Hubspot, Inc.(Q4 2022 Earnings)

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Corporate Speakers:

- Charles MacGlashing; HubSpot, Inc.; Corporate Treasure & Senior Director of IR
- Yamini Rangan; HubSpot, Inc.; CEO, President & Director
- Kathryn Bueker; HubSpot, Inc.; CFO & Treasurer

Participants:

- Samad Samana; Jefferies; Analyst
- Mark Murphy; JPMorgan Chase; MD
- Brent Bracelin; Piper Sandler; Analyst
- Terry Tillman; Truist Securities; Analyst
- Gabriela Borges; Goldman Sachs; Analyst
- Rishi Jaluria; RBC Capital Markets; Analyst
- Alek Zukin; Wolfe Research; MD
- Michael Turits; KeyBanc Capital Markets; Analyst
- Brian Peterson; Raymond James; Analyst
- Brad Sills; BofA Securities; Analyst
- Josh Reilly; Needham & Company; Analyst
- Adam Holets; BMO Capital Markets; Associate
- Elizabeth Porter; Morgan Stanley; Analyst
- Michael Berg; Wells Fargo; Analyst
- Arjun Bhatia; William Blair & Company; Analyst

PRESENTATION

Operator^ Good afternoon. Thank you for attending today's HubSpot Q4 and Fiscal Year 2022 Earnings Conference Call. (Operator Instructions)

It is now my pleasure to hand the conference over to our host, Chuck MacGlashing, Head of Investor Relations.

Chuck, the floor is yours.

Charles MacGlashing^ Thanks, Operator. Good afternoon and welcome to HubSpot's fourth quarter and fiscal year 2022 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 Yamini Rangan, our Chief Executive Officer; Dharmesh Shah, our Co-Founder and CTO; 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 27-A of the Securities Exchange Act of 1933 as amended and Section 21-E of the Securities Exchange Act of 1934 as amended.

All statements other than statements of historical fact are forward-looking statements, including those regarding management's expectations of future financial and operational performance and operational expenditures, the expected impact of the restructuring, expected growth, FX movement and business outlook, including our financial guidance for the first fiscal quarter and full year 2023.

Forward-looking statements reflect our views only as of today.

Except as required by law, we undertake no obligation to update or revise these forward-looking statements.

Please refer to cautionary language in today's press release and our Form 10-K, which will be filed with the SEC this afternoon for a discussion of the risks and uncertainties that could cause 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 such measures can be found within our fourth quarter and fiscal year 2022 earnings press release in the investor relations section of our website.

Now it's my pleasure to turn over the call to HubSpot's Chief Executive Officer, Yamini Rangan.

Yamini?

Yamini Rangan^ Thank you, Chuck, and welcome to everyone joining us on the call. Today, I want to focus on our Q4 results, reflect on 2022 and share our strategy for driving profitable growth going forward.

Before we get started, I want to acknowledge the restructuring announcement we just made 2 weeks ago, where we decided to part ways with approximately 500 HubSpotters. This was the most difficult decision in HubSpot's history and not one we took lightly but one we believe is in the best interest of the company over the long term. I'll talk further about the rationale and the impact in a few minutes.

Now on to our results. Q4 revenue grew 35% year-over-year in constant currency, and full year 2022 revenue grew 39% in constant currency. Our operating profit margin was 14% in Q4 and 10% for the full year. Total customers grew 24% to over 167,000 globally.

Our bimodal strategy is clearly working. We saw strong net customer adds of 8,400 in Q4 driven by a strong quarter of free CRM sign-ups; CMS Hub Free, which continues to open up our distribution channels; and the starter suite, which is delivering more value through better automation.

At the same time, we also have momentum upmarket where we are delivering clear value for larger customers. In fact, large deals were the fastest-growing area of our business in Q4. These results demonstrate that HubSpot's connected, easy-to-use, powerful platform is mission-critical for our customers.

In terms of the demand environment, I talked in November about what we are seeing with customers, including longer deal cycles, more decision-makers and increased budget scrutiny. While these trends and macro pressures persisted throughout Q4, they did not get materially worse. We continue to navigate this environment by demonstrating the value HubSpot can deliver. And we're increasingly becoming the platform of choice. We saw more multi-hub deals with the mix shifting even more to 3 and 5 hub deals. I'm pleased with how we continue to solve for the customer with product innovation while executing against our strategic priorities throughout 2022.

Now reflecting on 2022, it truly was a roller-coaster of a year. Much like our peers, we experienced a perfect storm of uncertain macro, tighter customer budgets and longer decision-making cycles. As I talk to our customers, a few shifts are increasingly clear.

SMBs are doubling down on digital. Their businesses are now built on digital compared to pre-pandemic. They're not turning back. But instead of operating in a "buy first, understand value later" mode, they're now in a "understand value deeply by cautiously" mode. HubSpot has always resonated with customers because we deliver easy-to-buy, easy-to-use and easy-to-manage solutions. Now in this environment, we're focused on helping our customers drive innovation and efficiency with a quick time to value with customers taking under 8 weeks on average to activate and see value.

