*

Great. Thank you. I wanted to ask about the Enterprise products and sort of the early demand you've seen there, and in particular on the net new retention – the net revenue retention metric you mentioned that you're seeing a lot of strong upgrade activity within the existing base. And I'm curious at this point how much of the demand you're seeing is that is existing customers looking to get more functionality for HubSpot – with HubSpot, and really interested in the Enterprise offering is a bill in demand versus bringing new customers into the fold with Enterprise? Where that is today and where you think your aspiration as you go over the next year or two is?

Q

Brian Patrick Halligan

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

Jennifer, I'll take that. Thank you for the question. It's kind of a mix. We're definitely seeing with the new Marketing Enterprise functionality, the people who had Marketing Professional are upgrading, and with the new Sales Enterprise SKU, people are upgrading there. The Service business is so new, there's not a lot of upgrading there.

A

We're also starting to see some net new demand from companies between, call it, 200 and 2,000 employees like our first \$1 million deal that was a net new customer at the Enterprise level. So I kind of call it a wash about the same of each so far. I think over the long, long haul, probably more from the outside as we work through the installed base of Pro customers, I think that demand will shift a bit to the outside.

I also just think we'll keep customers longer. One of the things that's always bothered me about HubSpot is when customers get to a certain size, they'll churn off us and go to another platform. And frankly, that's kind of irritating, and I don't think we see much of that happening in the future. I think we'll be very happy.

One of the things I think is interesting about HubSpot is, we ourselves have moved pretty much our whole business on the HubSpot, our whole front office application – front office operation and we have lots of employees, 2,500 employees, eight offices, relatively complicated organization. And we've got plenty of headroom to grow with the product, so we think our customers will scale right alongside us with the new Enterprise SKUs.

Jennifer Swanson Lowe

*Analyst, UBS Securities LLC*

Great. And as you think about opportunities to acquire new customers in this slightly larger buckets than where you played historically, how are you thinking about the sales investment behind that? Is it ticking the existing team you have and just giving them a broader scope of leads to pursue? Or is it a little bit more of a dedicated effort given that the price points are significantly higher than what you've sold traditionally?

Q

Brian Patrick Halligan

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

A

We might add – so we break our sales – our direct sales organization into three segments: the small business, which is I think 2 to 25 employees; medium, 25 to 200; and enterprise, it's 200 to 2,000. We might see a little bit of an increase in the size of the sales organization in that 200 to 2,000. We've put some things in place on the security side to help our customers understand how secure their data is with HubSpot, enable them to get that information more easily. We put some things in place on the legal side for contract review to make that more easy to do, and we're working on some cool stuff on the implementation side to enable that. And so, there's been some investment on our side. There'll be some continued investment to ensure that we're ready when they call on it. I think the reality of what happens is, we're on pretty much everyone's radar these days that they're looking at a net new CRM system. I just think we're going to win a lot more of those deals when they dig in and really evaluate it.

Jennifer Swanson Lowe

*Analyst, UBS Securities LLC*

Q

Great. Thank you.

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

Peter Levine

*Analyst, Evercore Group LLC*

Q

Great. Thanks for taking my question. This is Peter Levine in for Kirk. So, my first question here is, when you look at the adoption of the broader suite, is there any real difference in terms of what you're seeing in the U.S. versus international markets?

Brian Patrick Halligan

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

A

Go ahead.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

No, it's generally similar.

Peter Levine

*Analyst, Evercore Group LLC*

Q

Okay. Fair enough. And then, I know it's still kind of in the early innings, but you talked about a new kind of channel initiative targeting more IT implementation-focused partners. Can you kind of tell us about where you are today and your expectations from these newer partners over the next 12 to 24 months?

Brian Patrick Halligan

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

A

Sure. Let's talk about partners a little bit. We didn't talk about them in the prepared remarks. I'll give you perspective on it. First eight years of HubSpot, we sold marketing software, and we built a marketing agency channel that has worked, and is still working incredibly well. Now, when I look at those agencies, there are several thousand of them, some of them are really excited about the opportunity to move from marketing to sales to service to expand their offering from just helping companies with their marketing and the website lead generation

to helping them create a full flywheel and grow their business. But not all of them are, and we're not going to force them to do it.

Many of them come from website design businesses and they're just not that interested in doing it. So overall, that marketing [indiscernible] (38:37) performing well, many of them are selling the full suite somewhat.

At the same time, we have a new initiative underway that is going pretty well. It's still pretty new but I'm bullish on it, where we've got new agencies coming in sales agencies, CRM agencies, IT agencies. And it's still pretty early, it's going to get some nice investment next year. And I think that will grow nicely. And those agencies I think will be much more likely to sell either CRM or sell that full suite of products.

