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# Hubspot, Inc.

First Quarter 2023 Earnings

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## CORPORATE SPEAKERS:

**Chuck MacGlashing**

*HubSpot, Inc.; Corporate Treasure & Senior Director of IR*

**Yamini Rangan**

*HubSpot, Inc.; Chief Executive Officer, President & Director*

**Kathryn Bueker**

*HubSpot, Inc.; Chief Financial Officer & Treasurer*

**Dharmesh Shah**

*HubSpot, Inc.; Co-Founder, Chief Technology Officer & Director*

## PARTICIPANTS:

**Keith Bachman**

*BMO Capital Markets; Analyst*

**Mark Murphy**

*JPMorgan Chase; Managing Director*

**Samad Samana**

*Jefferies; Analyst*

**Elizabeth Porter**

*Morgan Stanley; Vice President of Equity Research*

**Joshua Reilly**

*Needham & Co.; Analyst*

**Rishi Jaluria**

*RBC Capital Markets; Analyst*

**Gabriela Borges**

*Goldman Sachs; Analyst*

**Brent Bracelin**

*Piper Sandler; Analyst*

**Brad Sills**

*BofA Securities; Analyst*

**Unidentified Participant**

*Wolfe Research; Analyst*

**Ken Wong**

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**Michael Turrin**

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**Brian Peterson**

*Raymond James; Associate*

**Arjun Bhatia**

*William Blair & Company; Analyst*

**Parker Lane**

*Stifel; Analyst*

**Michael Turits**

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*UBS; Analyst*

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## PRESENTATION:

Operator^ Good afternoon. Thank you for attending today's HubSpot Q1 Fiscal Year 2023 Earnings Conference Call. (Operator Instructions)

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

Mr. MacGlashing, you may proceed.

Chuck MacGlashing^ Thanks, Operator. Good afternoon. Welcome to HubSpot's first quarter 2023 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 considered forward-looking within the meaning of Section 27-A of the Securities Exchange Act of 1933 as amended in Section 21-E of the Securities Exchange Act of 1934 as amended.

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All statements other than statements of historical fact are forward-looking statements, including those regarding management's acquisitions 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 second fiscal quarter and full year 2023.

Forward-looking statements reflect our views only as of today and as accepted -- as required by law, we undertake no obligation to update or revise these forward-looking statements.

Please refer to the cautionary language in today's press release and our Form 10-Q, which will be filed with the SEC this afternoon for a discussion of the risks and uncertainties that could cause actual results to differ materially from expectations.

During the course of today's call, we'll refer to certain non-GAAP financial measures as defined by Regulation G.

The GAAP financial measure most directly comparable to each non-GAAP financial measure user discussed and a reconciliation of the differences between such measures can be found within our first quarter 2023 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 so much, Chuck. Welcome to everyone joining us on the call. Today, I want to focus on our start to 2023, share observations on the current macro environment and provide some perspective on what generative AI means for HubSpot and our customers.

Let's start with our Q1 results. We had a solid start to the year with revenue growing 30% in constant currency year-over-year. We delivered more than 4 points of margin expansion year-over-year, bringing operating margins to over 13%. Total customers grew by 23% to over 177,000 customers globally, fueled by net customer additions of over 9,900 in the quarter. I'm pleased with our momentum coming into the year and the focused execution by the HubSpot team. These results show that our product innovation is in high gear and that our bimodal go-to-market strategy is working. Our focus with our bimodal strategy remains clear. We want to drive volume at the lower end of the market while driving increased value upmarket.

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In Q1, we continue to gain momentum in both segments of the market. On the lower end, we saw a significant uptick in our net customer additions. This was driven by strength in free sign-ups and pricing optimization plays we ran in our starter edition. In addition to that, HubSpot is powerful, yet easy to use, and we are increasingly becoming the platform of choice for scaling companies.

Looking up market, we continue to see our multi-hub value proposition resonating. More professional and enterprise customers are starting with multiple hubs and over 45% of our ARR installed base is now on 3 or more hubs. Upmarket customers are increasingly looking for 2 things: a single source of truth, that provides full visibility across their entire customer journey and clear cost savings in this environment. HubSpot's connected platform delivers both. Specifically, Sales Hub continued to gain momentum in Q1 as customers look to build tighter alignment between marketing and sales to drive more efficiency across the front office.

Take Liquidity Services a B2B e-commerce marketplace, as an example. After adopting Sales Hub and Marketing comp, they were able to eliminate 8 other tools, reducing their overall cost by 50%. They were able to connect their marketing and sales data to get better insights and drive an increase in their conversions and campaign effectiveness. This is a great example of our customers, driving growth with multi-hub, while saving time and budget.

We also saw Operations Hub come up in more deals as customers focused on consolidation. They see the clear value of a solution that can connect systems, automate processes and demonstrate value, especially in this economic environment. In fact, over 2/3 of our top 25 deals closed in Q1 adopted Ops Hub, leveraging multiple hubs boost efficiency, and I'm excited by the value our customers are seeing from our connected platform. As you can see, our bimodal strategy is working, and we will continue to maintain our pace of product innovation.