Throughout 2022, we had 2 key areas of focus: maintaining our fast pace of product innovation while driving consistent results. On the product side, innovation was just cranking. We relaunched Service Hub, added CMS Hub Free and launched hundreds of new enhancements to meet our customers' evolving needs.

Three areas I want to highlight: we drove more omnichannel execution with launches like our WhatsApp integration; more intelligence and insights with customer journey analytics and Campaigns 2.0; and more connected commerce with payment subjects, recurring ACH and payment schedules. It was a record year of innovation capped off by being rated by G2 as the #1 global software company in 2023 and the #1 product in both marketing and sales. Just awesome recognition and a strong testament to the progress we are making on driving innovation.

Also, I'm happy to announce that we are promoting Andy Petrie to lead our product organization as EVP of Product and User Experience. Andy has had an incredible influence on our product over the past 13 years at HubSpot. He is one of the very early product leaders who drove the CRM platform vision, was the brain behind Operations Hub and is exceptionally customer-centric. Andy will be filling the role formerly held by Steph Cuthbertson, who made a personal decision to step down as Chief Product Officer at the end of 2022. I want to thank Steph for her contributions to HubSpot and wish her the very best.

In terms of go-to-market execution, as customer behavior shifted in 2022, we adopted. We leaned more heavily into total cost of ownership and got even better at communicating the tremendous value of HubSpot. We did more team selling and delivered clear messaging to the multiple buyers and personas that are now part of the buying process. In short, we stepped up to the challenge, executed well and helped our customers navigate choppy waters.

Now let's shift gears to 2023. Our continued focus is on driving profitable growth, maintaining agility and executing efficiently. I'm confident in our ability to normally navigate uncertain times but also to emerge stronger. Here are some of the decisions we've made to help drive long-term profitable growth.

First, in January, we announced plans to reduce our workforce by 7% and consolidate our facilities. We made this decision to thoughtfully align our people and resources to strategic business needs. We're also optimizing our real estate portfolio to better align with the needs of our hybrid workforce. These changes will help us drive profitable growth and enable us to invest more in innovation that solves for our customers long into the future.

We're also taking steps to drive more efficiency over the long term. Specifically, we're looking at multiple areas within sales and marketing. On the direct sales side, we're investing in systems and automation to improve rep productivity internally. We're continuing our journey on product-led growth, both to scale the low end of our business with starter and to drive demand for pro and enterprise in a more efficient manner.

On the partner side, we're making important changes to our commission structure to align partner incentives with customer value. We're leaning into better reward partners who source demand, who co-sell alongside us and engage deeply with our customers. These are multiyear initiatives and will lead to a more efficient direct, product-led and partner sales motions that set us up for profitable growth and margin expansion.

I want to wrap up by sharing our strategic objectives for 2023. While the environment may be uncertain, we operate in massive markets and are confidently pursuing our goal of becoming the #1 CRM platform for scaling companies. Our first objective is to become the SMB market share leader in marketing, sales and service. We are laser-focused on these 3 mega markets, and we'll enable more upmarket customers to adopt HubSpot with easier customization, greater extensibility and better governance capabilities.

We will help our customers drive revenue through improved customer journeys and greater rep effectiveness. And we will lean into omnichannel by expanding channels to serve the changing needs of our customers.

Our next objective is to continue on our journey to transform B2B commerce. We launched HubSpot Payments a little over a year ago, and early customer interest have been strong despite the macro environment. This year, as we continue to ramp, we'll be focused on driving greater awareness of our commerce capabilities and increase customer adoption while adding key functionality like native invoices, flexible billing and flexible payment processing that our customers need.

Third, we will double down on our bimodal strategy. Our strategy of focusing on volume of customer adds at the low end while expanding the value of customers at the upper end is working. We launched CMS Free, introduced self-guided demos, moved automation down to our starter edition and optimized sign-ups. These initiatives drove results, and we added over 30,000 net new customers last year with the majority landing on the starter CRM suite and expanding beyond. We will continue to find creative ways to make it even easier for customers to get started with HubSpot and get value out of our platform quickly.

Our final objective is to build a high-performing, sustainable and equitable company. We are focused on foundational investments that can help us scale better. That includes better coaching and development for top talent, better performance culture, better systems and better hybrid connection. We know when we invest in our employees' growth we will drive better outcomes for our customers and for HubSpot. We have a clear opportunity ahead to drive value for our customers, and we have the right strategy in place to drive profitable growth.

With that, I'll hand it over to our CFO, Kate Bueker, to take you through our financial and operating results.

Kathryn Bueker^ Thanks, Yamini. Let's turn to our Q4 and full year 2022 financial results. Fourth quarter revenue grew 35% year-over-year in constant currency and 27% on an as-reported basis. Q4 subscription revenue grew 28% year-over-year, while services and other revenue increased 8% on an as-reported basis.

Full year 2022 revenue grew 39% year-over-year in constant currency and 33% as reported. Full year subscription revenue grew 34% year-over-year, while services and other revenue decreased 5%, again, both on an as-reported basis. Domestic revenue grew 31% year-over-year in Q4, while international revenue growth was 38% in constant currency and 23% as reported. International revenue represented 45% of total revenue in Q4.

