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HubSpot, Inc. (HUBS)

Q1 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 Q1 2019 Earnings Conference Call. [Operator Instructions]

I will now turn the call over to Chuck MacGlashing, Head of Investor Relations. 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 First 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 second 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 February 12, 2019, for a discussion of 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 first quarter 2019 earnings press release in the Investor Relations section of our website at hubspot.com.

Now, it's my pleasure to turn the call over to HubSpot 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 first quarter 2019 earnings results. We're off to a strong start to the year overall, 35% revenue growth in constant currency, 9% non-GAAP operating margins and 35% customer growth bringing our total customers to over 60,000. Great quarter.

Now, I'd like to step back for a moment and give you a view into how we're seeing the world these days. We feel like the real arbitrage opportunity in business these days is the ability for company to create remarkable customer

experiences. Business schools used to teach that to win you need to create a 10x better product. But in the future, I believe they'll teach that to win you need to create a 10x better experience.

You may have heard this before, but I'll remind you of my morning routine as an example of what I'm talking about. So you see, I wake up every morning on a purple mattress. And then I reach over on to my dresser, and I put on my worthy parker glasses. And then I pick up my iPhone and I put on Spotify and I listen to the Grateful Dead and dance my way into the bathroom, and I shave with my Dollar Shave Club razor and then I put on my stitch fix outfit and I take a lift to work.

Now why do I tell you about my morning routine? Well, those companies that I'm doing business with they're fascinating, they all startups. All of those companies, those startups, they're growing like a weed. All of those companies won my business, not by selling me a better product, but by creating a better and lighter customer experience fueled by word-of-mouth. It's that new arbitrage opportunity that motivated us to build a slate of new products over the last couple of years. Those new products enable us to move from a company that helped its customer generate leads to a company that helps its customers create these remarkable buying experiences. Those new products enable us to move from a company that sold a single application to a company that sells a full suite of software. This shift is going very well.

We're getting major multiproduct adoption across our customer base in large numbers of new customers that are buying our whole growth suite upfront. This is great news as it signals to me that our value proposition, our products, are working and our flywheel is spinning. Really proud of the progress we've made in that shift.

One thing I'm not proud of is the recent product outage that we had. [ph] I think it meets our customers and give them we run (00:04:45) HubSpot on HubSpot and convenience to us. Here's what I'd say about that outage. It only serves to strengthen our resolve to delight our customers. Since the outage, we've already doubled down on HubSpot stability, security and reliability across the board. We've already built a new reliability team with some of our best engineers who made great progress already.

Now, the next phase of HubSpot is shifting from a suite to more of a platform. You might ask why would we do that. Well, the reality is that there's been an explosion of valuable SaaS applications created over the last decade and most of our customers use scores of them. Rather than fight gravity, we want to enable our customers to plug all those applications into HubSpot and help them orchestrate all of them to create an even more remarkable experience for their customers. This shift is in its early days for us, but there's been nice progress.

If you're a HubSpot customer, you have nearly 300 integrations to choose from that were built by our integration partners. That's on top of 10 integrations that are natively built or are top use cases by ourselves and an almost endless array of integrations you can create through our partnerships with iPass companies. This shift is really starting to work. The average HubSpot customer already integrates five different applications into HubSpot. This year we're adding fuel to our platform by opening up even more API endpoints and cranking up our investments in the developer experience. In fact, last week, we had 150 of these developer partners into HubSpot per meeting. And I was delighted to chat with many of them who are growing better together with us.

The health of any platform basically depends on two things. You have to invest in the supply of top-notch integrations and you need a steady growing stream of new users to use them. Our freemium motion is a major source of new users and our commitment to developers is a major source of new applications. More users we get, the more developers there are who want to build on the platform. More apps those developers build, the more valuable our platform gets for hundreds of thousands of HubSpot users, all of which spins our flywheel even faster.

Now, we don't only want to enable our customers to create remarkable experiences to their customers, we want to leverage our own platform to create a delightful low friction experience for our own customers. You see our customers expect the consumer great experience when they come to us. Specifically, they expect to be able to try product before buying them. To that end, we introduced a freemium set of products a couple of years back. That decision alone removed a great deal of friction getting started with HubSpot that's been going really well. Nowadays, we're working on making the buying process a better one for these users by relying heavily on HubSpot software to increase the amount of the process we can automate, leaning hard into chat and box, forming our sales org with the information they need to have conversations that help customers grow better, and making our software more intuitive for our users. We're just starting on this initiative and I suspect we'll be able to make some nice progress here.

All righty. We're laser focused on our customers at HubSpot, evolved our value proposition for them from an application to a suite to help them grow better over the last few years. We're evolving again from a suite to a platform to help them grow even better. We're also focused on applying HubSpot's technology on our own opportunity to make our own buying process light and delightful.

