HubSpot Q322 Earnings Call

Wednesday, 02 November 2022

Chuck MacGlashing Thanks, Operator. Good afternoon and welcome to HubSpot's third quarter 2022 earnings conference call. Today we'll be discussing the results announced in the press release that was issued after the market close. 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 forward-looking within the meaning of Section 27A of the Securities Exchange Act of 1933, as amended, and in Section 21E 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, expected growth, FX movement and business outlook, including our financial guidance for the fourth fiscal quarter and full-year 2022 and 2023.

Forward-looking statements reflect our views as of today and as accepted and 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 our Form 10Q which will be filed with the SEC this afternoon for discussion of the risks and uncertainties that could cause actual results to differ materially from expectations.

During the course of today's call we'll refer to certain non-GAAP financial measures, as defined by Regulation J. The GAAP financial measurements 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 third quarter 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 Rangan Thank you so much, Chuck, and welcome to everyone joining us on the call today. Q3 was another solid quarter for HubSpot, with revenue growing 38% year over year in constant currency. We added over 8,000 net new customers in the quarter, growing our customer base to nearly 160,000 globally, representing 24% growth year over year. These strong results reflect our focus on innovation and execution. Our connected platform is clearly driving value for customers, especially as they look to increase efficiencies while lowering the total cost of ownership during this period of uncertainty.

HubSpot continues to be a mission-critical platform for our customers as they depend on us to stay connected with their customers. On the last call I spoke about the launch of CMS Free and moving marketing automation down into our starter tier. These plays, combined with our focussed go to market initiatives, drove strong customer adoption and multi-hub momentum in the quarter. Before I get into some of the trends we're seeing in the business more broadly, I want to reflect on a recent milestone for HubSpot which was our Annual Inbound Event in September.

This year, as you know, we hosted Inbound in-person in Boston as well as online and had tens of thousands of attendees from all over the world join us. It was truly a week to remember with incredible speakers and fantastic opportunities to connect with our customers, partners and community. I know many of you attended as well, so thank you, again, for joining us. I left Inbound feeling more energised than ever about HubSpot's future. Through my conversations with customers and partners, it's become even more clear that we are well-positioned to drive long-term durable growth.

And there are three key reasons for this. First, we have a unique opportunity to help our customers with solving the crisis of disconnection. I spoke at Inbound about the crisis our customers are facing as a result of disconnected systems, disconnected customers and disconnection from their peers. To solve this crisis, our customers need to be able to seamlessly connect their data, connect with their customers and with each other, all in one place. That's exactly what we have been building at HubSpot with our connected customer platform.

We can already see the value customers are getting from being able to connect their entire front office. For example, take Growthlab Financial, a financial services company. Their growth was limited by disconnected tools and a legacy CRM platform. Without a central platform, their team spent hours manually tracking process and didn't have the insight they needed to optimise their growth. They consolidated onto the HubSpot CRM platform with marketing hub, sales hub and service hub. Growthlab now uses automation to boost conversion and shorten deal cycle and leverage the CRM data to get insight on revenue attribution, so they can make more data-driven decisions.

Since implementing HubSpot, Growth Lab Financial doubled their revenue and saved a significant amount of time eliminating manual tasks. This is just one great example of how scaling companies can grow better with HubSpot's connected CRM.

The second reason we are well-positioned is that our market opportunity is large, expanding and underserved. We operate a massive underserved market that is forecasted to grow to over $70 billion by 2027. Within this market, we have multiple levers to drive durable long-term growth. Our Land and Expand motion is working with the majority of our customers trying our free products before purchasing and our pathways for expansion have diversified with the breadth and depth we have added in our products.

We are also launching into new product categories, like payments and commerce, which will continue to open up new avenues for future growth at HubSpot. Even in the weeks since Inbound, we have a number of new exciting features in Private Data, including payment schedules and native invoicing. We're encouraged by the long-term opportunity to help B2B companies transform their buying processes and sell easily online.

Finally, our product innovation is cranking. We announced over 80 new product enhancements at Inbound to meet our customers' evolving needs and help them optimise for connection. Two product highlights where our new campaigns stood out are tools and customer journey analytics. Both are crafted to give businesses a more unified view of their customers' experience and bring data together for deeper insights. We're thrilled to see the positive feedback from data so far. As we look ahead, we are focussed on maintaining this pace of innovation so we can drive even more value for customers and emerge stronger as the connected platform of choice for the mid market.

I am energised by the opportunity we have, to solve the crisis of disconnection for our customers, serve mega markets and continue to drive the pace of product innovation in order to set ourselves apart. Next, I want to talk about the demand environment we see today and reiterate our playbook for managing through it. Last quarter I talked about the demand trends we were seeing in the business through the end of July, including a lengthening of deal cycle and more decisionmakers involved in deals. Since then the macro environment has become incrementally more challenging. We see two clear trends in this environment based on our customer and prospect conversations.

On the one hand, deals are taking longer to close. There are more decisionmakers involved, more approval layers and budgets are tighter. We continue to see this across the geographies and segments we serve. On the other hand, HubSpot is emerging as a platform of choice to help customers get through these uncertain times. Our customers need more leads, better conversion and better customer experience, but they need to do it all with less. Our value proposition of easy to buy, easy to use and easy to build resonates even more now as customers are looking to consolidate their tech staff.