We added over 8,400 net new customers in the quarter, bringing our total customer count to 167,000, up 24% year-over-year. Starter CRM suite continued to fuel our strong net adds again in Q4. Average subscription revenue per customer grew 9% year-over-year in constant currency and 3% on an as-reported basis to $11,200. The primary driver of this strength continues to be the adoption of multiple hubs by professional and enterprise customers.

We maintained a healthy gross retention rate in the high 80s in Q4 as customers continue to view HubSpot's platform as mission-critical. Net revenue retention was 107% in Q4, down 2 points sequentially, driven by continued customer optimization of HubSpot spend. As I've mentioned in the last few quarters, we continue to expect net revenue retention to remain pressured as a result of the challenging macro environment.

Deferred revenue as of the end of December was $546 million, a 25% increase year-over-year. Calculated billings were $542 million in Q4, growing 29% year-over-year in constant currency and 26% as reported. The remainder of my comments will refer to non-GAAP measures, except by comments relating to restructuring charges.

Q4 gross margin was 84%, up 2 points year-over-year. Subscription gross margin was 86% in Q4, while services and other gross margin was negative 14%. Full year gross margin was 83%, again up 2 points year-over-year. Subscription gross margin was 85%, while services and other gross margin was negative 29%. Q4 operating margin was 14% and full year operating margin was 10%, both up compared to 2021. Q4 operating margin benefited from the impact of slower hiring and reduced discretionary spending that we implemented in the second half of 2022.

Net income in Q4 was $57 million or $1.11 per fully diluted share. At the end of the fourth quarter, we had approximately 7,400 employees, up 26% year-over-year and up slightly sequentially. This does not include our recent workforce reduction of approximately 500 employees. CapEx, including capitalized software development costs, was $19 million or 4% of revenue in Q4 and $82 million or 5% of revenue for the full year. Free cash flow in the quarter was $71 million or 15% of revenue and $191 million or 11% of revenue for the full year. Finally, our cash and marketable securities totaled $1.5 billion at the end of December.

Now before I dive into guidance, I wanted to provide a bit more context regarding our recent restructuring. As Yamini indicated, this wasn't a decision we made lightly, but it is one that we believe will better align our people with our strategic needs and help position HubSpot as a more efficient and agile company. Our head count reductions allow us to continue to invest against a number of strategic business needs, including product innovation and systems and automation to scale better in a hybrid world.

We're also taking steps to optimize our real estate portfolio to better serve our hybrid employee base by consolidating leases, including our Davenport headquarters building in Cambridge. As we outlined in the 8-K filing a few weeks ago, we expect to incur charges in a range of $72 million to $105 million in connection with the restructuring. We expect the majority of employee severance costs to be incurred in the first quarter, while the lease consolidation costs are expected to be incurred throughout 2023. These charges and related cash expenditures will be excluded from our non-GAAP operating profit, operating cash flow and free cash flow results.

And with that, let's review our guidance for the first quarter and full year of 2023. As we've discussed, the macro environment remains challenging. The customer behavior we're seeing today is very similar to Q4: tighter budgets, deals taking longer to close and more people involved in the approval process. Our guidance assumes that these weaker macroeconomic conditions persist throughout 2023.

For the first quarter, total as-reported revenue is expected to be in the range of $473 million to $475 million, up 20% year-over-year at the midpoint. We expect foreign exchange to be a 4-point headwind to as-reported revenue growth in the first quarter. Non-GAAP operating profit is expected to be between $45 million and $47 million. We expect foreign exchange to be a 1-point headwind to operating profit margin in the first quarter.

Non-GAAP diluted net income per share is expected to be between $0.82 and $0.84. This assumes 51.5 million fully diluted shares outstanding. And for the full year of 2023, total as-reported revenue is expected to be in the range of $2.05 billion to $2.06 billion, up 19% year-over-year at the midpoint or 20% in constant currency, including a foreign exchange headwind of 1 point for the full year.

Non-GAAP operating profit is expected to be between $248 million and $252 million. We now expect foreign exchange to be a slight headwind to as-reported operating profit margin for the full year of 2023. Non-GAAP diluted net income per share is expected to be between $4.24 and $4.32. This assumes 52.2 million fully diluted shares outstanding.

As you adjust your models, keep in mind the following. Most of the operating margin increase we expect from our restructuring will be realized in Q2 through Q4 of 2023 and is included in our guidance. We expect non-GAAP operating profit margin to be between 9% and 10% in the first and second quarters, low double digits in the third quarter and high teens in the fourth quarter. We expect CapEx as a percentage of revenue to be roughly 5% and free cash flow to be about $225 million for the full year of 2023 with seasonally stronger free cash flow in Q1 and Q4.

And with that, I will hand things back over to Yamini for her closing remarks.

Yamini Rangan^ Thank you so much, Kate. As I look ahead, we have a clear long-term vision to become the #1 CRM platform for scaling companies and a focused strategy in

2023 to make progress on that vision. Our customers continue to depend on HubSpot, and we are more motivated than ever to help them grow.

We also have a clear strategy to drive profitable growth long term and thoughtful changes we are making to build a more efficient company. All of this makes me confident in HubSpot's future. I want to thank our employees for their adaptability and continued focus on solving for our customers. I want to thank our customers, our partners and our shareholders for your support.