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

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

Thanks, Brian. Let's turn to our first quarter financial results and our guidance for the second quarter. 2019 is off to a strong start. I'm pleased with the growth in revenue, free cash flow and non-GAAP operating profit we delivered in Q1. First quarter revenue grew 35% year-over-year in constant currency and 33% as reported. Q1 subscription revenues grew 33% year-over-year, while services revenue grew 27% year-over-year, both on an as-reported basis.

HubSpot ended Q1 with 60,814 total customers, which was up 35% year-over-year. Average subscription revenue per customer in Q1 was \$9,811, down 2% year-over-year as reported and flat in constant currency. We continue to expect this metric to bounce around depending on product mix and the amount of new versus installed base selling in any quarter.

Domestic revenue grew 27%, while international revenue growth was 50% year-over-year in constant currency and 42% on an as-reported basis. International revenue represented 39% of total revenue in Q1, up 3 points year-over-year. We continue to see significant opportunity for growth domestically as well as around the world.

Deferred revenue as of the end of March was \$193 million, a 28% increase year-over-year. Calculated billings was \$160 million, up over 31% year-over-year in constant currency and 27% as reported given an almost 5-point FX headwind to calculated billings in the quarter.

The remainder of my comments will refer to non-GAAP measures. First quarter gross margin was 82%, up slightly less than a point year-over-year. Subscription gross margin was flat at 86%, while services gross margin was 4%, up 12 points year-over-year.

First quarter operating margin was 8.6%, up almost 4 points from Q1 of last year. The adoption of ASC 606 had a minimal impact to operating leverage in Q1, but as a reminder, we still anticipate that ASC 606 will be a 1-point headwind to operating leverage for the full year.

Net income in the first quarter was \$16 million or \$0.36 per diluted share. At the end of the first quarter, we had 2,745 employees, up 20% year-over-year. CapEx including capitalized software development costs was \$7 million or 4.7% of revenue in the quarter. CapEx was lower in Q1 due to the timing of our facilities build-out plans throughout the year as well as some planned spending that pushed into the second quarter. We still expect CapEx as a percentage of revenue to be about 8% in 2019, primarily as a result of the build-out of our new Dublin facility in the second half of the year.

Finally, our cash, cash equivalents and marketable securities totaled \$984 million at the end of March. The substantial quarter-over-quarter increase was largely due to the \$343 million in proceeds we received from the 2.15 million share common stock offering we completed in February.

With that, let's dive into guidance for the second quarter of 2019. Total revenue is expected to be in the range of \$156.5 million to \$157.5 million. Non-GAAP operating income is expected to be between \$9.2 million to \$10.2 million. Non-GAAP diluted net income per share is expected to be between \$0.24 and \$0.26. This assumes approximately 47.6 million fully diluted shares outstanding.

And for the full year of 2019, total revenue is expected to be in the range of \$655.5 million to \$658.5 million. Non-GAAP operating profit is expected to be between \$50 million and \$52 million. Non-GAAP diluted net income per share is expected to be between \$1.26 and \$1.30. This assumes approximately 47.5 million fully diluted shares outstanding. We now expect full year free cash flow to be about \$62 million, up from our prior forecast of about \$60 million.

As you adjust your models, keep in mind the following. The recent strength of the U.S. dollar creates an incremental headwind to as-reported revenue growth in the second quarter and the full year. We're now anticipating a foreign exchange headwind of approximately \$10 million to as-reported 2019 revenue, which is up from our prior forecast of an \$8 million impact. This revised forecast equates to a full 2-point negative impact to as-reported revenue growth in 2019, up from our prior forecast of 1 to 2 points. In Q2, we anticipate a full 3-point FX headwind to as-reported revenue growth.

As we indicated on our last call, we expect the majority of our 2019 operating leverage in the first and fourth quarters. Given the strong leverage we delivered in Q1, we still expect the remainder of our operating leverage to occur in Q4.

Similarly, we saw strong free cash flow in Q1. Q2 and Q3 will be lower free cash flow quarters as a result of ramping CapEx spend in our annual INBOUND event in September. As a result, we anticipate the majority of our remaining 2019 free cash flow to come in the fourth quarter. To close, the first quarter represented a strong start to the year and we believe we are well positioned to build on this momentum throughout 2019.

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. We're off to a really strong start in 2019. Our suite product play is playing dividends as our customers are investing in HubSpot as their marketing, sales and service full front office and our flywheel play is reducing friction, so it's even easier for our customers to try, buy, and get up and running with HubSpot. And our platform play is gaining serious momentum as our customers and partners are finding it easier and more valuable than ever to extend, build on and get more leverage than ever from their HubSpot investment.