Next, I want to shift gears and share what we're seeing in the macro environment. Overall, we continue to operate in a tough environment, and we're not out of the woods yet. While we see our top-of-funnel activity improving, sales cycles remain long and budgets remain under scrutiny. These patients by committee have become the norm with multiple executives involved in sales cycles. It is clear based on my conversations with customers that they're continuing to tighten their belts in terms of budget, and we can see this in optimization across seats, contact tiers and portals.

Decision-makers are focused on budget optimization and continue to spend cautiously. Now despite these challenges, we have a solid playbook for executing and driving sustainable growth. We remain focused on product innovation and consistent execution.

On the product side, we're cranking. One of our strategic objectives is to become the market share leader in marketing, sales and service for scaling companies and we remain

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focused on delivering depth of features in order to get there. In Q1, with Marketing Hub, we moved customer journey analytics to general availability and the strong adoption and usage we're seeing gives me confidence that we are driving meaningful innovation that serves marketers needs today.

With Sales Hub, we significantly enhanced the sequences tools for upmarket customers with selective treating and advanced permissioning and removed generative AI e-mail functionality to beta. We also launched a key Service Hub Enterprise feature with multiple knowledge bases. This has been a top product request from upmarket customers who need to be able to support various audiences, products or brands. And in payments and commerce, we introduced a dual subscriptions and moved payable invoices to private beta. I'm thrilled with the progress we are making on our journey to become the #1 CRM for scaling companies.

On the go-to-market side, our strategy has been to focus on total cost of ownership for customers and communicating the value of HubSpot. Our quick time to value and connected platform message is clearly resonating as customers look to become more effective and efficient. We're driving enablement across both our direct and partner channels and we are keenly focused on value-centric conversations. Looking ahead, we'll continue to navigate this macro environment by following our playbook to drive product innovation and consistent strong execution.

Now I want to double click on innovation and share how we're thinking about generative AI and why we are well positioned to add even more value for our customers. We are in the early stages of a transformative shift. Generative AI is rapidly changing the landscape in three fundamental ways. It helps businesses generate content, generate insights and generate code, all using natural language. This will be a massive opportunity for SMBs and scaling companies. Activities that once took them time, money and deep expertise no longer do with Gen AI. And this shift will enable SMBs to reach more customers, serve them at record speed with unprecedented relevance.

So what does this really mean for marketing sales and service professionals. In the simplest terms, we believe AI will guide go-to-market teams and make them more effective. This will fuel a new era of AI guided growth for our customers. When we bring together the power of foundational models with the deep contextual data in HubSpot CRM, we can help go-to-market teams drive better results.

Marketers can use Gen AI to guide them in creating more effective block poles, e-mail campaigns and social content. Salespeople can use it to guide them to write better prospecting e-mail and deliver more relevant insights for customers. and service professionals can use Gen AI to anticipate customer needs, suggest resolutions and offer proactive support.

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We believe AI won't replace go-to-market teams. It will guide them to drive better outcomes. While there will be efficiency benefits, we're even more excited about effectiveness gains and the ability to drive guided growth for customers. While we are in the early stages of Gen AI, HubSpot has unique differentiators. First, we have unique data and broad distribution. HubSpot CRM data is unified and cohesive making it easier for AI to ingest and drive relevance. Second, we're at the center of our customers' workflows. HubSpot is where work gets done. So we can bring relevance to generate content and insights across the entire front office. We're not another AI point solution. We are an all-in-one CRM platform powered by AI.

Third, we've always had a human-centric approach in companies with a human feedback loop or at an advantage with AI. We made a ton of progress in Q1 with the launches of content assistant in public beta and chat spot in public alpha. Since our launch in March, we've had over 40,000 users sign up for ChatSpot, and the early feedback has been very positive. Content Assistant has thousands of users to date, and we are seeing customers leveraging it daily for creating marketing e-mails, blog posts, landing pages and more. We're ambitiously integrating AI across our entire CRM platform. So our customers don't have to become AI expert to reap the transformational benefits. I'm incredibly excited that the opportunity AI is creating to deliver even more value for our customers.

Reflecting on the quarter, I'm pleased with the progress we made on our path to becoming a CRM platform of choice for scaling companies. Our teams maintained the pace of product innovation and drove strong execution, which was just fantastic to see.

With that, I'll turn the call over to Kate to take you through Q1 results in more detail.

Kathryn Bueker^ Thanks, Yamini. Let's turn to our Q1 2023 financial results. Revenue grew 30% year-over-year in constant currency and 27% on an as-reported basis. Subscription revenue grew 27% year-over-year, while services and other revenue increased 12% on an as-reported basis. Domestic revenue grew 27% year-over-year, while international revenue growth was 33% in constant currency and 26% as reported. International revenue represented 46% of total revenue.

We added over 9,900 net new customers in the quarter, bringing our total customer count to over 177,000, up 23% year-over-year. Starter customer acquisition continued to fuel our strong net adds again in Q1. Average subscription revenue per customer grew 6% year-over-year in constant currency and 3% on an as-reported basis to \$11,400. Our ASRPC growth was driven by continued multi-hub adoption by our professional and enterprise customers, offset by the large volume of starter customers we added at the low end of our bimodal strategy.

