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HubSpot, Inc. (HUBS)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the HubSpot Q3 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions] I would like to hand the conference over to your speaker today, Chuck MacGlashing, Head of Investor Relations. Thank you. Please go ahead.

Charles Tupper MacGlashing

Vice President Treasury & Investor Relations, HubSpot, Inc.

Thanks, operator. Good afternoon and welcome to HubSpot's Third Quarter 2020 Earnings Conference Call. Today, we'll be discussing the results announced in the press release that was issued after the market closed. With me on the call this afternoon is Brian Halligan, our Chief Executive Officer and Chairman; and Kate Bueker, our Chief Financial Officer.

Before we start, I'd like to draw your attention to the Safe Harbor Statement included in today's press release. During this call, we'll make statements related to our business that may be considered forward-looking within the meaning of Section 27A of the Securities Exchange Act of 1933 as amended and Section 21E of the Securities Exchange Act of 1934 as amended.

All statements other than statements of historical fact are forward-looking statements including those regarding management's expectations of future financial and operational performance and operational expenditures, expected growth, and business outlook including our financial guidance for the fourth fiscal quarter and full-year 2020.

Forward-looking statements reflect our views only as of today and except as required by law, we undertake no obligation to update or revise these forward-looking statements. Please refer to the cautionary language in today's press release in 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 or further certain non-GAAP financial measures is defined by Regulation G. The GAAP financial measure most directly comparable to each non-GAAP financial measure used or discussed in a reconciliation of the differences between such measures can be found within our third quarter 2020 earnings press release in the Investor Relations section of our website.

Now, it's my pleasure to turn over the call to HubSpot's CEO and Chairman, Brian Halligan.

Brian Patrick Halligan

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

Thanks, Chuck. Good afternoon, folks. Thank you for joining us today. Well, none of us could have foreseen the difficult path this year would take as we enter the final quarter of 2020. We're grateful for our customers, partners and employees have grown through with us. Now, despite this challenging environment, HubSpot has grown very nicely. Demand trends have continued to strengthen in the third quarter as more companies digitize their end-to-end customer experience and build modern flywheels.

Revenue growth was 32% in Q3 and non-GAAP operating margin was 7% with a record total customer growth at 39% year-over-year, surpassing 95,000. While multi-product adoption has also continued to grow nicely, representing over 45,000 customers. These customers have also become more embedded in the HubSpot ecosystem as we've reached nearly two million cumulative platform integrations. The year is not over, but I believe the growth we've seen in the third quarter is both a story of digital transformation tailwind combined with excellent execution by our team's build and deliver a terrific product for our customers.

A big focus for 2020 has been on building a CRM platform that couples an increasingly powerful enterprise back end with an intuitive consumer-grade front-end. This is the rare combination in a software industry, and it's unique to us in the CRM industry. That rare combination is a result of the few things. First, we handcrafted HubSpot on a set of internal primary colors, reporting, content, messaging, data and automation. These primary colors have combined to create our hubs which all work the same intuitive way. This is in contrast to traditional CRM which are cobbled together through acquisition.

Second, we have a large multi-year investment in user research and design that gives HubSpot a consumer-like feel. Third, our entire company is laser-focused on delighting our customers. Culturally over the last few years, we have moved from a funnel mindset to a flywheel mindset where our growth rate is heavily influenced by the values our customers are getting from our offering.

Now, the really exciting thing that happened since we spoke last was the release of Sales Hub Enterprise which leverages these primary colors as custom objects, as proposal, as advanced sales automation and as accounting integrations like NetSuite, QuickBooks and Xero to our CRM. This was a huge relief for our customers and partners. In particular, the addition of custom object changes the game for a lot of our customers, custom objects was the very large investment for us that took over – well over a year to develop.

Prior to this release, our customers had to fit their business model into our relatively rigid object model. Now our customers can fit our object model around their business model. This was a big blocker for us with scale businesses that we've knocked down.

One customer, LegalZoom, an early Sales Hub Enterprise adopter praised this intersection of power and ease we provide by saying, we have had on 100% user adoption and couldn't be happier. Now, it's still early days, but we've had a strong start with Sales Hub Enterprise, net new ARR hitting a record high in October. There's still a lot of uncertainty in the world today, so it's hard to predict the future. But one thing I'm certain of is our approach to building products that delight customers is going to keep paying off.

I want to thank you for your time, so far, today. We're proud of the momentum we saw in Q3 and remain optimistic and focused on closing up the year strong.