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

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Tom Roderick with Stifel. Tom Roderick, your line is open.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hi guys, good afternoon. Thanks for taking my questions. So I wanted to just kind of hit on the FX headwind here that hit I think you said 5 points on bookings and was curious if you just speak to that a little bit more in terms of how much the deferred revenue versus the revenue on a year-on-year basis that hit versus, say, deferred on a quarter-on-quarter basis. And also if there are any particular geographies that are doing particularly well internationally that you'd highlight that you saw the strongest FX hit from that would be great. And then sort of modeling forward, any thoughts on how we should attempt to sort of think about the headwinds here to deferred in our models going forward? Thanks.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yes. Thanks. As we talked about in the past, there're a bunch of different things that impact billings which is why we don't point to billings as one of the primary metrics that we focus on internally. The story in Q1 was clearly an FX story and there's really two components of FX headwinds as it relates to calculated billings. The first one is around revenue, so you'll recall that we defined calculated billings as revenue plus the change in deferred. There was about a 2.5-point headwind to revenue growth year-over-year in the quarter, about the same frankly with the revaluation of the deferred revenue.

So we, as you know, recalculate the value in U.S. dollars of the deferred revenue balance on the balance sheet at the end of March, and the difference between the starting and ending point FX rates impacts that and that is another 2.5 points of headwind for us.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Excellent. Excellent. That's great. And then sort of turning to the product side, looking at the customer growth here, fantastic growth again, the 36% and I know Brian and Kate, you both talked about the ARPU bouncing around a little bit. But would love to hear some of the new SKUs that you introduced last fall with INBOUND, how they are starting to have an impact relative to ARPU. Perhaps you could talk about the Sales Hub Pro and some of the other SKU that might be starting to move that needle on ARPU a little bit. Thanks.

Brian Patrick Halligan

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

A

Sure, Tom. Thanks for the question. Just to get everyone on the same page, if you roll the clock back to INBOUND last year, last September, we announced a whole bunch of new products there and a bunch new

products on the Enterprise side, and for us, Enterprise is really mid-market, but we call it Enterprise and then a bunch of new products on the starter SKU which is really for startups and small businesses. Overall, I'd say it's done pretty well. I'm pretty happy with the performance of all the new products. All our products are – we're never done. It's not like a sculpture where we craft it and it's done, but man, they're doing well and those products are all going to get better and feeling good about it.

The tricky thing for investors is that ARPU number because it's – we got some customers who are definitely moving it up and we got some customers that are definitely moving it down. And that starter product line, particularly the marketing starter product line is doing really well and that's pulling it a bit. But overall, I feel really good about all those new products. Anything you want to add to that, Kate?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

No. I think the trend in Q1 is very similar to what we've been seeing over the last few quarters which is this product mix really being the thing that impacts both the customer count growth and the ASRPC, and we see it again in Q1. That said, if you look at the individual hubs, we are seeing growth or expansion in ASRPC, so on a standalone basis, the Sales Hub and the marketing ex starter are both showing positive trend.

Brian Patrick Halligan

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

A

That's a good point. Marketing ex starter is growing nicely.

Thomas Michael Roderick

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Outstanding. That's great. Thank you, guys. I'll jump back in queue.

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

Brian Peterson

Analyst, Raymond James & Associates, Inc.

Q

Hi. Thanks for taking the question. So maybe just a follow-up to Tom's question. But just on the international strength, could you expand a bit on where you're seeing some success? And if I think about what products are resonating internationally, any difference from what you're seeing domestically?

Brian Patrick Halligan

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

A

How are you doing, Brian? This is Brian. International is doing great. We've made lots of investments in international over the last five years, a big office in Dublin, then we did – we've done Australia. We've done Japan. We've done Singapore, Bogotá. We're just announcing and opening our Paris offices and big investments and I think we're seeing a really nice return on those investments. We also made some IT language in the localization investments and those investments are going well, and I think we're seeing nice, nice growth out of there. What's interesting about the growth internationally is it looked a lot like the domestic market. The mix between products is nearly identical. You think there will be some slight difference in there, but it's pretty close to the same across all the different product lines. That was really good question. Thanks.

Brian Peterson

Analyst, Raymond James & Associates, Inc.

Q

And maybe just one quick follow-up for Kate just on the retention number. I'm sorry if I missed that during the call, but anything you could share on the net revenue retention? Thanks, guys.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. So we don't actually disclose a specific number on retention. Q1 revenue retention was in the high 90s, which was expected. We said that this number is going to move around up and down. We tend to see a bit of strength in Q3 and Q4 in the, call it, heavier bookings quarters, and we tend to see it moderate a little bit in Q1. We still think that we can do a 100-plus retention over the long-term.

Brian Peterson

Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you.

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

Brad Sills

Analyst, Bank of America Merrill Lynch

Q

Oh, hey, thanks, guys. Wanted to ask about sales and how that's been ramping in the ad agency channel and within your direct sales force. Any color on how these two channels are getting up to speed and moving up the learning curve on selling sales?