Gross retention remained healthy in the high 80s for the quarter. Net revenue retention was 104%, down 3 points sequentially, driven by further customer optimization of HubSpot spend as well as slower expansion across seats, contact tiers and portals. While

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we expect pressure on net revenue retention in the near term to persist, we continue to believe we can maintain net revenue retention above 100%. Calculated billings were \$533 million in the quarter, growing 28% year-over-year in constant currency and 26% as reported. The remainder of my comments will refer to non-GAAP measures.

Operating margin was 13%, up 4 points compared to the year ago period. Operating margins benefited from restructuring actions we implemented at the end of January, which impacted our head count and facilities costs, including a temporary pause in overall hiring in Q1. Net income was \$62 million or \$1.20 per fully diluted share. Free cash flow was \$85 million or 17% of revenue, and our cash and marketable securities totaled \$1.6 billion at the end of March.

And with that, let's review our guidance for the second quarter and full year of 2023. As Yamini highlighted, we continue to operate in a difficult macro environment with customer behavior that is similar to what we saw in the second half of 2022. Budgets are tight, decision by committee has become the norm, and customers are spending cautiously on new products while looking for ways to optimize existing spend. Our guidance assumes that these weak macroeconomic conditions persist throughout 2023.

For the second quarter, total as reported revenue is expected to be in the range of \$503 million to \$505 million, up 19% year-over-year at the midpoint. We expect foreign exchange to be about a point of headwind to as reported revenue growth in the quarter. Non-GAAP operating profit is expected to be between \$54 million and \$56 million. Non-GAAP diluted net income per share is expected to be between \$0.98 and \$1. This assumes 52.4 million fully diluted shares outstanding. And for the full year of 2023, total as reported revenue is now expected to be in the range of \$2.08 billion to \$2.088 billion, up 20% year-over-year at the midpoint. Non-GAAP operating profit is now expected to be between \$275 million and \$279 million.

We now expect foreign exchange to have a neutral impact to as reported revenue and operating profit margin for the full year of 2023. Non-GAAP diluted net income per share is now expected to be between \$4.80 and \$4.85. This assumes 52.3 million fully diluted shares outstanding. As you adjust your models, keep in mind the following: we expect CapEx as a percentage of revenue to be roughly 5% and free cash flow to be about \$245 million for the full year of 2023, with seasonally stronger free cash flow in Q4.

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 with our commitment to driving durable, profitable growth long term. Looking ahead, we remain focused on foundational investments that will help us scale. As I shared during our last earnings call, we are doubling down on better development and high performance, better hybrid connection for our people, employees all over the world and better systems and automation internally. These initiatives will enable us to drive more efficiency long term



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and deliver even more value for our customers. I believe we have the right strategy and the right team to navigate this environment and emerge stronger. I want to thank our customers, our employees, our partners and our shareholders for the continued support on this journey.

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

## QUESTIONS & ANSWERS:

Operator^ (Operator Instructions) The first question comes from the line of Keith Bachman of BMO.

Keith Bachman^ Just to focus my question on generative AI. You talked about some of the activities and certainly enjoyed Dharmesh's video some time ago. But I wanted to hear how do you plan on monetizing it as you look out over the horizon? So is it a skew? Is it a pricing activity? How do you think about monetization? And as part of that is, when do you think some of these activities will be moved from beta to production environment? In other words, when might investors begin to see the benefits of in your financial results?

Yamini Rangan^ Keith, thanks a lot for your question. This is Yamini. Very executive about it is very transformative. And if you kind of like step back HubSpot got started when there was a fairly big shift that was happening in how people buy. And that led to us coming up and helping customers on how to market and sell. And we think generative AI is as transformative. And this is going to really cause our customers to think about how they market and sell. And so we think there is a lot of exciting potential. In terms of the monetization question, we have a very clear first principle when it comes to monetization. We focus on delivering customer value first.

And from there on, monetization will follow. And we think that this is pretty early days in terms of monetizing. Having said that, we're iterating fast, we are getting tons of feedback, especially with ChatSpot as well as content assistant that we just talked about, and we are improving these use cases so we can continue to innovate for our customers and really help them get much more value with this transformative technology. As we do this, some of the features are just going to become table stakes. They will just be part of our core products and part of how we drive customer engagement and adoption within the core product.

Now if there are more specialized use cases, then maybe it goes into higher value additions like co and enterprise and will increase our ASP longer term, and that's how we're thinking about monetization. First, we want to focus on delivering value for the product. You asked the last question, which was when do we plan to get this into the

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hands of customers? Well, we launched pretty quickly within the market in March. It's alpha and data. We're getting a lot of the feedback and the teams are pretty excited. We are having a lot of Acathons internally, and there's a long list of use cases that our teams are working on. So I think you'll see us maintain and even accelerate our pace of innovation, where we'll be introducing features in weeks, not months or quarters. So lots of exciting developments here.

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

Mark Murphy^ Congrats on the great execution during the quarter. Yamini, I'm noticing that HubSpot just has such a huge list of free products at this point. There's free CRM, free CMS, free form builder free business templates. So much is free, but your margins are expanding despite that. I'm wondering if you could comment on just how large an energetic that on-ramp is from free customers at the top of the funnel. And then for Kate, is it boosting kind of your multiyear visibility because it feels like you have these millions of little seeds that are there, that are kind of just starting to sprout and you can probably project forward and look at how it would turn into revenue.