With that, operator, let's open up the call for questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) The first question comes from the line of Samad Samana of Jefferies.

Samad Samana^ The initial FY '23 guidance is also very healthy considering the macro environment. How should we think about what -- yes?

Charles MacGlashing^ Sorry, we didn't hear the first part of -- yes, we missed the first part of that. Could you maybe start over for us?

Samad Samana^ Yes. Sorry. Yes, certainly. Was saying that it was an impressive 2022 under tough circumstances. And the initial '23 guidance is also very healthy considering the macro environment. How should we think about what's considered in the guidance when we compare it to your comments in the recent shareholder letter, the letter to employees about potentially tougher times ahead? And does it factor in the impact from the areas that will be deemphasized following the layoff?

Yamini Rangan^ Thanks a lot for your question. So maybe -- this is Yamini. Maybe I'll start with the strategic rationale for the layoff and then give a little bit of color in terms of demand, and then Kate can answer the question on guidance.

In terms of the layoff, this was the most difficult decision we had to make in HubSpot's history and something that we did not take lightly. And if we step back, this is not simply a short-term cost-cutting decision. This was a strategic realignment of our people and investments so we can drive long-term profitable growth.

And there are 2 reasons why we got to this decision. The first is that we had areas within the business where head count had grown faster than revenue, areas like recruiting and services. And even when we consider 2023 growth, we had that excess capacity. So we wanted to ensure that our people and our resources are clearly aligned to the growth in 2023 and our strategy in 2023.

The second rationale is that we want to invest thoughtfully in key areas of the business to drive profitable growth over the next decade. We want to invest in product innovation so we can drive customer outcomes and emerge stronger from the cycle. We want to invest internally in our own systems and automation wherever we find there are manual processes so we can be even more efficient and innovative as a company. So those were the 2 reasons why we got to this difficult decision.

Now you mentioned the employee letter and the comment that we have made in terms of the demand environment. Look, demand environment in Q4 remained very consistent with what we shared in Q3. We saw deal cycles lengthening. We saw more decision-makers involved. We saw more scrutiny of deals and budgets before approvals. Q4 did not get better, but it did not get materially worse. And so what we have assumed is that the demand environment will remain challenging going into 2023.

Kathryn Bueker^ Yes. And Samad, I will just follow up with Yamini's comments around how we thought about guidance. The baseline assumption in our 2023 guidance is consistent with Yamini's description of the environment, which is it stays difficult, but it remains very consistent with what we saw throughout Q3. It doesn't get materially better and it doesn't get materially worse.

Now that said, as you know, we always try to set guidance that contemplates a variety of outcomes, and we did the same thing this time. And so we feel good about our guidance with that set of base-case assumptions, but we also feel good about that guidance even if the external environment gets a little bit worse from here.

Operator^ The next question comes from the line of Mark Murphy of JPMorgan.

Mark Murphy^ I'll echo my congrats on the ability to navigate this environment out there. I am wondering if perhaps in any pockets, you might have noticed any change in the buyer behavior in the last 3 or 4 months. Basically, since we started to see some of the cooler CPI inflation data, I'm just curious if that development might be sporadically loosening up some conversations. I know you're saying the environment was just as tough overall in Q4. But do you think anything could be changing on the margin as we head into the spring and summer? Or do you think that, that will take more time?

Yamini Rangan^ Yes. Mark, this is Yamini. Thanks a lot for your question. And look, I think overall, the demand environment has remained consistent. It's not gotten better and it's not gotten materially worse.

As we looked at our pipeline -- now our pipelines tend to be just current quarter, next quarter. There are a couple of things that we're seeing at the margin, right? Short-cycle deals, ones that are typically created in month and closed in months and they tend to be in the lower end of our segments, are continuing to maintain velocity. So we see reasonable velocity there.

Longer-cycle deals that typically tend to be upmarket are taking just a little longer to close. And again, this is because of more decision-makers involved, more kind of caution in terms of looking at the budget. And so that's the maybe minor change or shift that I would say in terms of the types of deals.

Now if I look at pipeline, I've been talking to customers a lot more in Q3, Q4 and going into Q1. There are few kinds of characteristics of what we see within the pipeline. Customers care a lot about time to value. The #1 question that I get, we get, is how quickly can we migrate, what is the value and how quickly am I going to get there. And HubSpot is resonating because we can deliver value in a matter of weeks, not months.

The second thing that we are seeing is people care about driving productivity and a tight alignment between marketing and sales. This is the year where driving clear productivity across marketing and sales and getting much better visibility on the customers matter. And so we begin to see that in the pipeline.

And then finally, eliminating point solutions and driving down costs, a lot of conversations on platform consolidation and with a view towards cost savings, that's what we are seeing. It's a high bar for action amongst customers. That high bar remains, but I'm really pleased with how the team is focused on executing in this environment.

Operator^ The next question comes from the line of Brent Bracelin of Piper Sandler.

Brent Bracelin^ I wanted to follow up on the large customer cohort. This sounds like it's the fastest-growing part of the business. We've seen an appetite to consolidate vendors, which really spiked up in our survey ahead of the year. Enterprises seem to be more than willing to consolidate vendors more than ever.