Despite the softer macro environment, I'm confident in HubSpot's playbook for resilience growth through the cycle. Our playbook is based on three core principles that served us well during the pandemic and, again, through the macro volatility this year. We talked about these principles last quarter but they are worth repeating. The first is solve for the customer. Even during uncertain times, one thing we're certain of is that solving for the customer is good business.

What that means right now is that we're helping customers understand the value of consolidating onto a connected platform and the impact it can have on their total cost of ownership. We are also providing even more functionality at the lower end. We moved high value features, like marketing automation, down to starter and helping early stages businesses get online with free CRM and CMS. These players are resonating with our customers and you can see it in our results.

Second, we will continue to invest in innovation to emerge stronger. We're being more prudent with our hiring as well as discretionary spend but remain committed to investing in innovation. In fact, we're so thrilled to see that our product investments resulted in HubSpot being recognised as a leader in the magic quadrant for B2B marketing automation platforms by Gartner this past quarter. Moving forward, we'll continue to invest in innovation and functionality to help scaling companies optimise for customer connection.

Lastly, we execute with focus. For us, it is all about controlling the controllables. We're focussed on driving expansion through cross-sell and upsell motions and the percentage of ARR from customers with three-plus hubs grew nicely within this quarter. We're executing on our bimodal strategy with strength in both net customer additions at the lower end and momentum among larger customers driving double-digit AFRPC growth. And we're continuing to balance growth and profitability through more measured hiring and tighter control of discretionary spend.

Heading into the end of the year, I feel energised. We have a clearer opportunity ahead to drive value for our customers, our teams are focused on execution and we have the right playbook in place to drive growth in this uncertain environment. With that I'll hand it over to Kate.

Kate Bueker Thanks, Yamini. Let's turn to our Q2 2022 financial results. Third quarter revenue grew 38% year over year in constant currency and 31% on an as reported basis. Q3 subscription revenue grew 32% year over year whilst services and other revenue decreased 13% on an as reported basis. Domestic revenue grew 33% year over year in Q3 while international revenue growth was 44% in constant currency and 29% as reported. International revenue represented 46% of total revenue in Q3.

We added over 8,000 net new customers in the quarter, bringing our total customer count to nearly 160,000, up 24% year over year. A big driver of the strength this quarter was customers adopting the Starter CRM Suite as HubSpot continues to emerge as a platform of choice in times of certainty and uncertainty. Our subscription revenue per customer grew 12% year over year in constant currency and 7% on an as reported basis to $11,200. The primary driver of this strength continues to be professional and enterprise customers adopting multiple products.

Despite the more challenging macro environment, we maintained a healthy growth retention rate, in the high 80s, as customers look to HubSpot's platforms to drive increased efficiencies. Net revenue retention was 109% in Q3, down quarter over quarter as a result of slower net upgrades, particularly in the marketing contact and fee expansion motion. Deferred revenue, as at the end of September, was $474 million, a 26% increase year over year. Cash-related billings were $444 million in Q3, growing 34% year over year in constant currency and 26% as reported.

The remainder of my comments will refer to non-GAAP measures. Third quarter growth margin was 82%, up two points year over year. Subscription growth margin was 85% in Q3, while services and other gross margin was negative 49%. Third quarter operating margin was 9%, including a 1 point margin headwind from the impact of foreign exchange. Net income in the third quarter was $35 million or 69 cents per fully diluted share.

At the end of the third quarter, we had over 7,400 employees, up 35% year over year and down six points sequentially. We expect our hiring to moderate further in Q4 and to exit the year with headcount growth in the mid to high 20s. As we discussed last quarter, hiring for the remainder of the year will be focused in R&D and revenue-generating sales headcount. Capex, including capital on software development costs was $25 million or 6% of revenue in Q3, and free cash flow in the quarter was $36 million or 8% of revenue. Finally, our cash and marketable securities totalled $1.4 billion at the end of September.

And with that let's review our guidance for the fourth quarter and full year of 2022. As Yamini has described in her remarks, the macro environment has become incrementally more difficult through October. It's taking customers longer to make decisions, causing deal cycles to elongate. There are more people involved in the approval process and budgets have tightened. Our guidance assumes that these weaker macroeconomic conditions persist through the remainder of the year.

For the fourth quarter, total as reported revenue is expected to be in the range of $444 million to $446 million, up 20% year over year at the mid point. We expect foreign exchange to be a nine-point headwind to as reported revenue growth in the fourth quarter, representing an incremental $4 million headwind, relative to our previous forecast.

Non-GAAP operating income is expected to be between $47 million and $49 million. We expect foreign exchange to be a two-point headwind to operating profit margin in the fourth quarter. Non-GAAP dilute net income per share is expected to be between 82 and 84 cents. This has given us 51.2 million fully diluted shares outstanding. And for the full year of 2022 total as reported revenue is now expected to be in the range of $1.705 billion to $1.707 billion, up 31% year over year at the mid point.