Yamini Rangan^ Mark, I'll get started with the question^ and then Kate can answer. I love that question because it really gets to the heart of our strategy. When HubSpot got started, we had the deep conviction that we want to add as much value for our customers as possible and continue to get the most adoption from small, medium as well as scaling businesses and the free tools is really part of that strategy to get the widest possible top of the funnel. And by the way, the free tools have a ton of value. I mean -- you talked about free CMS. That adds a lot of value in a company getting a digital presence and getting started. There are a number of other growth tools. And that's clearly the strategy.

And tying this maybe to something that I just talked about, which is the bimodal strategy. When you have a really wide funnel, which is what free tools like this creates then we work to continue to deliver value. And so the number of starter customers and the conversion from free sign-ups to pay customers increases. And we've been looking at this over the past few quarters. We're very happy with how that conversion continues to happen. And even from our starter customers, how they continue to get value in terms of pro and enterprise. So it's really our strategy for delivering value that works. And Kate, maybe you want to address the second part of the question there.

Kathryn Bueker^ Yes. Sure thing. Thanks, Mark. I think there's a lot of reasons to really love the strategy of our product-led growth. I would not say that increased visibility over the long term is one of them. That said, it's a really great low-cost way to get lots of customers using HubSpot really early in their business life cycle. And we think it creates a lot of interesting dynamics over and above just the economics, which I can talk about. It creates a nice moat, a competitive for us against low-end disruption, it also enhances pretty dramatically the value of our overall platform just based on the scale of customers at the low end. Now some portion of those starter customers will upgrade to Pro and

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Enterprise over time. I think you already know that. Oftentimes, that happens with a bit of a faster sales cycle that we also like. But this is really just one of many motions that will drive our growth over time.

Operator^ The next question comes from Samad Samana of Jefferies.

Samad Samana^ Great quarter, guys. Yamini, I feel like for the last couple, you've talked a lot more about market customers and how much the portfolio is attracting larger customers. And I think sales up has been an integral part of that and the maturity of the product seems to be really unlocking this kind of next tier of customer size. I'm just curious if you think that that's an even bigger key than marketing hubs maturity to unlocking those larger customers that you've been talking more and more about.

Yamini Rangan^ Thank you so much for that question. We're really happy with Sales Hub as well as what it unlocks up market. And I think Marketing Hub is \$1 billion-plus kind of product line that's got the ability to go to multibillion and Sales Hub is a \$500 million-plus business that can grow into multiple billions, and both of them are kind of going at plan. We're super happy with that.

Now specifically looking at Sales Hub, we've been on the steady march over the past few years to build the functionality that a true upmarket business needs to have as a system of record. And I think we've reached that point. We have hit that critical mass for an upmarket customer. We are a viable alternative to other legacy enterprise actions within the market and Sales Hub is now a legitimate front door to HubSpot. And this is a couple of reasons, right?

On the product side, we're now serving larger customers and more sophisticated use cases. The steady drumbeat of product releases that you've been hearing from us are just all aimed at expanding our upmarket TAM, and these are custom objects and CRM customization, deeper permissioning, more features for admin. All of that is working. In addition to that, over the last couple of quarters, we're also adding our ability to serve more sophisticated use cases, right? I just talked about sequencing. That's something upmarket customers have needed much more ability to do in addition to that sales intelligence forecasting, all of these are areas within the product. So huge kudos to the product team for keeping the pace of innovation that serves upmarket customers really well.

In addition to that, our go-to-market side, the investments that we have made in upskilling our reps as well as the partner ecosystem is working. Our sales teams live and breathe in our product every single day. So it's very easy for the show Sales Hub demo and how that actually works with Marketing Hub and drives their own productivity and partners are very much in rolled in this journey of going upmarket. So look, the momentum really comes down to meeting the needs of our customers in this moment,

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and we're very happy with what we're seeing and how we are able to deliver for our customers.

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

Elizabeth Porter^ I wanted to hit on the really impressive kind of net customer adds and get a better sense for where the incremental demand is coming from kind of beyond that initial expectation for around 7,000 a quarter. So are you seeing HubSpot actually displace other vendors? Or is there still a lot of greenfield deployments at the low end that you're landing and that can just how durable is this trend?

Kathryn Bueker^ Yes. Thanks, Elizabeth. I think in general, these are really small, early-stage companies that are, in large part, trying our free tools and converting from free tools into starter. And so I would think most of them are coming from a more greenfield place than HubSpot displacing someone else. If I look at the quarter-over-quarter trend in net customer adds, like we are obviously very excited about the 9,900 new ads. The vast majority of the increase quarter-over-quarter is coming at that starter tier. And there are a couple of things that are driving it. Yamini talked about the healthy volume we are seeing free sign-ups as a result of our strong top-of-funnel demand. We are also continuing to test pricing optimization levers as we do, frankly, on a regular basis, and that is also working.

That said, like Q1 always has tended to be seasonally strong. I do not expect that we're going to stay at 9,000 customer ads, but we do feel good about net adds continuing to remain strong. I would advise 7,000 to 8,000 range over the next couple of quarters, with the biggest variable there being (technical difficulty).