So, I think what you'll see over time is our agency program will diversify much more in the future. One of the things I love about HubSpot, we actually have two channels that work very well. We have a direct channel, the unit economics are really good on our direct channel. It's growing very fast. And we have this agency channel, growing very fast, unit economics work, that agency channel I think we have a chance to innovate and really do some cool stuff with over the next year or two.

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Peter Levine

*Analyst, Evercore Group LLC*

Q

Great. Thanks, guys. Appreciate it.

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**Operator:** Your next question comes from Terry Tillman from SunTrust.

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Terry Tillman

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Yeah. Hey. Thanks for taking my questions. Brian, maybe the first question just relates to one of your comments earlier around Service Hub, and seeing faster ramp than you saw five months plus with the Sales product. I guess could we just delve into that a little bit more in terms of some of the drivers of the faster rate of success there? And also, what I'm curious about is competition-wise, what are you seeing in terms of, it is replacing something, because you've had a month in the market now, is it replacing something or is it greenfield?

---

Brian Patrick Halligan

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

A

Yeah. A couple of thoughts, when we first came out with the Sales product, and I think you probably remember this, it was very light. It was – we actually called it Signals, we didn't call it Sales Hubs. And it was a couple of very light features for our sales rep really. And it did well, it was priced very low. Over time, we grew that thing into a full-on sales force automation product that we call Sales Hub.

What I would say about Service Hub is a little – it started off far more robust than that Sales product. In fact, we came out initially with that product in the spring as a professional offering, because it's pretty robust.

One of the – you've all seen us increase our R&D investment over time. One of the use of proceeds on that R&D investment was a big investment in, what we call, the HubSpot framework, which is an underlying platform underneath HubSpot, where you can imagine there's workflows, there is e-mail, there's social, there's webpages. And then, the hubs themselves, we combine those different things and we add interesting functionality to it to bring it to life. So, what we were able to do when we built the Service Hub is to leverage that framework to build something relatively robust right out of the gate. That's the big difference.



The second big difference, obviously, is we are much larger installed base to sell to, than we have in the Sales organization. So, those two reasons I think are combining for faster growth and a bigger business more quickly with the Service Hub and the Sales Hub.

Terry Tillman

*Analyst, SunTrust Robinson Humphrey, Inc.*

Q

Okay. Awesome. And then, a follow-up question just relates to the touchless sales motion. I know that's still evolving. But like any kind of quantification on how much of the business that is actually more of that approach? And could that be a by-product of this increased kind of touchless sales be faster leverage on sales and marketing? I mean you're seeing leverage in the model, so I'm not complaining. But maybe talk a little bit more about the touchless sales motion.

Brian Patrick Halligan

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

A

Sure. I can touch on, Kate can add. That is nascent, going well. What's interesting about it – one of the most interesting things going – we talked a bunch about that enterprise layer of product, just as interesting, if not more, is that Marketing Hub Starter product is going very, very well. We came out with kind of the version 2.0 of that product in the end of July and the uptake has been excellent on that product. And over half of that is touchless and I really like that motion. And what we expect over time is that to be a very large pool of customers, and that they over time will buy Sales Starter and Service Starter, some of them move from Marketing Starter to Marketing Pro. So, we're investing in that. We're making good progress, and that will be a big initiative for next year. I think you will continue to see us move on that path.

One of the people who really inspires us is a guy named Jay Simons. He's the President of Atlassian, he's on our board. And the reason we put him on our board is, we really like the way Atlassian does business and goes to market. I don't if we'll ever get all the way to where they are, but we're kind of headed in that direction and I really like that direction we're headed.

**Operator:** Your next question comes from Scott Berg from Needham.

Ryan MacDonald

*Analyst, Needham & Co. LLC*

Q

Hi. This is Ryan MacDonald on for Scott Berg. I guess just starting out, with the Sales Hub, it seems it appears to be have been accretive to subscription gross margins. And when we're looking at Service Hub, what sort of impact would you expect to have there on the margin?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

I think that the subscription gross margin numbers have trended sort of up a couple points over the last few years. It all runs on the same infrastructure, and so teasing apart the margins of the individual products in hubs is frankly not something that is a very easy endeavor.

Brian Patrick Halligan

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

A

Yes, Scott (sic) [Ryan] (44:16), one of the things that we talked about the last quarter that moderated to a large extent this quarter was, we had some incremental COGS associated with GDPR through the first half of the year. That largely went away in the third quarter. They gave us some sequential benefit as well.