We expect foreign exchange to be a six-point headwind to as reported revenue growth for the full year of 2022. Non-GAAP operating income is now expected to be between $152 million and $154 million. We expect foreign exchange to be a 1-point headwind to as reported operating profit margin for the full year of 2022. Non-GAAP diluted net income per share is now expected to be between $2.48 and $2.57. This assumes 51.1 million fully diluted shares outstanding.

As you adjust your models, keep in mind the following. We continue to expect capex as a percentage of revenue to be roughly 5% and now expect free cash flow to be about $195 million for the full year of 2022, reflective of the incremental headwind from the strengthening of the US dollar relative to our prior forecast. While it's too early to provide formal guidance for 2023, given the material moves in foreign exchange rates this year, we thought it would be helpful to quantify the impact of foreign exchange on 2023 revenue.

At current spot rates, we expect a four-point or $70 million headwind to as reported revenue growth for the full year of 2023. And with that I will hand things back over to Yamini for her closing remarks.

Yamini Rangan Thank you so much, Kate. I want to close by emphasising that HubSpot is operating from a position of strength. We have built a robust connected customer platform that is meeting the evolving needs of our customers. We have a strong balance sheet and an incredible team and company culture that allows us to attract and retain top talent. We're thrilled for HubSpot to be ranked number one in employee happiness among top-rated large companies by Comparably just last month. Our culture and people continue to be a competitive advantage for HubSpot.

Looking ahead, we will continue to adapt to the realities of the environment without losing sight of our mission to become the number one CRM platform for scaling companies. Thank you so much to our customers, our partners, our employees and shareholders. With that, Operator, let's open up the call for questions.

Operator Thank you. If you would like to ask a question at this time, please press star, then one on your touchphone keypad. Please could I ask you to limit yourself to one question and one follow-up to allow all investors to speak on today's line? The first question we have comes from Brian Peterson of Raymond James. Your line is now open, Brian.

Brian Peterson Thanks for taking the question and congrats on the really strong quarter. So, really taking a step back here, Yamini, we've heard from a number of companies that the macro got incrementally worse over the course of the quarter. It sounds like that was the case for HubSpot as well. Would appreciate any colour on what changed and how you're thinking about the macro impacting the fourth quarter guidance.

Yamini Rangan Thanks a lot, Brian, for the question. Yes, we are seeing many of the same trends in our customer base that we saw in Q2. It was just a bit more intensified in Q3. We saw the longer deal cycle that we talked about in Q2, we saw more decisionmakers getting involved on deals and more approvals needed. Typically we would talk to the VPs of marketing sales for approval, now we're talking to the CFO, CEO and sometimes even the Board. Product evaluations are taking longer as buyers are generally much more risk-averse and budgets are tight now.

So, look, I think we are seeing a lot of things that are very much in line with what you've heard from other companies this quarter. The overall environment is just incrementally more challenging than it was in Q2. So, having said that, Brian, we continue to win and our value proposition resonates really well in this environment. Customers want a clear value case and they want a clear business case for driving growth and efficiency.

So, we're working with our champions, we're working with our point of contacts within customers to be able to articulate the business case and then we're able to present to the C suite and Board. Our customers want ease of use and ease of implementation because the combination of those two lead to value and that's what matters in this environment.

Now, both of those, ease of use and ease of implementation, they've both historically been core differentiators in the past and continue to be a differentiator now and it's really important in this environment. And then finally I'd say that customers are looking to standardise on a platform. They're looking to eliminate point solutions. They're looking to reduce their budgets and they're looking to us to be able to bring more data and have a single platform. We're now no longer a nice to have solution, we're just becoming a must have mission-critical solution for our customers.

So, all of those are resonating within our customer base and you can see that within our results. Now, look, looking forward, I don't have a crystal ball but we expect these conditions to persist in Q4 and possibly even into 2023. We're navigating through all of these choppy waters from a position of strength and we will remain exceptionally focused on executing the playbook that I just walked through.

Brian Peterson Great, I appreciate the colour. Maybe as a follow-up, in particular with the value of the platform, were there certain products on top of marketing that you saw particular strength in the quarter within the sales hub or the service hub in order to understand maybe where the cross-sell was really successful this quarter? Thanks.

Yamini Rangan Yes, Brian, I think the combination of marketing and sales is becoming exceptionally more important right now. When I talk to customers, they are expecting much more from their marketing and sales organisation. They're expecting more leads, better lead quality, better conversion, better visibility into the pipeline and they want all of this for less, and that means we're definitely seeing the value of having a connected marketing and sales hub solution. That's what is really key within our customer base and so when we talk about multi-hubs, most of our multi-hubs have sales hub and marketing hub involved, and we're helping our customers navigate through this environment as well.

Operator Thank you. The next question we have from the phone lines comes from Mark Murphy with JP Morgan Chase. Your line is now open, Mark.

Mark Murphy Yes, thank you very much. I'll add my congrats on the execution in a tough environment. So, I wanted to ask you, as you're building out these more sophisticated enterprise features, we'll start off with custom objects, can you share perhaps how some of the upper thresholds are changing for HubSpot if we think about the upper bands for MRR or even just the seat counts for sales hub as you gravitate into the enterprise. Mostly what I'm wondering is do those continue to increase even despite the macros that you are encountering?