Joshua Reilly^ Nice job on the quarter here. Can you give us a sense of how the direct versus the partner business is performing over the last couple of quarters here. I think last year, you made the comment that the partner business was performing stronger into the downturn. And what are just the dynamics or additional color there?

Yamini Rangan^ Josh, thank you for the question. This is Yamini. Both direct and partner are executing as planned. We've shared in the past that our with a partner ecosystem is we want to be able to scale both selling as well as servicing with partners. And in the last couple of years, as we have gone up market and as we have really transitioned from being a marketing automation company to a CRM platform, and we've really spent a lot of time as well as energy and efforts with our partners to bring them along that journey. And that strategy is working. So as you look at like Q1, the partner ecosystem performed well.

When you talk to partners, I know many of your top partners, you'll hear them talk about multi-hub deployments and as well as leading us a little bit upmarket. So they are helping us in that journey. And there's just a lot more joint co-selling. And if you step back

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(technical difficulty) environment make decisions, they want high returns and low risk and therefore, jointly executing with partners and having clear migration implementation and change management plans are really working. The direct side is going along with that. And so there's still the healthy balance of about 40% of our installed base coming from our partners and the rest is from our direct and both are executing really well.

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

Rishi Jaluria^ Nice to see continued strong execution. I wanted to ask another generative AI question and kind of go back you do in your prepared remarks, you talked about the ability for people to business just to use generative AI on the back end to generate code. I want to think about from your perspective, how do you see your ability to use generative AI, maybe to iterate features and functionality faster and potentially narrow the gap with some of the upmarket players that maybe customers want to move on to HubSpot, but some of those features and functionality may be missing. Just how should we think about that?

Dharmesh Shah^ Yes. Thanks for that question, Rishi. This is Dharmesh. So a couple of things on generative AI with HubSpot. One is we're making the investment to make generative AI part of the HubSpot framework. That gives us 2 things. It gives us kind of short-term speed to market because all of our product teams can now benefit from the generative AI features we're building in the core platform, but we think has why to put the ability across the entire suite of application hubs within HubSpot. So that's what gets us to be really excited. And one thing that kind of gives us an advantage in terms of -- versus other companies is that HubSpot grew up with an organically built for SMB platform where all the data is cohesively stored and normalized.

And this becomes very, very important because in order to kind of get the value from generative AI, you need to be able to kind of use the existing data that you have. It's not about having tens of millions of records. It's about having all the data points on individual customers so you can provide context the generative AI models to say, "Oh, we know we can web page do this customer in. We know how many times they interacted with us. We know if they have a support ticket in service hub or not.

We know exactly all the sales interactions we have. We can take all of that context and use it for a generative AI model. And one of the benefits to companies like HubSpot that has this kind of very rapid iteration, get something in the hands of users, as I believe and the team believes that they who can actually get something in users' hands and get that feedback and have a very tight feedback loop are the ones that win. So we think generative AI levels the playing field in terms of the incumbents that are there. And we think HubSpot is building the platform and the way we track HubSpot framework and the primary colors.

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

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Gabriela Borges^ I will stay on the generative AI topic either for Dharmesh or for Yamini. I wanted to follow up on your comments on leveling the playing field. Do you think over the longer term, this leads to less crowdedness or less competition in the front office stack? And then I wanted to ask directly about the trade-off between efficiency and effectiveness, what are your thoughts on the potential bear case on if marketing people and salespeople become more productive and HubSpot has a seat-based model, how do you think about the risk that seats go down while you're monetizing incremental functionality on the way up, if that makes sense.

Yamini Rangan^ I'll start, and then Dharmesh certainly feel free to join here. We do think of it as leveling the playing field, especially for SMBs. One of the things that we've been very consistent about is taking powerful technologies, sophisticated technology and democratizing that for SMBs. And that's exactly what we are trying to do with generative AI. SMBs typically don't have large teams of AI experts sitting and we want to be able to bring it in with the same power and ease of use. And that will allow our customers to really compete effectively within the market.

I think the second question you asked was (technical difficulty) can see. And look, I think it's very hard to predict in the long term or maybe even the next 3 to 5 years, what happens with a lot of the jobs. From our perspective, some jobs are going to become less relevant and more automated. At the same time, AI is probably going to create more jobs and new skills. It's a little too early to predict longer term. Having said that, our belief is that AI will not replace humans. But humans who use AI will replace humans who don't use AI, and we're in the business of helping humans use AI much better and that's exactly what you're seeing in terms of our strategy. The first stage of our strategy is to help people to drive better outcomes, a lot more in terms of the effectiveness focus. And you can already see this happening with content assistant and ChatSpot and that's empowering our customers to drive better outcomes, not just like safe time.

And the next stage is really taking generative AI and really making it applicable across our platform Dharmesh just talked about how we think about it from a framework perspective. It's like one of our primary colors and repeatable tasks can be commoditized and the real value is going to come from that last mile of human intelligence. So we are of the mindset that this is going to drive to better outcomes for everybody within the front office. Dharmesh, anything else that you'd want to add?