Now, I'll hand things over to Kate to take you through our Q3 financial and operating results in more detail.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

Thanks, Brian. Let's turn to our third quarter financial results and our guidance for the fourth quarter and full-year 2020. Third quarter revenue growth reaccelerated to 30% year-over-year in constant currency and 32% as reported. Q3 subscription revenue grew 32% year-over-year, while services revenue increased 12% year-over-year on an as reported basis.

Domestic revenue grew 24% in Q3, while international revenue growth was 39% year-over-year in constant currency and 42% as reported. International revenue represented 44% of total revenue in Q3, up 3 points year-over-year.

Deferred revenue as of the end of September was \$259 million, a 27% increase year-over-year. Calculated Billings was \$246 million in Q3, up 33% in constant currency and 38% year-over-year on an as reported basis.

Earlier in the year, we introduced proactive measures to provide customers and partners with flexibility needed to remain productive and engaged parts of the HubSpot ecosystem. As I shared at the Analyst Day, we saw the vast majority of these COVID customer relief requests in the first half of the year.

Overall, we continue to see a small number of new requests and the retention of our customers at the end of the short-term plays remain strong. We continue to watch these trends carefully, particularly given the recent uptick in global COVID cases. We also saw continued strength in demand from new customers during the quarter. We ended Q3 with over 95,000 total customers, up 39% year-over-year. Net customer additions were nearly 9,000 and set another company record, driven by broad strength across the business, although we continue to see notable growth in our starter Growth Suite customers.

Average subscription revenue per customer of roughly \$9,700 was up a few points sequentially, but down year-over-year as a result of the strength that we've seen at the low end of the portfolio. Total revenue retention was greater than 100% in Q3. While retention benefited from the performance of customers upgrading at the end of short-term discounts, revenue retention would have remained above 100% without this benefit.

The remainder of my comments will refer to non-GAAP measures. Third quarter gross margin was 82%, flat year-over-year. Subscription gross margin was 86%, while services gross margin was negative 20%. Third quarter operating margin was 7%, up 1 point compared to the same period last year. Operating margin in the quarter exceeded our expectations primarily as a result of strong revenue performance.

At the end of the third quarter, we had nearly 4,000 employees, up 24% year-over-year. Net income in the third quarter was \$14 million or \$0.28 per diluted share. CapEx, including capitalized software development cost, was \$30 million or 6% of revenue in the quarter. We expect CapEx as a percentage of revenue to be 6% to 7% in 2020.

Free cash flow in the third quarter was \$25 million, driven by strong business performance. As a result, we're increasing our expectations for full-year 2020 free cash flow to approximately \$60 million.

HubSpot ended the quarter with \$1.2 billion of cash and marketable securities. We remain confident that our strong balance sheet will provide us with the financial flexibility to invest for the long-term.

And with that, let's dive into guidance for the fourth quarter and full year of 2020. For the fourth quarter, total revenue is expected to be in the range of \$235 million to \$237 million, up 27% year-over-year at the midpoint. Non-GAAP operating income is expected to be between \$13 million and \$15 million. Non-GAAP diluted net income per share is expected to be between \$0.21 and \$0.23. This assumes 49.6 million fully diluted shares outstanding.

And for the full year of 2020, total revenue is expected to be in the range of \$866 million to \$868 million, up 28% year-over-year. Non-GAAP operating income is expected to be in the range of \$63.5 million and \$65.5 million.

Non-GAAP diluted net income per share is expected to be between \$1.13 and \$1.15. This assumes \$48.7 million fully diluted shares outstanding.

As you adjust your models, keep in mind the following. At current spot rates, we expect a 2-point FX tailwind to Q4 reported revenue. And now expect a neutral FX impact to reported revenue for the full year of 2020.

We have delivered modest operating margin leverage in 2020 as a result of our strong business performance coupled with some cost savings from our shift to remote work. At our Analyst Day, I reiterated our commitment to investing for the long-term, and indicated that we expect to increase our R&D spending as a percentage of revenue. As a result of this increase, coupled with a return to a more normal level of employee spend over the next year, we do not expect to deliver operating margin leverage in 2021.

We are still early in our planning process, so we will share a more detailed outlook for profitability when we report our Q4 results. The investments we're making in both our product and go-to-market teams are paying off, and will position us well to grow in 2021 and beyond.

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

Brian Patrick Halligan

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

I'd like to close by thanking my leadership team and all the HubSpotters out there who are listening tonight. It's been an exceptionally challenging year. You all have stepped up during these tough times with great execution and terrific resilience. I feel lucky to be on your team.