Yamini Rangan Mark, thanks a lot for your question. Look, some segmentation strategy, we're very much focussed on the 2 to 2,000 segment. So, for us the upper balance of the segment continue to be 200 to 2,000 employee company. We're winning our fair share within this market and, as you rightly pointed out, over the past couple of years we have invested, going upmarket with teachers, like custom objects.

At Inbound we announced more than 80 new enhancements and features across the entire platform and a number of these enhancements in teachers were really driving better UI customisation, better data management, advanced permissioning, granular ability for admin to control the environment. So, a lot of the features have enabled us to win our fair share going upmarket, and in this environment one of the things that we see is customers, as I just talked about, care about better visibility.

But they also care about better time to value and cost-effective solutions, so going back to, really, the fundamental value proposition of HubSpot. We're easy to use but we have very powerful features and that makes us exceptionally competitive in that upmarket. So, we're remaining true to the segmentation and winning our fair share of that market.

Mark Murphy I understand, thank you, Yamini. And just as a quick follow-up, I was wondering if you or Kate could just clarify… Because I think we're trying to maybe understand somewhere in the results where we would see some of the signs of incremental strain but just based on what you saw, are you trying to convey that the months of September and October did, in fact, feel a bit tougher, say, than July and August in terms of the friction in the selling cycles? Because I think that's generally what we're hearing elsewhere.

Yamini Rangan Yes. To be very clear, what we saw in Q3 was just an incrementally more challenging environment than what we saw in Q2 and specifically budgets are tight and every approval is being carefully considered and because of that the approval processes are longer. Customers are spending a little bit more time getting value chains delivered to their C level for approval and sometimes even going to the Board. So, we're continuing to see that pressure.

We're also seeing the need for a crystal clear plan to deliver value, which means more time to understand implementation plans, user option plans, more time to understand the training plans and all of this means that there is just a lot more rigour, more demos and more conversation. So, we definitely are seeing incrementally more challenging environments from a macro perspective.

Having said that, like we talked about, we have put in some plays from being focussed on the customer and those plays continue to work at the bottom end, which is where you see the strength in net ads and our multi-hub value proposition is resonating. And so we'll continue to work through this tough environment.

Mark Murphy Excellent, thank you very much.

Operator Thank you. We now have Samad Samana from Jefferies. Please go ahead when you're ready.

Samad Samana Hi, great, thank you, and I'll just echo great work and focus by the whole organisation. That's all HubSpotters, great job. Yamini, maybe a first one for you. I know you talked about the macro getting incrementally worse, longer cycles, more approval but what you didn't mention is a change in the top of the funnel or maybe inbound interest. So, could you shed some light on are you seeing any changes in terms of the customers that are reaching out or coming into the top of the funnel and just interest levels? Maybe is that even upticked because you had Inbound in this quarter? Maybe just to understand what you're seeing at the top of the funnel versus just in terms of the deal closings or the cycles.

Yamini Rangan Samad, thanks a lot and I will double down and emphasise, I think, congratulations to the entire company, both in the product and flywheel and the entire company, for executing in a very tough macro environment. Look, on the demand side, if you consider a year ago, it was primarily all inbound. So, there was a lot of people raising hands and coming to us, mostly qualified, and so it was fairly quick to take that kind of a qualified lead and convert it into a customer win. What we are beginning to see is that that level of inbound has changed and right now it's a combination of that and our customer success being our sales organisation going to customers and going to process and having conversations about HubSpot.

So, it's a combination of people raising their hands and coming to us and that part of it has slowed down a little bit, so it's us going back to our installed base and having conversations on how we can add more value. So, certainly from a demand perspective we see a pretty big shift from last year and somewhat of a shift from the first half of the year. Having said that, what I think is like there's just a higher bar to action within the pipeline.

There's more conversation, more approval and more demos that are needed to get to action and so the way I would characterise it is demand has slowed. We've compensated it by going out and proactively having conversations with the customer base and it takes much longer for us to close and we continue to be very, very focussed on executing in this environment.

Samad Samana Very helpful. And maybe, Kate, if I just ask a quick follow-up. I wanted to make sure… I think you said a four-point FX headwind is where you stand today for 2023 revenue. One, did I hear that correctly and, two, is that the level that you had assumed when you gave the flat margin guidance at the Analyst Day or should we rethink that as well?

Kate Bueker Yes, thanks for asking. I do think it's a really important point for us to communicate. As you know, foreign exchange has been one of those things that has moved pretty dramatically throughout 2022 but, frankly, even within the back half of Q3. So, you are right, given current foreign exchange rates, we would have a four-point headwind to 2023 revenue growth and that's about a $70 million nominal headwind.

If foreign exchange did get harder in the last couple of months, you heard us talk about our Q4 guidance as having an incremental $4 million of headwind relative to the last time we guided, you should assume that 2023 saw similar trends to that.

Samad Samana Okay, thank you so much.

Dharmesh Shah As far as the 8% margin that we talked about at the Analyst Day, it did incorporate where we extend to that.

Samad Samana Okay, thank you for clarifying. Have a great day.