Dharmesh Shah^ Yes, I want to add just in terms of kind of the long-term view on generative AI overall. Right now, kind of 95% of the attention calories are in use cases where we take natural language and convert them to something that a human is going to consume, be it a block host or an image and we'll eventually see video. And I think 95% of the opportunity for companies like HubSpot is actually using natural language comps and generative models to create codes met for computers.

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So we can look at examples like creating a report definition in HubSpot, creating a custom workflow action in Ops Hub, all these things where we can take things that were historically only acceptable to like a small percentage of the users within the company, and we can expand that now so that a larger portion of people can generate sophisticated reports and write custom workflow actions and do data cleansing and all these things. So just put power tools in the hands of many more customers. So we're just very excited about that kind of ability to kind of democratize and make things easy, which is what spot's always been known for.

Operator^ (Operator Instructions) The next question is from the line of Brent Bracelin of Piper Sandler.

Brent Bracelin^ Obviously, really impressed here with the number of net adds and test, obviously, a pretty challenging backdrop. I wanted to ask maybe a longer-term question around vendor consolidation, which feels like there's a longer-term tailwind here. You talked about one customer consolidating 8 tools, down to the combo of Sales Hub and Marketing Hub. Where are we at in that cross hub cross-sell opportunity relative to the installed base. We're not quite seeing in ARPU yet given the volume increase we're seeing at the low end with starter but it feels like longer term, there's opportunity. So could you just address vendor consolidation, how meaningful can that be as a PON looking out to '24, '25, '26?

Yamini Rangan^ Yes, it's a great question. And I do think this is a longer-term trend that we are beginning to see. And maybe if you kind of like (technical difficulty). Our customers took a couple of different paths. Either they had a lot of point solutions, which becomes really hard to be able to manage both from a cost as well as the complexity of the overall tax perspective or they went with maybe legacy enterprise-class solutions and they've quoted themselves into a corner.

And when I talk to customers now, they want something that is paraffin, that is simple that provides the entire visibility across their customers' journey and is cost effective. And if you look at HubSpot, we do all of that. This is why the strength in terms of customer addition, even in the current macro kind of like backdrop is not surprising because it is very clear that we are becoming a platform for SMBs as well as scaling companies.

Now you asked the question of how is to lay out. It's very early days. when we look at our installed base as well as when we talk to prospects, it's pretty early days in this type of consolidation. And we want to build the best-in-class marketing sales service solutions that can drive value for customers. And so we're going to keep the pace of product innovation. And I think that we still have a long way to go in terms of seeing this consolidation play through.

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

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Brad Sills^ Wonderful. Great start to the year here. I wanted to ask about Operations Hub. Yamini, you called it out as an area of strength. We're certainly hearing that from the channel would love to get your perspective. To me, this seems like a platform. You're running two or more hubs, you need the glue to automate workflow across different hubs using Operation Hubs. Is that why you're starting to see the success now with Operations Hub. In other words, you're getting to the point where customers are running more customers are running 2 or more hubs, they need that glue. Just any color on what's driving that Operations Hub strength.

Yamini Rangan^ I love this question, Brad, and you actually gave the answer. We hit it on the head. It is that we are seeing a macro-driven front office unification. And I also think that Operations Hub is like the perfect glue that brings together Marketing, Sales, other hubs, but give the value, right? I mean if you really think about what it does, it brings data from multiple sources is able to automate like workflows and the better insights from just more sophisticated data sets. And so you hit the nail on the head in terms of why Operations Hub is seeing an attraction. Maybe a couple more points of color in terms of how our product efforts as well as go-to-market efforts have been in this area. We have expanded value for our customers, particularly around data quality.

Now late last year, we launched some major updates to Operations Hub capability, particularly around data quality and portability. And you may remember us talking about data quality command center, that has been a pretty big hit with our Pro and Enterprise customers. In addition to that, we've also ramped up our own enablement efforts around advanced capabilities. Now selling technical products like data warehouse connectors and custom code actions is always difficult.

By the way, custom got actions and workflows is like one of my absolute favorite new features in Ops Hub, so much value for customers. But one of the things that we have done is like continue to enable our direct teams and partners to showcase the value of these sophisticated features. And so it's still super early innings in terms of Operations Hub, but it's on an exciting path, and I'm very happy with the momentum that we saw in Q1.

Operator^ Next question is from the line of Alex Zukin of Wolfe Research.

Unidentified Participant^ This is Ryan on for Alex. Congrats on a great quarter. So my question is around retention. (technical difficulty) And with the environment is still tough. What's your level of confidence that it can stay above 100%? And if that is the expectation, how are you thinking about when it could normalize?

Kathryn Bueker^ Yes. Thanks very much for the question. I think we've talked about this in the past. There's really types of retention or 2 pieces of retention that we pay a lot of attention to internally. Gross retention that we refer to as customer dollar and net revenue



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retention. Customer dollar retention, we continue to see general stability in customer dollar retention in the high 80s. We expect that gross retention is going to hang in, in that zone for the rest of 2023.

On the net revenue retention side, you are right, we did see a step down of 3 points from Q4 into Q1. And we're seeing that step down across all the same reasons that we've been talking about for the last few quarters, right? There is a pressure that we are seeing from our customers really optimizing their spend of HubSpot. That is particularly notable in contacts and seats. We are also seeing some of our multi-portal customers now leveraging some of the upmarket features to consolidate their portals in HubSpot. In addition, we are seeing customers upgrading seats and contacts at a slower rate than we have in the past. And we think that we're going to continue to see those pressures going into Q2. But where we think that we're going to see some balances a couple of other trends.