Have you seen a change relative to the size of the large customers wanting to consolidate on the HubSpot? I ask because it does feel like you're getting pulled into the enterprise. So can you just refresh us on your ambition to move upmarket versus staying in the core mid-market swim lane?

Yamini Rangan^ Yes. Thanks a lot for the question. Look, we remain very focused. Our segmentation and the segment that we care about deeply is 200 to 2,000 employees. That's the segmentation that we care about. Within that, the 200 to 2,000 segment is what we consider upmarket customers. And as I mentioned, we certainly saw momentum and a lot more larger deals in Q4, and we are continuing to see that now.

I think if you step back and think about these larger customers, they are expecting a lot more out of their marketing and sales spend this year. They want more leads. They want better visibility of pipeline. They want better rep effectiveness. And as you think about this, HubSpot delivers that. We are a connected marketing sales and front-office solution, and our hubs are clearly delivering value, which is why we see that.

The second thing that you mentioned is also around platform consolidation. One of the key priorities this year is to look at the sales stack and the martech stack and look at ways of eliminating point solutions to drive cost savings. And in all of those considerations, HubSpot is becoming the platform of choice.

Now that's certainly because of the product momentum we have. It's because our go-to-market has adapted with our partners to be able to drive value for these upmarket customers. And we're really proud of the work that the entire organization is doing in terms of where we are in the market.

Operator^ The next question comes from the line of Terry Tillman of Truist.

Terry Tillman^ Congrats from me as well in terms of the strong execution. Yamini, I had a question related to partners. I mean funders over time, I mean, some of these partners have grown up with you all and scaled up as you all scaled up, and they've become pretty big themselves. But I'm curious if we can get an update on partner influence or percentage of the businesses from partners and if you could just unpack a little bit about it. It sounds like there's some changes or evolution with partners. But maybe you can just help us a little bit more on kind of what's instigating that. And what kind of outcomes or benefits come out of the work you're doing there incrementally with partners?

Yamini Rangan^ Yes. Absolutely. Happy to take that, Terry. Look, our partner strategy is working. And a few years ago, we went to our partner ecosystem and we said, look, we are transitioning to marketing automation to CRM platform. And our vision is to scale selling and servicing with export partners. That is working. And our partner-influenced MRR or ARR is about 45% compared to the overall. So it's a good split between direct and partner-influenced MRR.

We have momentum. We are co-selling much better over the last 3 years, and partners are behind us. Now I did mention that we are making a structural change to the commission. If we step back, our partner commission was initially set up when HubSpot had one hub and just a couple of additions. This is like 10 years ago. And then as you all know, over the last couple of years, we have expanded our product portfolio. We have added Operations Hub, we've added CMS Hub, and we've added more additions to the hub.

So as we step back, and we looked at our partner commission strategy, we want to incentivize our partners who are now coming along this journey with us to do a couple of things. We want them to first be deeply engaged with customers. When partners get involved with customers, it leads to better close rates and it leads to better retention, and we want to drive that.

And second, we want to be enabled to incentivize them on driving more multi-hub as well as co-sells. And so we just announced -- I just came from the partner kickoff today as well as yesterday, where we announced a few changes to the commission structure, which again, incentivizes them to have deeper connection with our customers.

And I've been talking to a number of our top partners over the past few weeks in terms of this change. They get it. They understand that we are evolving to a multi-hub company, and they understand that we are going to continue to invest within the ecosystem. So overall, excited by the change as well as the evolution of the partner strategy.

Operator^ The next question comes from Gabriela Borges of Goldman Sachs.

Gabriela Borges^ Questions for Kate on the net retention number. Give us a little bit of a sense on how much exposure you have to growing and scaling customers in the technology vertical, specifically looking to understand what's going on with the shift from hiring in the technology vertical to perhaps being more of a headwind. And do you think 107 will be the trough for 2023?

Kathryn Bueker^ Yes. A couple of questions in there, Gabriela, but let me give it a shot. I mean just maybe start with the facts, which is I shared in the prepared remarks that our net revenue retention in the fourth quarter was 107, which was down a little bit from Q3 but really very much in line with the expectations that we shared in Q3.

And I think you know, there's really 2 big components of net revenue retention. One is the gross retention or what we call customer dollar. And that's really hung in there very resiliently in that high 80s. The other piece is the net upgrade rate. And that includes a number of motions, some of that you are talking about, which are seat upgrades, contact-tier upgrades, edition upgrades, some cross-selling. And it's really that net upgrade motion that has been challenged in the economic environment as customers are both slowing the rate at which they are upgrading but also have a bit of a sharper eye on their overall spend with HubSpot.

And so we're seeing pressure both on the upgrade side and also on the downgrade side. And in the near term, we expect that, that pressure will remain. We actually think that net revenue retention is likely to tick down again in Q1. But we feel really good about our ability to hold net revenue retention above 100. Over the longer term, we continue to believe that we can deliver net revenue retention of 110 in any healthier macro environment.

Operator^ The next question comes from Rishi Jaluria of RBC.