Brian Patrick Halligan

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

A

Brad, it's Brian. I'll take that. If I just kind of step back and describe what's going on at HubSpot with the channel, when we really early on when we first started HubSpot, HubSpot was only a marketing software company. We helped people generate leads. And we started pretty early an agency channel, so it was a lot of search engine optimization agencies and website building agencies and PR agencies and it went great. And basically what happened was folks had a choice if they're going to buy HubSpot. If they wanted to do it themselves, they would buy directly from us. If they wanted to do it through an agency, they would buy through an agency, it's scaled really well.

Over the last couple of years, we've been shipping our value prop from a lead generation business to sort of a full flywheel business helping people not just generate leads by creating this whole process. What's been happening underneath behind the scenes is a lot of our best marketing agencies have transformed themselves into customer experience agencies, flywheel agencies, agencies that really help people with that entire experience.

And then we started a new effort to pull in different types of agencies, and we've got a lot of these agencies signing up, a lot of boutique sales agencies, sales coaching, sales implementations, CRM implementations, and we're starting to sign up some more IT implementation types of agencies. And that was an initiative we started probably a year ago and it's tracking, it's going pretty well.

Now in the next couple of weeks, we're having all of our top tier agency partners into HubSpot. And I get to meet with them all, I'm having them all over my house for dinner. I really look forward to meeting them. That group and

overall the agency program is performing really well at HubSpot. Really happy with the progress that the whole group's making and I'm bullish on the new sales and IT partners over the mid and long term.

Brad Sills

Analyst, Bank of America Merrill Lynch

Q

That's great. Thanks, Brian. And then one more if I may. You made some comments earlier on the outage disrupting your own sales operation. Could you elaborate a little bit? Did you see deals push in the partner channel and in your direct channel as a result into Q2, or are you more speaking to the impact being more just on your own sales operations given that you're running HubSpot yourself? Thank you.

Brian Patrick Halligan

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

A

Sure. I mean I'd like to comment a little bit more broadly on the outage. If folks are super interested in, then we published a bunch of stuff out there. It points to our blog. JD, our COO, published an article while the outage was going on. And then our Chief Architect did a post on our blog with like a postmortem of what happened in there. If you really want to dig in those, you've got places to look. Around the outage that happened right at the end of March, I have talked to a lot of our customers who were hit by it, and if any of those customers are listening me on the call, I just [ph] want (00:25:15) to apologize for it. It was disruptive for you, it's disruptive for us and that's the long day at HubSpot. So we're kind of disappointed in ourselves frankly about that outage.

Since then, we've been very, very active. We've built a new reliability team, built around – we took our top engineer and built a reliability team. We've changed some of the process by which we built product and we're only a few weeks in but we're already making some really nice progress. So I'm pleased with the effort. And as the Dalai Lama like to say when you make a mistake, don't lose the lesson. I don't think we'll lose the lesson. I think we're going to learn our lesson and make sure we change our processes, change our org, so we can be even better in the future. In terms of us, yeah, we use HubSpot. There wasn't a major impact. It was one day out of a quarter. It wasn't a huge, huge impact, maybe a very, very slight impact there on the last day of the quarter, but nothing that I lost sleep over – a lot more sleep over the disruption we get to our customers.

Brad Sills

Analyst, Bank of America Merrill Lynch

Q

Thanks, Brian.

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

Mark R. Murphy

Analyst, JPMorgan Chase & Co.

Q

Yes, thank you, Brian. If you continue to succeed in the very long run, what percent of your customers do you think are going to end up using all three parts of the Growth Stack, in other words marketing, sales and service or essentially viewing HubSpot as the core front office system? And I'm also just curious what you think that can do for retention and stickiness if they do end up integrating many apps into HubSpot, I think you said they're also integrating five apps.

Brian Patrick Halligan

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

A

Yeah. How are you doing, Mark? Thanks for your question.

Mark R. Murphy

Analyst, JPMorgan Chase & Co.

Q

Good.

Brian Patrick Halligan

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

A

I don't know what the number is, but it's going to be high. And I go on tons of sales calls and talk to tons of customers. And what I'm seeing happening in the market is people – it's a little bit like I myself – for better words, I'm an Apple person. I have an iPhone, I have a couple of Macs, I have the earbuds, I even use Apple TV. I don't mix them. I don't have a Windows machine that mixed in with my iPhone. I think companies are kind of doing the same thing where they're picking a core platform provider for the front office, buying some applications from that platform provider and then plugging lots of other applications in. That's kind of what I see in the market and the two primary ones I see every day – obviously I see HubSpot every day and we see Salesforce every day, they're a very good competitor for us.

And I think we compete quite well. Our offering is really good and I think our offering is getting stronger and stronger every day. So I think over the long haul, a very high percentage of our customers will pick us as a platform. They may not use us for all three, they may plug in something different in a different part of our product, but I think they will consider us sort of their system of record and they'll plug in a couple of our apps and they'll plug in tens of other applications into that.