Okay, operator, let's open it up to some questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Mark Murphy from JPMorgan. Please go ahead.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Yes. Thank you very much, and congrats on a very special performance. Brian, I was thinking back inbounded, you had commented that this is the year that you started adding legitimate power to the platform. And now, we're hearing so much discussion of custom objects. Are you surprised at how quickly the enterprise functionality has resonated in this kind of environment, and do you see more activity at the upper bound of your target market in terms of company size?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Hey, Mark. Thanks for the question. I read your report that came out. That was great. I'm not that surprised. There's been a lot of hard work that's gone in kind of on the platform level on custom objects side of things, it's been really going on for a long period of time. And this was the year we really wanted to strengthen that enterprise tier of our product, the product that we sell into like 200 to 2,000 level customers.

And we knew for customers of that size, a major objection from existing customers who were graduating and new potential customers was, gosh, we've got this evolving business model, but we have to kind of jam our business model into your relatively fixed object model into your context, company deals that sort of rigid the way we structured it. And what custom objects gives them the ability to do is wrap HubSpot in our object model around an evolving or more complicated business model. And so, this makes us a better fit, for example, for a university.

There can be a student object or a SaaS company, there can be a subscription object. There can be for a manufacturing company, inventory could be an object. So, it just gives you a ton more flexibility if you're a scaling company. And so, I'm not shocked that we're getting good adoption on it. It's [indiscernible] (00:15:39) loud noise from that tier of customer for us for a number of years. And so, we undertook that project as a part of last year and it came out great.

The nice thing about Sales Hub Enterprise and about those custom objects is they're part and parcel of HubSpot. So they inherit all the great automation and all other great reporting and that's kind of bolted in there. It's sort of like an Apple like deal to them. They're really powerful and really easy to use. So, I guess I'm not shocked.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Okay. Great. Now, Kate, I had a mathematical question for you. I was trying to run the math at the Analyst Day. I think you'd said Marketing Hub was over \$600 million, growing at least 20%. And Sales Hub, I think over \$160 million, growing at 60%. And so, yeah, so I ran the math on that. It looks like you're almost booking as much of new business with Sales Hub now as you are with Marketing Hub or it's getting close, kind of, this twin engine situation? Is it fair to start thinking of it that way already this soon? Or is it possible we'd see crossover there in the next couple of years, because I was also considering, I think Brian just said that October actually - I thought he

said October not September, was the highest level you hit for Sales Hub Enterprise net new ARR. So I'm trying to kind of tie all that together and see what you think?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. Yeah. Look, I think you're going to see and have seen ebbs and flows across Marketing Hub and the Sales Hub over time. I think they're both great engines for the company and I think they're both going to be big growth drivers to come.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Thank you.

Operator: Your next question comes from Alex Zukin from RBC. Please go ahead.

Alex Zukin

Analyst, RBC Capital Markets LLC

Q

Hey, guys. Thanks for taking the question. Maybe just the first one on just what you're seeing with respect to sales cycles, the demand environment, and the pipeline. How is that different from, call it, 90 days ago and even since inbound, what you saw come out of inbound, because it does feel like some of the results you are posting, the billings numbers, it does feel like there's a bit of an acceleration in terms of the priority set that you're solving for customers. So, just any high level comments there? And then I've got a quick follow-up on everybody's favorite topic of billings.

Brian Patrick Halligan

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

A

Hi, Alex. I'll take it. It's Brian. It's been an interesting year. Like, if I think about this year, the year started really strong, January and February. We were very bullish about this year internally. We had done with a lot of hard work last year to trying to get ready. So started with the kind of a tailwind [indiscernible] (00:18:38) end of March to early June, huge headwinds. And starting at the end of June, that headwind turned into a tailwind and that tailwind blew all through Q3, it blew through October, too.

And so, I'm pretty happy with where we're sitting at the moment. Things are going really well. And I think we are very well-positioned to help our customers through that, and I give some credit to that. I also give some credit to just a lot of hard work from the team in execution over the last couple of years to put us in this position. So it's a little bit of both.

It's hard to say what's – with the election and shutdowns, like, I'm not sure what's going to happen over the next six months. But I'm pretty optimistic, like, the pipeline looks good, customers are quite happy, our value props are quite strong, our products are getting better.

Customers need to move from an outbound model to an inbound model, from outside selling to inside selling, from offline to online. Our product is a really, really, really good fit for that type of thing. And so, I'm feeling quite positive these days actually.

Alex Zukin

Analyst, RBC Capital Markets LLC

Q

And, Brian, I guess when you think about – as you look to next year, you're clearly going to invest to take advantage of the growth. A lot of investors and companies start thinking about comps for – some comps are easing. Some comps are getting tougher depending on what kind of software you're selling. But for you, guys, it feels like because of the way you're coming out of it, and the sales cycles are working, and everything's resonating, is it possible that if we do get stimulus, you can actually accelerate as we look at next year? Or what's the right way for us to think about that, and any tie in with the puts and takes around billings that we should keep in mind both next quarter and just in general from here?