Ryan MacDonald

*Analyst, Needham & Co. LLC*

Q

Got it. And then, just a quick follow-up. In regards to professional services, that line item continues to grow faster than software. Is there anything that's changed there in terms of the services you're providing? Or are customers consuming more for any particular reason?

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

Yeah. A couple things on the services business, the first thing I would just remind you is that it's a very small part of the overall revenue for the company. And so, sort of small changes in that revenue stream, generating big changes in the growth rates and profitability profile there. So, just I would first just keep that in mind.

That said, I think there are a couple of positive things that we've seen in the services revenue stream this quarter. One is just a benefit from the mix of subscription products that we're selling. So, as we sell more Pro and Enterprise products, as we sell more Marketing products that has a benefit, flow through benefit to services revenue. The other thing is with the adoption of 606, there is a small amount of revenue that gets attributed over to the services business that was not there in 2017, and so that's going to show a little bit of benefit in terms of growth rate.

Brian Patrick Halligan

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

A

I'd add there's no strategy change there. One of the things I've always liked about HubSpot is we give our customers two choices of implementation. Choice number one is they can do it themselves, and we teach them how to do it. Choice number two is they can outsource a lot of it to an agency partner. We're sticking with that model. We really like that model. So, there's little tweaks, little tiny changes in here, but there's no big strategy shift going on.

Ryan MacDonald

*Analyst, Needham & Co. LLC*

Q

Thanks.

**Operator:** Your next question comes from the line of Koji Ikeda from Oppenheimer.

Koji Ikeda

*Analyst, Oppenheimer & Co., Inc.*

Q

Oh, great. Thanks for taking my questions, and congratulations on the quarter. I'm going to throw this question out there for either Brian or Kate. Back at the Analyst Day, you gave a ton of great insight on ARR metrics for Marketing, Sales and Service. And I know this is not something that you want to give out numerically on a quarterly basis, but I was wondering if you could just give some qualitative commentary on how ARR trended for the three segments here.

Kate Bueker

*Chief Financial Officer, HubSpot, Inc.*

A

That's sort of the backward play into trying to get us to tell you on a quarterly basis. I think the trends that we outlined at the Analyst Day we're continuing to see in terms of the relative growth rates of the segments.

Koji Ikeda

*Analyst, Oppenheimer & Co., Inc.*

Q

Okay. Thanks, Kate.

Brian Patrick Halligan

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

A

[indiscernible] (47:06)

Koji Ikeda

*Analyst, Oppenheimer & Co., Inc.*

Q

And I wanted to go back to that \$1 million [ph] TCB (47:11) deal, I mean that's an awesome, awesome win for you guys. Congratulations. Just thinking about the installed base as a whole, I mean is that really that big of an anomaly in deal size? Or are there other customers in the wheelhouse that are already somewhat near that ZIP code or even trending to sort of that level? I mean, any sort of commentary there would be great.

Brian Patrick Halligan

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

A

Yeah. Just to remind you, that's a four-year deal, so let's just say, I don't even know if this is the case, let's say, it's \$250,000 per year. We have other customers in that range at this point. I think you'll see customer – the largest customer we have in per year revenue, I think we'll see that drift up over time, as we get more Enterprise deals, and we get more of these suite deals. Because really there's two growth factors going on, one is, the north factor, and the other is the east-west factor. So, there's room to move there. I think there'll be more, but we're not moving to the Enterprise.

One of the reasons we don't move to the Enterprise is there is a lot of competition in that Enterprise. Salesforce.com, Adobe, IBM, Oracle, lots of interesting companies that are executing well. We like as SMB. We like that the Internet kind of disproportionately benefits SMB versus the Enterprise. Our genetic code is there. Our go-to-market is there. And so, we're likely – very, very likely to stay kind of in our swim lane of between few employees up to a couple thousand employees.

Koji Ikeda

*Analyst, Oppenheimer & Co., Inc.*

Q

Great. Thank you for the color. Congrats on a great quarter.

Brian Patrick Halligan

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

A

Thank you, sir.

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

Jeffrey Parker Lane

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

Q

Hi. It's actually Parker Lane in for Tom. Thanks for taking my question. Brain, if I look at HubSpot Connect, it's obviously a big priority for the company to land customers and then integrate with other enterprise and SMB apps out there. But when I look at the page, I see a lot of players like Salesforce that are sort of involved with businesses they've involved in your east-west expansion strategy. I'm just wondering how much disruption you're seeing in the HubSpot Connect ecosystem from the launch of your products, if any. And what kind of customer would be using Salesforce alongside of HubSpot?