Now over the long haul, what will that do to retention? I think our retention can be a lot higher than it is today. I don't know what that can be. I think Kate is staring me a hole in the side of my head right now, so I wouldn't dare to give what that is, but I think it gives me a lot [indiscernible] (00:28:38). But there's a mix problem like while we're getting a lot of our existing customers to buy all three of our products and really commit to our platform, there's lots of people just buying the marketing starter. So, that's why we say over the long haul because in the short haul, as JD likes to say, we've got kind of – what did he call it?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

A humidifier and a de-humidifier.

Brian Patrick Halligan

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

A

We get a humidifier or a de-humidifier going on on ASRPC and going on retention inside HubSpot, and that there are these great things going on with lots of new customers on this point solution and this allows lots of people upgrading. But over the long haul, I think we'll have much better retention rate than we have today.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yes, I think, Mark, your instinct is right. We do see for multiproduct customers a meaningfully higher retention rate than we see for single-product customers. But Brian is right in that journey has a long way to go.

Mark R. Murphy

Analyst, JPMorgan Chase & Co.

Q

Okay. Okay, great. And Kate, just a very quick follow-up. I think you said billings grew 31% in constant currency, nice to see. You had adjusted that for currency. Did you also adjust that for duration as, I believe, you had done that in the prior quarters or was that just for currency?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

That's the actual results in constant currency. But as you point out, there are a bunch of different things that play into billings. Again, that's why we don't obsess about it internally. There's some seasonality to billings in Q1. There is a bit of push and pull on billing terms and we probably had a little bit of impact here from [indiscernible] (00:30:12) as well, so a lot of stuff happening in billings this quarter.

Brian Patrick Halligan

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

A

Overall, though, like I look at all the leading – we look at a million numbers. Leading indicators of the business are very good. I feel good about really – I feel fine about where the business is at, a little bit of currency headwind, but I feel like really good just like I felt a year ago.

Mark R. Murphy

Analyst, JPMorgan Chase & Co.

Q

Okay. And that's a reference to the [ph] forward pipeline (00:30:35) and just the tone and tenor of the sales feedback and whatever else comes across your dashboard, is that what you're talking about, Brian?

Brian Patrick Halligan

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

A

Yeah. We look at a million numbers. A lot of them are backward-looking, some are kind of forward-looking. Everything looks good generally compared to a year ago. Nothing is [indiscernible] (00:30:53) perfect, but like if I look at today versus a year ago, I was bullish a year ago, I'm still bullish today like sales reps are making their numbers, our win rates are good, our competitive position is good, like I'm still feeling good. There's a little currency headwind there that's hard for me to get by control app, but business is good.

Charles Tupper MacGlashing

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

A

Which of course is captured in our guidance, Mark.

Mark R. Murphy

Analyst, JPMorgan Chase & Co.

Q

Thank you, Chuck, for clarifying. All right, have a good night.

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

Samad Samana

Analyst, Jefferies LLC

Q

Hi, good evening. Thank you for taking my questions. I just wanted to make sure – I think you said the head count was up 20% year-over-year. I was just looking back, I think that's pretty decent slowdown in terms of the employee head count growth rate. I'm just curious how you guys view maybe hiring. Is that just a seasonal effect? Should we expect higher growth? As I think about some of the other companies that we look at, that are even

larger and they're still growing heads faster, so I'm just curious what the company's head count investments are. And then I have a follow-up question as well.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. So Q1 head count was frankly a very hard compare for us. 2018 Q1 was a really notable strong hiring quarter. That said, I think, January we got off to a little bit of a slower start coming out of the holidays. We're really encouraged by the hiring trends that we're seeing in March and April, and we also continue to see relatively low levels of attrition which is great.

Samad Samana

Analyst, Jefferies LLC

Q

Got you. And then Kate maybe just one follow-up on the outage, I know it happens to other companies as well. Was there any type of – just any change in maybe churn rates or any impact – or is there any financial remediation for customers? Just want to make sure if there is one-time items that we kind of adjust accordingly.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. I mean it's obviously hard to quantify the specific impact of the outage, but I think there's probably a small impact on a bunch of different things including churn, including billings, including revenue.

Brian Patrick Halligan

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

A

[indiscernible] (00:33:00) just add to that.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah.

Brian Patrick Halligan

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

A

One of the million metrics we look at is customer Net Promoter Score, customer happiness referral rates. As you might imagine, they really dipped. And I look at it weekly. It really dipped down that week to a low since I've been looking at it and it steadily climbed back up and it's all the way back up to where it was pre-outage. So I think it's very unfortunate and we apologize for it. But I don't think it's going to change the game for us.

Samad Samana

Analyst, Jefferies LLC

Q

Yeah, we definitely appreciate the amount of information that's in the blog. I think it was very helpful. I just want to ask, and Brian just one maybe big picture question. I think we're about a year into the customer service offering being out. I'm curious just maybe how you feel the ramp of that's going and how that's impacting the overall suite adoption. And that's it for me. Thanks again for indulging that extra question.