We continue to see solid trends in upgrading. You see the volumes from starter into professional at pretty consistent upgrade rates. We're seeing a bit of benefit from some of our recent pricing adjustments. And that in combination with the solid gross retention really in that high 80s is what gives us confidence that we can retain net revenue retention above [100] for 2023. Now we still believe that [110] is the right benchmark for us in terms of net revenue retention over the long term, but that's going to require a more normal macro environment.

Operator^ The next question comes from Ken Wong of Oppenheimer.

Ken Wong^ This one is geared towards you, Kate. I believe last quarter, you characterize the macro environment is kind of not better, but not worse. As you exit Q1, I guess, what's the right thinking in terms of what's baked into the outlook?

Kathryn Bueker^ Yes. Thanks for the question. I tried to share in my prepared remarks, a bit of color around just that. The external environment really does remain difficult, and we assume that it remains difficult throughout 2023. That said, as you know, we've approached guidance in a very consistent way. We did the same thing in Q1 and really tried to set guidance that contemplates a whole variety of scenarios. Our baseline assumption is that the remainder of 2023 feels like Q1, it feels like the back half of last year. It's still early in the year, and the external environment has been really volatile. FX has been very volatile, and we want to deliver against guidance with that baseline assumption or even if things get a little bit worse.

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

Michael Turrin^ Look, there are so many good big picture questions I'd like to ask, but I'll go into a metrics question instead because it's something we're getting some questions on. There are some moving pieces in terms of currency with respect to the results and the change in assumptions on the guide. And so if we look at the Q1 number and the change

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in currency for the rest of the year. It looks like the second half constant currency assumptions for revenue might actually come down a touch on a constant currency basis. So I just want to understand if that interpretation is accurate. And maybe just help us split out the currency movements versus just any fundamental change in what you're thinking through and contemplating with the rest of your guidance. Obviously, great job across the board on the Q1 results. Just looking for some clarity there.

Kathryn Bueker^ Yes. Thank you. we executed. We're happy with the execution in Q1 despite the challenging macro. And as you pointed out, we raised the full year by the full amount of the Q1 beat, which I think does speak to the confidence that we have in the business. But as you heard from both Yamini and I, the macro remains challenging. It's very volatile, including FX. We're not out of the woods yet. And on top of that, we're still early in the year. And so we took all of this into account when we set the guidance for the year. Our philosophy on guidance remains the same. We're aiming to put out guidance that we have a high degree of confidence in being able to achieve across a variety of scenarios.

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

Brian Peterson^ Congrats on the strong quarter. So I wanted to unpack what's driving the average revenue per customer higher? I know we kind of hit on that a little bit. But it's just amazing to see the net adds and that figure is still up 3% year-over-year. So is the cross-sell sales cycles in the enterprise? Are those actually getting better or vendor consolidation or ROI for customers? I'd love to just maybe understand what's happening upmarket to that figure to be growing 3%.

Kathryn Bueker^ Yes. Thank you again for that one. There's really 2 things happening in ASRPC, right? We continue to see multi-hub adoption broadly across our professional and enterprise customers. And that is offset by sort of the volume that we are seeing at the low end. If we just look at professional and enterprise, ASRPC continued to be up double digits in constant currency in Q1. And it's the headwind from the volume of starter customers that is moving the ASRPC from that sort of double-digit level to 6% in constant currency.

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

Arjun Bhatia^ Perfect. Kate, maybe another one from you -- for you. I'm just trying to reconcile a little bit the comment about upgrades still happening, right, customers wanting more capabilities, more features versus there still being some headwinds around optimization, seats, contacts, et cetera. Is there any kind of characteristics amongst those customers that you can point out that maybe we could hang on to where you're seeing a specific vertical or a specific customer size, do one versus the other?

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Kathryn Bueker^ Yes. I mean, it's a good question. These are not new trends for us. We've been seeing the same type of pressure and dynamics within our customer base over the last quarters. And what we are seeing is a focus initiative to get the most out of their spend with HubSpot. Well, I don't believe we're alone in that. And that, for us comes in the form of them cleaning up their contacts, cleaning up unused seats. It comes in consolidating when they're on multiple portals, consolidated and using all the features that they have signed up for. That doesn't mean that our customers are continuing to use more of our products. But what we're seeing more and more is that is an offset. They're doing the cleanup in conjunction with the expansion.

Operator^ The next question comes from Parker Lane of Stifel.

Parker Lane^ Circling back to the partner ecosystem. Yamini, know you made some changes there earlier this year around compensation levels of partners and what they need to do to continue the relationship financially with HubSpot. You want them selling and servicing partners. Do you expect there's going to be some consolidation in that channel in 2023, 2024? And then what exactly are you guys doing behind the scenes to upskill those partners to get them in a position to be more effectively servicing the customer base?

Yamini Rangan^ Parker, yes. Thanks a lot for the question. I think maybe two parts there.