Rishi Jaluria^ It's nice to see continued resilience in the business model. Yamini, I wanted to dig a little bit more into some of the momentum you're seeing with Service Hub post relaunch. What has kind of been the momentum you've seen so far? And really, importantly, when you think about the feedback that you've gotten from customers so far, are there any other kind of enterprise-grade features or functionality that need to be developed further in order to be more competitive against some of the incumbents like the likes of Zendesk? Or is that something that's already happening?

Yamini Rangan^ Rishi, thanks a lot for the question. Look, we're very excited about Service Hub. Last year was a pretty big year. We did relaunch, and there were a number of features that move the needle in terms of Service Hub, and we see that in the momentum in terms of the go-to-market.

Now I mentioned in the prepared remarks a little bit about multi-club momentum, a lot more 3- as well as 5-hub deals and customer wins that we're seeing. And part of that is the strength of Service Hub. And we are going to continue to focus on it. It's one of our strategic objectives in 2023 is to go deep in terms of leadership in Marketing Hub, Sales Hub and Service Hub.

And we are evolving to support workspace. We are going to be driving even more omnichannel service through improved calling functionality, knowledge base, SMS. The recent WhatsApp launch in Q4, that was a pretty big win. And we got a lot of positive feedback from our customers, and we're pretty excited to share more there.

As we do these things, we step back and listen, are we getting more multi-hub customers; are we delivering more value; and when the customers begin to use it, are we driving improved customer satisfaction. And for each of those questions in Service Hub, the answer is yes. So we're pleased with it, and it will continue to be a strategic objective this year to drive thought leadership within Service Hub.

Operator^ The next question comes from Alex Zukin of Wolfe Research.

Alek Zukin^ Congrats obviously on a solid quarter. I guess, if we think about the shape of the growth curve for '23 versus '22 from the standpoint of customer adds versus ASRPC, how has it changed given some of the momentum upmarket that you're seeing? Where -- would you expect it to be similar, slightly different?

And then I guess, just to clarify the comment on net revenue retention, expect to keep it over 100 in the short term but return to potentially 110, how -- what's -- meaning when does that trough? Like if you were to think about from a quarterly basis, is that -- is there comp that you'd get past where this activity started, meaning like as of 3Q of this year where you start to see that rebound? Or help us there a little bit.

Kathryn Bueker^ Yes. Thank you. I will try to hit all of your questions. I will do my very best. Let me just start with the revenue retention question. The short answer is, like I wish I knew. To me, it's very much tied to your view of the macroeconomic environment. And I think -- when I think about the areas of pressure on the net upgrade rate, they are very much tied to the external environment. And as we start to see that like solidify and recover, I think that's when you'll start to see net revenue retention recover.

I will then try to address your KPI question around ASRPC and net adds. I think you astutely noticed that things are shifting a little bit here. This is now our second quarter of really strong net customer adds at the low end. We are seeing really nice sign-ups of our free CRM. We're seeing the free CMS really resonate. And it's that sort of sign-up volume converting into our starter tier that is driving a real strength in net customer adds.

Now like -- as you know, there's push and pull across ASRPC and net customer adds when it's being fueled by that low end of our bimodal. And what you saw in Q4 is after a period of real strength at the enterprise that drove ASRPC up in the double digits in constant currency pretty consistently, we dipped below 10% in ASRPC growth. And that pressure that we're seeing from the success at the low end is going to continue into 2023. And we expect that ASRPC growth in 2023 is going to look more like low to mid-single digits.

Operator^ The next question comes from Arjun Bhatia of William Blair.

The next question comes from Michael Turits of Key Capital (sic) [KeyBanc Capital].

Michael Turits^ Congrats on everything, especially on the margins. So maybe I'll take that margin as a topic -- as an extension to Alex's question where you went with that, Kate. To the extent that you are more focused on adds as opposed to ASRPC as a driver, how does that impact the balancing act with margin expansion to the extent that you should be getting a lot of easy -- relatively easy leverage out of ASRPC growth, arguably less so out of cost of adds?

Kathryn Bueker^ Yes. I guess, maybe I'll just start by answering your foundational comment, which is like focusing on adds versus focusing on ASRPC. These are output metrics, and I think we've talked about this in the past. Like our goal is consistently to drive top line growth in ARR over time, not to drive growth in one or the other of ASRPC or new customer adds.

And when you see us consistently investing in that bimodal strategy, there's going to naturally be some periods of time where we have more expansion in ASRPC and more expansion in other times in net customer adds. And probably, that's just as the balance of new versus installed base sort of moves around.

The other question you had was around leverage, and I'm glad you asked. We provided guidance for this year that reflects our ongoing commitment to balancing growth and profitability. We delivered nice results in Q4 at a full year of 10% operating profit margin. And our guide implies another 250 basis points of margin improvement. Over time, we have the financial framework that shows and demonstrates our balance between growth and profitability, and we continue to remain committed to delivering against that.

Yamini Rangan^ Yes. I think like Kate hit on all of the points there. The one thing I would say is, as we think about this mid- to long term and especially as we think about our sales and marketing efficiency, look, we have product-led growth, it's sales rep growth and partner-led growth. And all of these are the input engines that then result in our net adds as well as ASRPC.