Brian Patrick Halligan

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

A

That's okay, Samad. Nice to hear from you. Service offering is doing great. We came up with that – I think we started that in May of last year. Historically, the way we released products is we release kind of a small footprint of a product and then it continually gets better and better and we've seen that with that service product. It's getting a lot better a year from now; it's going to be even better. We're seeing people adopt it and enjoy it so feeling good. It's growing.

One of the things I think we said last quarter or the quarter before is we compared the growth rate of the service offering from the day we released the service offering, relative to what we did on the sales offering, it continues to grow a lot faster than that sales business did, and we're seeing lots of customer by the whole suite upfront, which is really heartening.

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

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Perfect. Thank you so much for taking my question. Brian, maybe if I could just chime in on what you mentioned as far as the multiproduct adoption, any metrics that you guys can share with us on how adoption of that is going versus like the 20,000 that you mentioned on the Q4 call?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

I can take that. I think what we've said is we will give you some milestone numbers and we have passed that 20,000 milestone of multiproduct customers, we're sort of comfortably above that now. We're tracking in the mid-30% of our customer base to have more than one HubSpot product.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Got it. And maybe if I could just go back to the average subscription revenue per customer metric, in Q1, it dipped 2% quarter-on-quarter and I understand that there is some FX headwind, but we saw similar dynamic over the last two years wherein Q1 it dips fairly significantly compared to all the other quarters. Is there some kind of a phenomenon that happens in Q1 from a mix shift or some kind of customer dynamic that takes place in Q1 that really hits that average revenue per subscriber? Thank you.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah, I think we announced a lot of products in Q4, we announced new Enterprise suite, we announced price increase, there's a lot of attention on that side of the – I guess I'm going to call that the humidifier side of the equation. Then Q1 was a particularly strong quarter for the sales and service hubs side of the equation. And so depending on sort of the composition of selling in any quarter, you're going to continue to see that bounce around.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Got it. All right. Thank you so much.

Operator: Your next question comes from Bhavan Suri from William Blair.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Hey, this is actually Arjun on for Bhavan. I just wanted to touch on the multiproduct customers a little bit more. I know you're seeing more customers land at HubSpot with more than one product. But just curious if you're seeing any impact on the sales cycle and how long customers are staying in the funnel before they make a purchasing decision. And also is there a greater proportion of these multiproduct customers that are landing at HubSpot through the channel or is it fairly consistent in terms of single-product customers?

Brian Patrick Halligan

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

A

I guess I'll continue that humidifier/de-humidifier theme. If you look overall at the sales cycle, it really hasn't changed much at all. Some of the deals are faster, particularly if they're buying the growth suite or a point starter solution. If they're buying the Enterprise Growth Suite, it might be a little longer, but net-net, it really hasn't moved much. In terms of – and I haven't looked at this carefully, but I believe it's pretty similar – I don't know if you have this, say, a pretty similar process [indiscernible] (00:38:05) direct and indirect channel in terms of the...

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

I actually don't know the answer, but I'm happy to follow up.

Brian Patrick Halligan

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

A

Yes [indiscernible] (00:38:12)

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Okay, that's fair. And then I know the international growth has been pretty phenomenal at 50%. Just curious if there's – if you see any difference in the competitive environment abroad versus what you're seeing at home from a competitive presence perspective or everything else?

Brian Patrick Halligan

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

A

Pretty similar, similar dynamic going on internationally in the U.S. SaaS companies like HubSpot and Salesforce and others, it's a lot easier to go international. So we do business in over 100 countries now. And so you don't need an office in Tanzania to have a bunch of companies down there and the same goes for our competitors. So unlike maybe 10 or 15 years ago the competitive landscape looks pretty similar.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Okay. Thanks for taking my questions.

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

Eric Lemus

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Hey guys. This is Eric Lemus on for Terry. Thanks for taking the question. I just had one for you. We talked about in the past by reducing friction in the buying process. Have you guys seen any sort of outcomes with the strategies you've been doing to reduce the friction in the buying process? And more so on that, anything around in that purchasing?

Brian Patrick Halligan

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

A

Eric, one of our big initiatives is around this idea of freemium and lowering the touch. And if I just think about HubSpot [ph] with (00:39:39) large, we have two channels that generate leads and opportunities for us inside of HubSpot. The traditional channel we use is we create lots of content and that pulls people in through search, through links, through the blogs, through things like that.