I'll first start with the changes that we made and then answer the second part of your question. I'm really pleased with the response from the partner channel. And since the announcement and even before the announcement, I've spent a lot of time talking to our partners, lead diamond partners in terms of the change? And just to step back, we really looked at our partner commissions, and we are incentivizing our partners to have more consistent engagement with our customers to sell and go sell more with us and to do more multi-hub. And the partners understand behind the change, and we're also giving partners a lot of time to be able to adapt which they appreciate.

And so at the end of the day, the changes that we made are going to be a win for our customers and therefore, good for partners as well as HubSpot. And at the margin, we're actually seeing some of the partners increase their engagement with our customers as a result of this.

The second part of the question is, do we think it's going to lead to some level of consolidation, how do we enable the partners I think it will. And it's not necessarily because of the commission changes, but it's because we are moving upmarket, and we are guiding our partners to be able to scale to better serve the needs of upmarket customers. And as we do that, we are definitely beginning to notice that partners are either already consolidating or figuring out ways to scale.

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And therefore, the percentage from elite partners from top partners is probably going to increase as we continue the transition to driving multi-hub as well as serving the needs of upmarket customers. And our focus on partner enablement is really high.

We've been really on this journey to enroll them to drive more certifications. There's an upcoming certification week that's coming up for our partners, and we are putting a lot behind that, and we'll continue to drive the level of technical capabilities within the partner ecosystem. Overall, really happy with the response and where our partner ecosystem is going.

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

Unidentified Participant^ Great. congrats on the quarter. This is [Bobby Day] on for Terry. Curious what you're seeing globally in terms of strength or weakness across geographies?

Yamini Rangan^ [Bobby], thanks a lot for that. Overall, fairly consistent in terms of what we are seeing in North America as well as our international markets. As Kate just mentioned, International is about 46% of our overall base and growing reasonably well. There is not that much of a divergence in terms of the trends.

What we see in terms of the longer deal cycles and more decision makers is across North America and international. And what we see in terms of the reasons why our customers want HubSpot is also consistent.

We deliver quick time to value, which is what is important across all customers. And most of the time, value is in a matter of weeks, not months or quarters. And customers really care about their costs and they're consolidating with fewer platforms. And so we see a lot more platform consolidation and multi-hub conversations, both in regional as well as international markets.

And there's kind of a high bar to action across all customers. But we are executing in both markets with consistency.

Operator^ The next question comes from the line of Michael Turits of KeyCorp.

Michael Turits^ Great quarter. I wanted to ask about the move-up market and how you're approaching from the direct channel -- direct sales force perspective? This is a year in which you're increasing margins, and you've had a RIF. But -- so what are you doing in terms of investing in the direct sales channel to drive more engagement? And how are you managing the costs on that?

Yamini Rangan^ Yes. Thanks a lot for the question. Maybe I'll start with upmarket and what we're doing with the sales team and Kate, feel free to add in terms of the cost there.

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if we step back and think about why upmarket is working and what is upmarket for HubSpot, we're still very, very focused on the 2 to 2,000 employee segment. And for us, upmarket is the 200 to 2,000 employee segment. And if you think about customers there, they care deeply about cost savings within this environment, and they care deeply about navigating the macro while driving resilient growth. and HubSpot helps with both of those. We are powerful solution that's still very, very easy to use and easy to implement, and that's what is resonating within upmarket.

As we've thought about our own sales teams and internally driving the efficiency, we've talked about this. We are driving more data into the hands of our direct sales reps. We are arming them with the right kind of total cost of ownership as well as value messaging. This is the tightest level of alignment I have seen between product, marketing and sales in terms of the key messages that we are delivering and our teams are very, very focused. And so I think from an internal standpoint, systems, automation, messaging alignment are all in favor of driving consistent execution there.

Operator^ The next question comes from the line of Taylor McGinnis of UBS.

Taylor McGinnis^ Congrats on a really great quarter. The 1Q margin performance was really strong, particularly sequentially. So are you able to break that down and quantify the drivers of the uplift? Like how much was on restructuring or hiring and efficiencies in the business, just to help us think about the future margin trajectory and the durability of the progress that we're seeing?

Kathryn Bueker^ Yes. Taylor, it was a really good question. The margin upside in Q1 versus our expectation is primarily related to the restructuring. So revenue came in a little bit better than expectations on some favorable FX rates. But we, frankly, underestimated the impact the restructuring would have on our overall hiring plan and resulted in really a delay in returning to our regularly planned hiring cadence. That said, we're feeling really good about where we are now. What this means is we expect to sort of return to that normal seasonal pattern in our operating margins from this point on through 2023. Q2 margins are going to decline slightly. It's a typical sequential pattern for us with annual merit increases and a return to the investment in hiring as well as some hybrid connection.

That said, we will expect that operating margins are going to expand through the back half of the year with low double digits in Q3 and high teens in Q4, consistent with what we provided last quarter.

Operator^ Thank you. And with that, we will conclude our time of question and answer.

I would now like to hand the conference back over to Yamini Rangan, CEO, for any closing remarks.

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Yamini Rangan^ Thank you so much for all the engaged questions as well as the support and look forward to connecting back again in a few months.

[Mike]?

Operator^ And with that, we will conclude today's call. Thank you for participating.

You may now disconnect your lines.