And as we think about each of these 3 things: product-led growth, we're driving more and more initiatives so we can get efficient; sales-led growth, we're driving more automation, more systems, more investments so we can make our reps even more productive; and partner-led growth, we talked about some of the changes that we are structurally making so that we can become even more efficient. And so as we think about how we balance growth and profitability, we have short-term initiatives and then we have medium-term initiatives, and we are really committed to balancing both growth and profitability.

Operator^ The next question comes from Brian Peterson of Raymond James.

Brian Peterson^ I'll echo congrats on the strong quarter. I'd love to understand on the multi-hub adoption and the success you're having there, is that more a function of the landing with more hubs and higher attach rates on starter tiers? Or where we've seen a lot of success on cross-sell as well, there's a lot of time kind of spend on the net down sell, but I'd love to understand what the cross-sell motion has looked like for net new in the existing base as I think that's obviously got a secular perspective there.

Yamini Rangan^ Yes. I think that's a great question. Look, I think we're seeing both multi-hub lands as well as strong cross-sells. And let me step back and maybe look at this from the customer perspective. As we talk to customers, a couple of things are becoming very clear. As they think about 2023, it is a lot about driving sales and marketing alignment. The handoff between marketing and sales has all has been tricky. Whose pipeline are you getting? And is this good quality of pipeline?

So if you think about customers, they want more needs, they want better campaign effectiveness, they want more activity tracking, and they want all of this to line up to growth from a sales perspective. And therefore, in our conversations, we see that there are more multi-hub starting points, more starting points with Marketing and Sales and Operations Hub, for example, in the initial sale. So that's happening within new land.

And then similarly, what we see is when our customer has adopted, for example, Marketing or Sales, and they see the value proposition of HubSpot, which is easy to use, easy to manage, driving adoption, then it becomes an easier conversation to have a cross-sell dialogue with the VP of Sales or the VP of Service. And so we do find that in the first year of HubSpot purchase, customers have a high propensity to kind of look at additional hubs and get the visibility across customer base. And so the combination of both of those lead to very healthy 3-hub as well as 5-hub wins from a customer perspective.

Operator^ The next question comes from Brad Sills of Bank of America.

Brad Sills^ I'll add my congratulations on a real nice finish to the year in a tough environment. Maybe if you could drill in a little bit on that same topic there, Yamini, where are you seeing these 3- and 5-hub deals where there's incremental strength across the stack? I mean Sales and Marketing, obviously, the core. It sounds like Service Hub is strong, CMS. Would love to get some color there. And anything on Payments? So just any incremental strength across the stack and these larger multi-hub deals?

Yamini Rangan^ Yes. Thanks a lot, Brad. Look, I think if you look at our performance in Q4, we're very pleased because it shows strength in upmarket, it shows strength in multi-hub, and it shows strength in our low-end adds of starter suite. And this is our bimodal strategy. Our bimodal strategy is we want to add volume of customers at the lower end. And as they scale and as they see value within HubSpot, they continue to upgrade to pro and enterprise tiers and get even more value from HubSpot. And that bimodal strategy working.

And in terms of which product areas are we seeing strength, certainly, Marketing and Sales are core front doors. And we are very pleased to see Sales Hub become a legitimate front door. A lot more conversations on tying Sales and Marketing, and that's an area that we've talked about. And when they buy Sales and Marketing and they want to deeply integrate and connect with other systems within the organization, Ops Hub comes in. And Ops Hub, we've talked about how it drives value from an integration perspective and providing and building on that reporting, and then Service Hub. So across all of our core hubs, we are seeing pretty good momentum.

In terms of commerce, now that's a longer-term bet. We are pleased with the levels of merchant activation as well as the transactions. It's early, early stages, and there's just a lot more to go. And as I look at our strategy this year, it's super clear. We want to go deep in Marketing, Sales and Service. And we want to continue to maintain the momentum that we have in commerce, and we want to do both of those by focusing on the bimodal strategy, which is working. I hope that gives you a little bit more color, Brad.

Operator^ The next question comes from Josh Reilly of Needham & Company.

Josh Reilly^ One of the interesting points I thought highlighted at the Analyst Day last year was the large mix of starter customers as a percent of total paying customers, which potentially is creating the kind of pent-up demand to migrate to pro and enterprise when the market recovers. How would you characterize the magnitude of the mix of customers postponing upgrades due to the macro today versus prior slowdowns? And is there a point in time where these customers need to migrate regardless of the macro? Or what have you seen in past cycles?

Kathryn Bueker^ Yes. It's an interesting question. Thanks for that. We do feel like the momentum in the starter customer adds is a great long-term strategy for us. In terms of what we're seeing today around starter upgrades, the newer cohorts that have started with us are actually upgrading at pretty healthy rates.

We took a number of actions last year to solve for the customer to really drive that volume that we're seeing at the lower end. We talked about things like bringing marketing automation down, introducing a free CMS. And we continue to experiment around pricing and packaging. All of that has resulted in like a nice expansion of the number of starter customers that are joining us. But at the same time, we watch those cohorts really closely to make sure that their usage and their upgrade patterns are consistent and healthy, and they are pretty consistent with what we've seen in the past.

Operator^ The next question comes from Keith Bachman of BMO.