Operator Thank you so much. We now have Arjun Bhatia of William Blair. Please go ahead when you're ready, Arjun.

Arjun Bhatia Yes, perfect, thank you for taking my questions and my congrats on the quarter. Understandably, as more buyers and more approval levels get involved in the process, it creates a tougher selling environment, but you did mention that you're getting a little bit more exposure, higher end organisation to the C suite, to the Board. What does this do for HubSpot in your ability to paint yourself as a more strategic partner to make a broader platform sale to maybe buyers that you didn't have access to as much in prior years? And how equipped do you think that the whole team is to make that pitch to those higher level buyers at this point?

Yamini Rangan Yes, really good question. Certainly more CEOs, CFOs, CTOs than we have dealt with in the past, and while the conversations take longer, they are really good conversations. The way I'd characterise it is that when we talk to the C suite within our customer organisations, there are few things that matter to them. First is time to value. They really care about how quickly they are going to get to value and how their teams are going to feel the impact and so part of it is us having a clear articulation of value as well as cost savings to the C suite.

The second is really talking about the value of a consolidated platform. Over the past couple of years a lot of these companies have ended up buying disconnected point solutions and that's costing them. And so when we have conversations with CEOs and CFOs, we talk about how we can help them with eliminating some of these point solutions and consolidating and seeing the value of a consolidated platform, and that certainly resonates.

Now, on the second part of your question, this has meant that we've doubled down on enablement for our sales teams, for our customers sales teams as well as the partner organisation. We have rolled out TCO playbooks as well as value playbooks so that they can bring these conversations earlier in the sales process. They can proactively talk about how we can help them get to time to value as well as cost savings and that part of the enablement is something that they're doubling down and we're doubling down in terms of execution as well. So, absolutely see all of those within the pipeline.

Arjun Bhatia Okay, perfect. And then the other part, your new customer adds actually picked up and this was something that we're not seeing, I think, with your peers where new customers have seen greater headwinds. I'm curious, as you look at that new customer cohort that's coming in, are you seeing more replacement opportunities even in that Starter CRM Suite where customers are wanting to rip out existing solutions versus more of a greenfield opportunity that you may have seen in the past?

Kate Bueker Yes, thanks for the question. Maybe I'll dive in. You are right, the net adds for the quarter came in a little better than we had even expected and where we saw the strength was really at that starter tier, particularly in the Starter CRM Suite. These are not customers that typically are ripping and replacing. These are customers where HubSpot is the first tool that they are largely using. And there are a couple of things that we think really contributed to the strength this quarter. Yamini talked a little bit about them but you may remember, we took a bunch of actions last quarter that were really customer first in nature that leaned into the value proposition at the starter tier.

One is that we added automation to market hub starter. We launched CMS Free at Inbound and we continue to experiment on pricing and packaging in that starter tier. And it's really the combination of these three actions that we believe drove the increase in net customer additions quarter over quarter. It's not something we solved for as an output. Our goal is really to drive both long-term and short-term growth in the business but this quarter the plays that worked really drove customer additions and really focussed customer additions at the low end.

The one thing that I would just add about that, there's two pieces of the KPI equation. One is the net customer additions, the other is RPC, and so when you see really strong quarters like this one in terms of net customer adds, particularly at starter, what you're going to see on the other side is a little less strength in the ASRPC growth and as a result what I would encourage you to see in a Q4 is that ASRPC will likely be more like 10% in constant currency.

Dharmesh Shah And one thing I'd like to add, just on that starter tier, is that obviously it's nice to have revenue from those 8,000 new customer adds but the other way it helps, and that's part of our bimodal strategy, which is as we get more and more customers, it helps with our brand and word of mouth, which has been a strong driver of growth for us historically. The second piece is that we're looking to build a CRM platform at the de facto standard in AFMB and the more customers we have, the more attractive the platform is for third party applications to build on, for solutions partners to partner up with our customers. So, it's a net positive all around but that starter tier has been a really strong driver for us.

Operator Thank you. The next question comes from Rishi Jaluria from RBC. Please go ahead, Rishi, your line is now open.

Rishi Jaluria Wonderful, thanks so much for taking my questions. Nice to see continued execution in spite of the macro. I want to go back to the commentary about the opportunity to consolidate point solutions. I think that makes a lot of sense in theory. I was wondering if you could point to any examples of that sort of behaviour that you've already seen and if there are particular areas within the more tech stack or within CRM that you're already seeing that sort of interest from existing customers. And then I've got a quick follow-up.

Yamini Rangan Yes, Rishi, the elimination of point solutions is a place where our customers look to as their budgets get super constrained and, again, an example in the prepared remarks of one of our customers consolidating, there are many more like that that we're having conversations. We have a ERC software solution organisation in North America that we're using multiple tools for marketing as well as sales efforts and all of that was extremely manual siloed, and so they looked to us and over a period of time we had multiple conversations and initially started with marketing hub and then extended to marketing and sales and eliminating six tools as we were looking to help them consolidate their go to market stack.

And so that led to not only just improved marketing efforts but also reducing their overall sense. So, a number of customers… Now, I'm not seeing that these are easy, I'm not saying that these are quick because that's not happening within this environment but when we start with either marketing or sales, we do have the opportunity to engage with our customers strategically and talk about the entire stack and how we can help them consolidate their stack.