And I would say we're pretty good at that. We have room to improve. There's opportunities there, but we're pretty good at that. That freemium is pretty new. We're kind in the first inning of that initiative and I would say, I'm very pleased with the way it's gone. Lots of opportunity left in the freemium model. And then what I draw, I draw this thing on the whiteboard around here all the time where I draw on one side of the whiteboard Atlassian which is my favorite company. And then on the other side of the whiteboard, I'll draw Oracle, Salesforce, a company with a longer sales cycle [ph] Enterprise Salesforce (00:40:24) and we're kind of in the middle of that and we're moving towards the left closer to Atlassian's model. We're not all the way there, lots of opportunity between here and there. I don't know [indiscernible] (00:40:35) to get all the way there, but that's kind of where we're heading. So far, so good on it, lots and lots of opportunity with that.

Eric Lemus

Analyst, SunTrust Robinson Humphrey, Inc.

Q

Great. Thanks, Brian.

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

Jennifer Swanson Lowe

Analyst, UBS Securities LLC

Q

Great, thank you. I wanted to touch a bit on the Enterprise success that you're seeing. And I guess sort of the first question there is how much of that is customers who are at other price tiers growing into that versus you starting to land a customer that sort of sits sort of at the upper echelon of the segments that you traditionally targeted?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

It's relatively similar. I think it's like 60-40, but we can get you an exact number.

Brian Patrick Halligan

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

A

Generally, what's going on in the market is people will buy a HubSpot and they'll grow with us, and that is a really good model for us. And we've learned that model from a lot of other companies like Slack, like AWS who get in when you're in the start-up phase with five people. And the next day, you got 50, the next day you got 500 people and we're the platform of choice. That's kind of the game we're playing. We're certainly going into a 500-person company and if they haven't settled on a platform yet, we do quite well in there. But they're already on a

competing platform, they get completely set up and customized, and everyone's trained. That's a bit of a tougher compete for us.

Jennifer Swanson Lowe

Analyst, UBS Securities LLC

Q

Okay. And that was a little bit where I was going with the question as people start to embrace having a more – I think in the past, a lot of the opportunity was greenfield. Customers don't have anything or have very fragmented tools and HubSpot can go in and kind of replace that or push it out. Now as you start to have the suite and you start to have maybe a bit larger of a customer that you're able to target, are you starting to see more replacement of technology versus greenfield? What's sort of the landscape like from that perspective?

Brian Patrick Halligan

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

A

It's a good question. Like if I think – let's just take a 5-person company, a 50-person company and a 500-person company, a 5-person company hasn't picked a platform yet. A 50-person company, 50-50 chance that they picked the platform, so half of them let's say have picked the platform, half of those are unhappy with their choice and having completely set it up and trained everyone, so they're kind of losing the socket. And then the other half of those haven't got a platform. It's a bunch of point solution. Let's say 75% of those are really good fit.

500-person company and this is the total swag, more of them have picked the platform you could imagine and more have got it set up. And so certainly there's plenty left there. We're winning those deals and people will replace the existing platform, but we compete extremely well in that 50. Where I think the business will go and where all disruptors go over time is they get in early and they grow with their customers. And that play – a play has been in place for a while now, and it's working really well.

Jennifer Swanson Lowe

Analyst, UBS Securities LLC

Q

Okay, great. Thank you.

Operator: And our next question comes from Kirk Materne of Evercore.

Peter Levine

Analyst, Evercore Group LLC

Q

Great. Thank you. This is Peter Levine in for Kirk. So most of my questions have been answered. But I guess, one that kind of sticks out is, it's roughly \$950 million, \$960 million cash, cash equivalents. So just any comments, how you plan on deploying that capital? I believe in prior calls you kind of discussed the potential fourth hub. So maybe discuss what you feel about M&A evaluations today versus kind of organic development? Thank you.

Brian Patrick Halligan

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

A

Sure. Let's talk about M&A. We do have some cash on the balance sheet. I would say that cash doesn't increase our urgency to do a deal, but it increases our flexibility to get a deal done. I just spent a month in San Francisco. I rented an apartment Airbnb in San Francisco for the month of March. And while I was out there, I did sort of a learning tour and met with the heads of corp dev and with lots CEOs of companies that have successfully done M&A. And so I learned a lot and that we've got a little team of people who looks at deals.

But overall, I think you'd see our approaches, we're prudent about it. If we're not going to buy something, you want to enable it – have it enable our customers to grow better, so really fits in with the story and helps with our grow better story. We want to buy a team that's a good culture fit, and something we learned a lot about it. If you buy a company without a team that really fits in nicely, that can be dangerous. Tech stack is going to matter. If it's fully different tech stack, that makes it much more difficult to integrate. And then evaluation, everything – you look at multiples are relatively high today. And so we're going to be careful, we're going to be prudent and we're going to be good stewards of that cash. It's how I would think about it.

Peter Levine

Analyst, Evercore Group LLC

Q

Okay. Thank you.

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

Michael Turrin

Analyst, Deutsche Bank Securities, Inc.