Brian Patrick Halligan

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

A

Oh, really good question. Let me give you a little color on that. We've been investing over the last couple of years, but [indiscernible] (49:29) more this year in moving HubSpot to be more of a platform. We invested a lot in increasing the number of API end points we have. We invested a lot in increasing the quality of those endpoints. We've invested a lot in building integrations ourselves and enabling third-party to build integration to HubSpot.

We built integrations to really cool product like Shopify, Stripe, Slack and others that are really going well. And what we want to do over the long, long haul is just, they pick HubSpot as a partner and we're not just all-in-one, we're all-on-one. And if you want to use HubSpot Service Hub, that's great. If you want to use Intercom or do you want to use Zendesk, that's great.

We came out with Service Hub and we still have lots and lots of happy customers that are using Zendesk for Service and Intercom for Service. Intercom recently improved their integration with HubSpot around that. And so we have to grow up and we have to be a platform player just like all the other platform players and give them a choice and make sure they get a great customer experience. That's our philosophy around it.

Jeffrey Parker Lane

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

Q

Great. Thanks for the color.

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

Brian Peterson

*Analyst, Raymond James & Associates, Inc.*

Q

Hi. Congrats on a quarter, and thanks for taking the questions. So, Brian, maybe as – can we talk about this move to north a little bit, as you guys have phrased it? But what are the competitive dynamics like there now versus maybe when you were public back in 2013? We've seen some M&A in the space. And you mentioned as customers had grown in the past, they migrated to different platforms. What are we seeing in that kind of up market movement now?

Brian Patrick Halligan

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

A

I mean, it's super early, no huge changes. I mean, we of course see Salesforce.com. They're a very good partner and competitor in deals. And we win our fair share. The Adobe deal is interesting. We've always seen Marketo up in that space, and I think we'll see Marketo up in that space in the future. But so far, we're keeping an eye on it, but no, no huge changes so far in our competitive landscape. I think we're just going to win more deals in that 200

to 2,000 segment and I think we're going to be able to hold on to more customers as we move on from 2,00 to 2,000.

What I'd like to see happening is let's just say you're using HubSpot for marketing and sales and service and maybe for whatever reason our Service Hub isn't answering the mail for you, you say I want to continue HubSpot, but I'm going to use ZenDesk instead of Service Hub for whatever reason their functionality in there that's more enterprise. That's what I'd like to see happen over the long haul. Take HubSpot sort of as your hub and build around it.

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**Brian Peterson**

*Analyst, Raymond James & Associates, Inc.*

Q

Got it. Thanks, Brian.

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**Operator:** Your next question comes from Ross MacMillan from RBC Capital Markets.

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**Ross MacMillan**

*Analyst, RBC Capital Markets LLC*

Q

Oh, thanks a lot, and congrats from as well. Brian, in our fieldwork, when we think about sales adoption, I think it, at least my perspective is, it is more skewed to net new customers as opposed to base customers. And I'd love your perspective on that and whether you think over time there's mechanisms to get the base to adopt faster as well.

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**Brian Patrick Halligan**

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

A

I think that the research is pretty good. We have done remarkably well in getting net new accounts who don't use our Marketing product to buy that Sales product. I've been delighted with that. And I think we're pretty good at cross-selling our Marketing product to those Sales customers and I think we're pretty good at selling our Sales product to the Marketing customers. I think that's in the area where we're going to continue to improve in and where there's leverage in as we go forward. But you're right that we have a lot of folks coming into HubSpot as net new customers buying Sales Starter and Sales Pro. And I'm actually delighted about it. I think that's filling up in our installed base that we can cross-sell to over time. That Sales business, Ross, is really humming – going really, really well. Very, very happy with the way that thing is growing.

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**Ross MacMillan**

*Analyst, RBC Capital Markets LLC*

Q

That's great. And then, just one for Kate. I know you don't guide to billing – calculated billings and I know you say it's a misunderstood metric. But I did just want to make sure that we were thinking about Q4, because I think the comp is very hard. I think there was 5 points of FX tailwind Inbound, timing is different. I know it wasn't big, but there's maybe a little bit of the price change impact in Q3. So maybe I don't know, what are the things that we should think about as we set up our models here for Q4?

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**Brian Patrick Halligan**

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

A

Yeah. I think for Q4, what we've said on the call is that there's a couple of – 1 point to 2 points of headwind on the revenue side. There's probably another 1 point to 2 points of headwind on the deferred revenue side, so calculated billings will have more of a headwind than revenue.

Ross MacMillan

*Analyst, RBC Capital Markets LLC*



Okay. That's helpful. Thank you. Congrats again.

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Brian Patrick Halligan

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

Okay. Thanks everybody for joining the call. Look forward to talking to you soon.

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

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