Operator Thank you. We now have Alex Zukin of Wolfe Research. Please go ahead when you're ready.

Alex Zukin Hey, guys. So, just maybe two numbers questions from me. I guess I want to understand, given the commentary on the incremental macro and demand environment, which doesn't seem to be denting gross retention today, I guess how do we think about your assumptions for growth retention for Q4 and also net revenue retention, that 109? Does it go down and then stabilise at some notional level when we think about Q4 and beyond?

And then on the margin side, is it fair to assume you're reiterating the margin guide you gave for 2023 at the Analyst Day. Just remind us how you think about that balance of growth and profitability, again, in the context of the first question, if you do continue to see the macro deterioration, what are the levers that you have for next year?

Kate Bueker Yes, why don't I start and then Yamini, to the extent that you have comments to add, please don't hesitate to dive in. You're right, Alex, I shared in the prepared remarks data points for both growth and net retention this quarter remained in the high 80s. Net revenue retention fell to 109 and that was as a result of really lower net upgrade motions from that growth retention. We've talked about this. We talked about it on the last earnings call. We talked again about it at Analyst Day, that we thought we would see pressure on that net revenue retention in the near term, really as a result of macro environment factors, the difficulty that we're seeing there. And so I would expect that you would see Q4 net revenue retention continue to be pressured for all the same reasons that we are seeing in Q3.

I think the good news in all this is that we have seen the customer dollar retention really stick in the high 80s into Q3 and again into October. Our customers are staying with HubSpot. They are doing things to optimise, like cleaning up contacts and eliminating new seats. They're upgrading seats at potentially a lower rate but we think that it puts us in a really nice position as we start to see the economy turn to really lean into that growth with a recovery. Over the long term, we still feel good about 110 plus but, to your question, in Q4 we think net revenue retention will continue to be pressured.

And then on your margin question, as it relates to the 2023 margin that we talked about at Analyst Day, look, if I just take a step back, I think that about 2023 as having a few things that are really driving the margin profile for the year. The first is we hired pretty aggressively in 2021. We hired pretty aggressively into the first half of 2022 and we want to realise the productivity efficiencies of these hires but when you think about 2023, you're going to see a full year of the cost associated with that hiring.

The second thing that I would say is we have actually pulled back pretty significantly and taken a number of steps to reduce hiring in the back half of this year and reduce overall discretionary spending in things like TNE and facilities and we're going to continue to do that as we move into 2023.

And then, finally, we talked a little bit about foreign exchange and the impact on 2023. There is real FX headwind to operating margin. It's about a point in this year, 2022. It's an incremental point in 2023. And so if I step back and think about all of those things, we're taking a bunch of actions to be really prudent in our spending, and we're going to continue to do that into 2023. But we will retain investment in certain areas, like R&D and revenue generating headcount to preserve growth, both in the near term and long term.

So, all that said, we said 8%. We're committed to delivering 8% and we will share very specific guidance with you when we announce our Q4 results.

Operator Thank you. As a reminder, if we could ask all questioners to limit yourself to one question moving forward. We have the next question from Gabriela Borges of Goldman Sachs. Please go ahead when you're ready.

Gabriela Borges Good afternoon, thank you. One clarification on the earlier demand comment. Is the rate of change still getting worse in 4Q or is it stable at the new lower demand level? And as for my question, I wanted to ask about the earlier comment on restricting demand from more of an inbound-looking to a HubSpot drive mission. What are the implications for costs and acquisition cost longer term? Do you think that this dynamic is more temporary or structural in nature? And what I'm looking to understand as well, is it cheaper for HubSpot to sell or to acquire $1 in the installed base or in the new customer lines? So, a couple of things in there but I'd appreciate the colour. Thank you.

Yamini Rangan Gabriela, multiple questions there. I'll try to answer those and I'm sure Kate can jump in there as well.

Gabriela Borges Thank you.

Yamini Rangan In terms of the demand, we did see an incrementally more challenging environment from a demand perspective in Q3 than we saw in Q2. It's a new level. It's not getting worse. It is an incrementally more challenging demand environment than Q2 and all of the things that we talked about. More conversation, more time to get approval, more demos, all of that adds to the incrementally challenging environment. And when I talked about last year, almost everything that we did was just inbound where we had customers coming in, raising their hand, coming to us, wanting digital transformation.

Right now that is not the kind of tailwind that you can hear from all of the macro commentary from even other peers within the industry. It's a combination of some of the inbound demand, the digital trend is continuing, but it is meagred by the cyclical macro trends. And so partly our teams have to go engage with our customers and identify opportunities for them to save costs or control data on a platform or continue on their digital journey.

Yes, I think it's cyclical in nature. I think it's based on what is currently happening from a macro environment perspective and the overall structural need for digital and the belief that our customers have in digital transformation have not changed. Kate, do you want to add anything on the lateral part of that question?

Kate Bueker Yes. Why don't I do that? I think, Gabriela, what I really tried to communicate during Analyst Day is that we have a number of different motions to acquire new customers and we are continuing to make investments in all of those motions that we think are over the long-term going to drive real leverage on the sales and marketing side. So, we talked about a number of them at the Analyst Day.