Q

Great. Thanks. Just quickly, I wanted to follow up on the channel. Apologies if I missed it, but can you add how much of a contributor that was during the quarter? And then longer term, is there an [ph] ARPU (00:45:59) mix for us to think about? Is the 40% we've seen more recently also a good mile marker to use going forward or as you move more towards to this Atlassian type of motion, does that, in any way, change or influence that mix? Thanks.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

So I can start with the performance in the quarter. So 40% of our revenue came from the channel.

Brian Patrick Halligan

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

A

And then just long term, what percent from the channel, it's been 40% for a while. And if you look at the way we make our investments inside of HubSpot, we've invested a lot of indirect and channel. The unit economics are quite similar, so it gets similar levels of investment and we're continuing to invest. We're going to have our partners in in a couple of weeks and we're not going to talk about some investments we're making. So make it easier to become a partner, make it easier to be happy and profitable partner that grow. So, pretty similar investment. I don't know exactly what it will be long term, but I would just say we're paying close attention to both or investing in both. Both of them work. And so, steady as she goes, as far as I'm concerned.

Michael Turrin

Analyst, Deutsche Bank Securities, Inc.

Q

Got it. That's helpful. Thanks.

Operator: Your next question comes from James Rutherford from Stephens.

James Rutherford

Analyst, Stephens, Inc.

Q

Hey. Good afternoon. Just one for me. And thanks for taking the question. You mentioned, Kate, the net revenue retention was in the high-90s and that seems similar to what you all were saying in the first quarter of last year. I'm just curious if you can comment on what you're seeing with retention at the Enterprise tier now that you've

rebuilt that marketing product in Enterprise. Are you seeing any benefit from those product investments start to hit the retention line at that tier yet?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah, I mean we don't tend to share information beyond sort of that top level number, but we do – I think you've got instincts around the relative retention, the Enterprise versus the starter product is right.

James Rutherford

Analyst, Stephens, Inc.

Q

Okay. Thanks. That's it for me.

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

Ken Wong

Analyst, Guggenheim Securities LLC

Q

Great. Thanks for taking my question, guys. Brian, I believe last quarter you mentioned a lot of high-return projects in 2019 specifically around Enterprise that could be valuable to customers. Just wondering any update on that and how you think that might impact some of the upward migration of your customers towards Enterprise and potentially multiproduct attach?

Brian Patrick Halligan

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

A

Yeah, I think we made lots and lots of investments last year and over – I think we've done a pretty good job of making investments in the product and we've seen nice returns on them over time. The way I kind of think about our product – I'm not sure I got your question exactly, but the way I think about the product and the way to think about a modern software company is you kind of want to make the front end, so it's consumer grade. You want it to be fast, you want it to be highly usable, you want the uptime to be really good.

And at the same time, you want the back end to the Enterprise grade. Again you want the uptime to be high, you want to be scale as people grow, you want to have open APIs that people use. That's sort of the way we think about it. And to that extent and to the extent we can continue to deliver value for our customers and get that word of mouth up, we're going to continue to invest. We're good at hiring developers, we think we can build more product and we think we can make our existing products a lot better.

Ken Wong

Analyst, Guggenheim Securities LLC

Q

Got it. I appreciate the answer. Thanks.

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

Ross MacMillan

Analyst, RBC Capital Markets LLC

Q

Thanks so much. I had two, maybe one for Brian, one for Kate. So, Brian, the net customer adds was really strong again this quarter. Was there anything specific you did on like the freemium funnel or the top of the funnel for that low tier that maybe drove, I don't know, outsized performance in net customer adds? And then for Kate,

just on the calculated billings, you obviously mentioned FX. I was just curious were there any impacts from average duration on that number to all this quarter. Thanks so much.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. Maybe I'll start and then Brian you can add in. As it relates to the billings, I think the main player in the billings story in Q1 was definitely FX. But yes, you're right. There are a bunch of other things that impact billings. We talked about seasonality, we talked about billing terms, we talked a little bit about the [indiscernible] (00:50:33) all of those things also impact, but really FX was the main driver.

Brian Patrick Halligan

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

A

Hey, Ross, it's Brian. Nothing – we didn't really do anything special, I would say, in Q1. Our freemium motion, our free CRM all that stuff is a case of continuing to innovate. The product folks are continuing to deliver functionality, trying to make the product faster and more usable and more performing, all those kinds of things. There is no running special campaign or something. It was steady as she goes.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. And the customer count growth in Q1 continues to show the same trends that we've been seeing over the last couple of quarters. The marketing hub starter, customer adds continue to be really strong. But as Brian talked about, we have a balance there with also strong trends in multiproduct adoption.

Ross MacMillan

Analyst, RBC Capital Markets LLC

Q

Yes, that's great. Thank you so much. Congrats.

Brian Patrick Halligan

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

A

Thank you.

Operator: And that was our last question. At this time, I will now turn the call back over to Brian Halligan, Chief Executive Officer of HubSpot.

Brian Patrick Halligan

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

Thanks everyone for joining the call. Look forward to talking to you again soon.

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

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