Adam Holets^ This is Adam on for Keith. I wanted to dig a little deeper into the 2023 revenue guidance. So I hear your comments on Payments being relatively early still. But I think you previously commented that you expect contributions to growth next year for Payments. And then I know we have ongoing contribution from the margin kind of enterprise price hike. So I was wondering if we could parse out the benefits to each of those for next year.

Kathryn Bueker^ Yes. Thanks so much for the question. You're hitting on all of the details here. I would just say Payments, as we -- I'll reiterate Yamini's comments. Payments is early. We are investing for the long term in Payments. As I shared with -- at Analyst Day, it is not going to be a material contributor to our growth or profitability in 2023. On the Marketing Hub Enterprise price change, we continue to hear positive feedback on the change. Again, it is not a material driver of the results in 2023.

Operator^ The next question comes from Elizabeth Porter of Morgan Stanley.

Elizabeth Porter^ You talked a lot about deals taking longer and more scrutiny, which we're clearly hearing across the broader landscape. I was curious on what you're seeing just at the top of funnel and how the pipeline is shaping up. And anything we should look for outside of just macro factors to help us convert that faster in the medium to near term? I know you highlighted investments around sales and partners. Are these more tailwinds that are after 2023?

Yamini Rangan^ Yes. Elizabeth, great question. Look, it's very interesting. When we talk to customers, 2 things are happening at the same time. SMBs are deeply committed to digital. And it's -- there was a question about whether SMBs are going to thrive during the pandemic. There's a question about whether SMBs are going to survive this downturn. But what we find is that SMBs are committed to digital. They're continuing to build their businesses on digital. They're continuing to leverage digital solutions to be able to stay in touch with their customers. And I hear this in -- over and over in my conversations with customers. And we see this within the pipeline.

Now at the same time, what we've been talking about is that they want to understand value deeply. They want to buy a little bit more cautiously, and that translates into longer deal cycles. I think we, like everybody else, we're going to continue to monitor and continue to look at leading indicators as we go.

And how does that change our dynamic and how we have adapted our execution? I think a few things based on what we are seeing. We're leading with value. Every conversation is about value, about delivering quick time to value as well as the cost savings that our customers can see in terms of consolidating on the platform. And our sales teams as well as the partner organizations are enabled to have these conversations, and our value proposition really resonates. So for us, the go-to-market has really adopted.

And from a product perspective, we're in a place of strength. You just heard us talk about G2. In G2, we've been rated as #1 in marketing, #1 in sales. And we've become a platform of choice for mid-market companies and scaling companies that are looking at options. Whether they're driving productivity or they're driving cost savings, we are in those conversations.

So I feel even given the macro conditions, the combination of our product innovation as well as go-to-market execution positions us really strongly. And then overall, as we all expect me, at some point, this cycle, the economic cycle is going to turn. And so part of the focus in terms of the leadership team is how do we make strong and thoughtful decisions right now to position ourselves to emerge stronger when the cycle turns. So that's how we think about this year and then beyond.

Operator^ The next question comes from Michael Turrin of Wells Fargo.

Michael Berg^ This is Michael Berg on from Michael Turrin. Congrats on a great quarter. I wanted to double-click on the margin seasonality you laid out on your -- earlier in the call. When I'm thinking about the back half of this year, is there any benefits from the real estate consolidation that's baked into that number? Or are those benefits expected to be seen beyond 2023?

Kathryn Bueker^ So thank you for the question. There -- the benefits of the restructuring will accrue to the business in Q3 and Q4. As you know, we tend to have seasonally stronger back half margins anyway. There is some amount of real estate benefit in the back half of the year. And the benefit from the workforce reduction is spread pretty evenly across those quarters.

Operator^ And our final question will come from the line of Arjun Bhatia of William Blair.

Arjun Bhatia^ Yamini, maybe one for you, just going back to the restructuring a little bit. I'm curious if there is any impact to the product road map to the launch of new hubs as a result of the restructuring or if this was purely focused on maybe more support-type roles? How should we see that impact playing out?

Yamini Rangan^ Yes. Good question, Arjun. Just to kind of share some perspective of how we thought about this, we've mentioned this a couple of times, this was not short-term costing decision. This was a strategic realignment of our investment so that we can drive long-term innovation as well as scalability within the organization.

So as we step back, we look across the company on how best to align our people, resources to our strategy so that we can emerge stronger from this economic cycle. And the fact is we have teams with excess capacity like recruiting and services. And those were the areas that we pulled back aggressively. We also looked at areas where there was duplicate work and opportunities for us to be much more efficient.

Now throughout the process, we were very careful about protecting product innovation as well as direct quota-carrying roles. And in fact, as we've said a couple of times, we are reinvesting in areas of product as well as internally so that we can drive scalability. So we feel very good in terms of our strategic objectives and ability to continue to fuel the pace of innovation that we have had.

Operator^ And with that, we will conclude our question-and-answer session for today's call. I would now like to pass the conference over to the management team for closing remarks.

Yamini Rangan^ Thank you so much, everybody. We really appreciate your support. A huge thanks to HubSpot employees, customers, partners for their resilience as they've navigated all of these times. Look forward to talking to you all next quarter.

Operator^ And with that, we will conclude today's conference call. Thank you for participating. You may now disconnect your line.