We're investing in data and systems that are really designed to improve efficiency. That helps a lot of this outbound motion that Yamini is talking about. We're continuing to invest in our product-led premium motion. We have been doing that for a number of years and we still think there's a lot of runway there. And we're investing in non-linear growth opportunities like commerce. And so all of those are long-term vests for us that will take time to impact the P&L but will openly drive nice leverage in our go to market.

In the more near term, we do have a number of plays that are focussed on driving increased productivity in the sales organisation. Again, Yamini talked about a number of these. We have invested pretty aggressively in sales enablement. We're arming both the sales teams that offer our customer success teams the TTO playbook that really help them engage customers in a relevant way at the moment. We're leaning into the partner channel that's always been a successful channel and it's even more important when we see from upmarket more complicated, multi-product deals. And we're really looking at our own marketing organisation to drive efficiencies in top of funnel demand investment. So, all of those things, we believe, can translate into higher sales productivity, even in this more difficult environment.

Operator Thank you. The next question comes from the line of Keith Weiss from Morgan Stanley. Please go ahead when you're ready, Keith.

Keith Weiss Excellent, thank you, guys, and thank you for taking the question. Really nice quarter in an environment that everybody on our side of the fence were definitely quite worried about, given the macro shrink that we're seeing. In particular, where we're most worried has been Europe. And I was wondering, one, if we could kindly get your guys' perspective on trends in Europe versus the US. I know you guys talked about Europe a little last quarter. That incremental weakness, has that spread into the US more so? Because your international growth was strong this quarter on a constant currency basis.

And then, two, when you're talking about these macro impacts, it sounds a lot like it's new customers coming in the door. The new customer count was good. Am I misunderstanding that? The elongation of sales cycles, is that on upsells as well as it bringing new customers in the door or where did that really rear its head? Thank you.

Yamini Rangan Yes, let me answer the first one and then maybe Kate can answer the second part. So, international revenue grew 44% in constant currency in Q3. That's pretty good in a macro environment like this. As we mentioned before, even starting in Q1, and certainly in Q2, the trends for longer deal cycles started in EMEA but, however, what we're seeing now is the macro environment is just draw-based. We're now seeing those trends starting in all segments and all geos. So, really not a notable difference in EMEA versus North America for now.

Keith Weiss That's helpful, thank you.

Kate Bueker You cut out a little bit and I think you were asking whether or not elongated deal cycles were seen across both new customers and existing customers.

Keith Weiss Exactly.

Kate Bueker The answer is we're seeing elongated deal cycles everywhere and so there isn't anything that I would necessarily call out, other than what Yamini has already talked about, which is the broad action is just higher across the board.

Keith Weiss Got it. So, when we see your new customer count actually improving nicely in this quarter despite those elongated deal cycles, is it a difference in kind? Is it the starter edition and the experimentation you're doing there enabled better new customer additions at the low end but the higher end stuff is where you saw the longer deal cycles?

Kate Bueker You are exactly right. The investments and experiments we're doing at the low end with our premium motion and product-led growth are the key drivers for our quarter over quarter uptick in our new customer additions.

Operator Thank you. We'll now have a question from Brad Sills of Bank of Americal Merrill Lynch.

Brad Sills Great, thank you. I wanted to ask a question around service hub. It's a big category and one where you've made a bit step forward with the new release earlier this year. Just curious, is there a different sales audience here versus sales and marketing versus support, particularly as you go upmarket, or is it that platform sale here where you're already in sales and marketing, you've got that warm lead. Just curious to get your thoughts on just the adoption curve for service hub versus sales and marketing at your end of the market? Thank you.

Dharmesh Shah Yes, thanks for the question. So, as you noted, last quarter we did a relaunch of service hub with a bunch of really pivotal features, including SLAs and mobile help desk and inbound calling. And that's really going to open the door for more sophisticated service teams to be able to implement service hub. And to get to your question, what's happening now in service hub, we asked ourselves post launch, are more people buying service hub, are they adopting the feature set more readily, are they happy with the product, and the answer to all those questions is, yes.

So, we're overall happy with where service hub is headed. But right now we're still seeing a lot of interest in multi-hub deals, a lot of cross-sell between marketing and sales and going to what Yamini spoke of earlier, people just want visibility into the entire marketing sales pipeline, going all the way into customer service and success.

So, service hub right now is a strong participant in that multi-hub across that opportunity. Over the mid-term we think it will become an increasingly large opportunity for being a front door where people come in as a result of service hub and then we sell marketing and sales hub to those customers. But right now very strong on the cross-sell motion and multi-hub deals but we're pleased with the progress.

Operator Thank you. We now have Michael Turrin of Wells Fargo. Please go ahead when you're ready.

Michael Turrin Hey, there. Thanks. Obviously, a lot to talk about. I just wanted to take a step back and there are two key metrics that we tend to focus on, just based on disclosure, the net new customers and the ASRPC number. With 8,000 net new added and 14% constant currency growth, that number in Q3, I'm not sure we've seen these metrics as well in balance this quarter as what we're generally used to seeing. So, I can appreciate the commentary around the starter. I think that's useful but can you just talk more about the interplay? I know you don't necessarily manage the business to these two inputs but the reason that they're both coming through so well, particularly given a tough macro backdrop, I think is just useful for us all to hear a bit more about. Thank you.

Kate Bueker Yes, thank you, Michael. In truth, the trend that we're seeing this quarter in the KPIs are a continuation of some of the trends that we've been seeing for a while, particularly on ASRPC. Our strength in installed base selling is very much aligned with the platform value that you are hearing from Yamini, at that professional and enterprise, and that is what is enabling us to continue to grow ASRPC, even with the larger customer adds at the low end.

Operator Thank you. We now have Ken Wong from Oppenheimer. Please go ahead when you're ready. Ken, can you please unmute your line locally? There has been no response. We now have the next question from Parker Lane of Stifel.

Parker Lane Yes, hi, thanks for the question. Wondering if you could comment on the general health of the partner channel. A lot of your agency partners are small businesses themselves, so wondering if they're seeing any added pressure here and just overall what does the performance of the agency partner channel look like relative to your own direct sales efforts in inbound demand?

Yamini Rangan Yes, Parker, a really good question. I think, look, no one's immune to the macro headwinds that we are overall seeing. So, I think if we see it, partners will also see it. Now, having said that, we have about 6,000 partners within our overall ecosystem and they contribute about 40% of our revenue. Over the last couple of years we have invested pretty heavily in the partners in terms of enabling the partners, in terms of helping them really transform from being a marketing agency to a full-fledged CRM implementer and being able to take upmarket customers and drive solid [unclear] for our upmarket customers. And I would say that is working really well.

Partner contribution to total rep-driven MRR, both what they're sourcing as well as what they are co-selling, is doing well. It was pretty high in Q2 and it continued to be pretty high in Q3 and that's a sign that partners are very engaged and they are moving on the journey with us as we really provide a platform for scaling companies. So, we're happy with how our partners are executing and they're executing in a tough environment, so a huge thanks and shoutout to them.

Operator Thank you. We now have Sarah Hindlian from Macquarie. Please go ahead when you're ready.

Sarah Hindlian Great, thank you so much for squeezing me in, I really appreciate it. Maybe I want to ask a little bit more of an esoteric question. When you're in your meetings and you're speaking with the C suite, I would be curious to know what you're seeing about their desire to move marketing away from some of the really predominant social platforms that seem to be stumbling a little bit right now, perhaps restrictive moving to TikTok, and how that's helping drive more conversations around inbound marketing.

Yamini Rangan Hey, Sarah, thanks for that. I'm going to maybe get started and then, Dharmesh, feel free to jump in here as well. Look, the conversations right now are all around driving efficiency, driving time to value and getting results that can impact the outcomes in the near term and as we think about that, omnichannel marketing is really important. When I have conversations with CMOs and CEOs within customers, they clearly understand that it cannot be just one channel and so a lot of it is omnichannel marketing.

And this is why what we announced and launched at Inbound, which our teams worked really hard on, customer journey analytics and campaigns [unclear] functionality, both of those really meet the needs of where the marketing organisation is expected to step up and deliver right now. And that's the kind of conversations that we're having. In general a lot of marketing spend is around driving direct impact to revenue and pipeline in the short term and away from things like apps or event spend or brand spend. That is what we are hearing, based on talking to customers.

Dharmesh Shah Yes. One quick thing I would add is that it's a combination of these new channels emerging and it has to be omnichannel. Part of HubSpot's differentiated value proposition is that because everything is on one data platform, in one database, in one unified experience, we have the data to be able to draw the insight, not just how many people the website or how many engaged through social or how many through adds. Who were those customers and what was the revenue associated with that? We can do full circuit reporting, which is really hard to do when you've got these siloed products and that's one of the appeals of that platform.

Operator Thank you. We have our final question from Siti Panigrahi from Mizuho. Please go ahead when you're ready.

Siti Panigrahi Thank you. Thanks for squeezing me in. Not sure if this question was asked. If I look at your Q4 guidance, that looks really conservative when I look at historical guides for 4Qs, usually 4% sequential versus FX this year. I'm wondering if this is mostly effect or you have some kind of incremental conservatives backed into the guidance, considering the macro environment.

Kate Bueker Yes, why don't I take that? If you were paying attention on the call, we've definitely spent a lot of time talking about the challenging environment in which we're operating and that is certainly reflected in the Q4 guidance. In addition, you highlight FX. That is also an incremental headwind for us in Q4. We talk about $4 million of incremental headwind as a result of foreign exchange movement. And so it's really both of those things that are contributing to our Q4 guidance. We are assuming that the environment stays about how it is operating today and, as always, we want to make sure that we're confident in our ability to deliver, even if it gets just a little bit worse from here.

Operator Thank you. I would now like to hand it back to you, Yamini, for any final remarks.

Yamini Rangan Well, I want to do a big callout to HubSpotters globally. They are just so focussed in executing, so thank you. My heartfelt thanks to all of the employees and also thanks to customers, partners and investors. Look forward to talking to you next year.