Brian Patrick Halligan

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

A

I don't know is the honest answer. I don't know if the stimulus is coming and I don't know what the impact will be on HubSpot. I can say – I try to really think a lot about what I can control and what I can influence. And I can influence our employees and our customers and our partners. And I think we're in very good shape. Like, you've been tracking our company for a long time, just feeling really very solid about where we sit. And I think – I just think it's – really it's we think way back, like, when we first went public years – is seems like a hundred years ago, we were just making the transition from a marketing app to a CRM platform.

And we're making great progress on that. It's a multiyear art and we made huge investments. It's still pretty early in that art, like, our vision for what a modern CRM value prop is to companies relative to what we built, we've made a lot of progress on. There's a lot more progress to come. So, in general, I'm feeling quite good these days.

Alex Zukin

Analyst, RBC Capital Markets LLC

Q

That's awesome. And just, Kate, anything on billings that we should be aware of given the different terms for some of your products now in the market?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah, I guess last time we talked about compression in the upfront duration of billings, I think we have a different conversation to have this quarter. I would just start frankly with a reminder that the FX is different on billings than it is on revenue. And so there was a 5-point benefit to billings in Q3. So the number I would really focus on is that constant currency billings growth of 33%.

And there's a couple of things I would point out. One is just strong business performance is going to drive strong revenue growth and strong billings growth. Quarter-over-quarter, we did see an improvement to the billing duration. And some of that is a mix where we saw some strength in Marketing Hub and in the pro and enterprise SKUs. But we also saw a bit of a tailwind just like we saw with retention to the return to normal billing for some of the customers that were under these short-term COVID discounts as they came out the other side. So, I would advise just long-term the right anchor point really still is constant currency revenue and constant currency billings tracking one another.

Charles Tupper MacGlashing

Vice President Treasury & Investor Relations, HubSpot, Inc.

A

Alex, we're getting some feedback there, so we had to unmute your line. Thanks for the question. Operator, if we can take the next one?

Operator: Your next question comes from Samad Samana from Jefferies. Please go ahead.

Samad Samana

Analyst, Jefferies LLC

Q

Hi. Good evening. Thanks for taking my question. Let me echo the very strong results, we're great to see. Kate, maybe first a question for you. It was a really impressive performance that that net adds was up quite a bit quarter-over-quarter. But ASRPC also increased quarter-over-quarter. So is it fair to assume that the company either had more pro and enterprise signings as a percentage of the mix in 3Q or was that a function of something else?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. Thanks for the question. We are, obviously, really happy with the new customer adds for the quarter. I would say Starter Growth suite was another quarter of really strong adds, so that was a big driver of the customer count growth in Q3. But one of the things that I liked about the quarter was that we also had really strong adds in the professional and enterprise additions, and, frankly, both in marketing and in sales. So, I would caution us not to expect 8,000 or 9,000 new customers every quarter. But it was a great quarter for new customer adds.

As far as ASRPC, some of the sequential uptick is going to be attributed exactly as you expected to a bit more in the professional and enterprise customer adds. I think there is also a little bit of help there from the customer coming off of the short-term discounts and going back to more normal pricing.

Samad Samana

Analyst, Jefferies LLC

Q

Great. Very helpful. And then, Brian – sorry.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Go ahead, Samad.

Samad Samana

Analyst, Jefferies LLC

Q

No, no, go ahead. Sorry. Please. Sorry. [indiscernible] (00:24:56).

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

I would just finish, we talked about having – expecting that ASRPC was going to be under pressure for the next few quarters at least as the customer mix shifts to that starter tier. I think that still holds true.

Samad Samana

Analyst, Jefferies LLC

Q

Okay. Great. That's helpful for modeling. And then, Brian, maybe just a follow-up for you. If we maybe zoom out, we've now been kind of all stuck at home for almost seven, eight months. But what we've seen for you guys is even ex the upgrades off of discounted pricing that a pretty strong net retention. So it seems like existing customers are buying again and adding additional products. Could you maybe help us just stepping back, what

are customers prioritizing as they adjust to kind of our new reality, particularly heading into 2021 and how that's translating into selling back into the base?

Brian Patrick Halligan

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

A

Yeah, I think that everybody now – as you know, so many companies Samad had on their to-do list to really digitize their go-to-market. There's very few people in the world today, they're like, that's a bad idea. Whereas 10 years ago or early start in HubSpot, people thought we were crazy with all of these inbound digitization, but it's become pretty mainstream. And I think COVID might have sped up some of the plans on there that people are – they're at home and their prospects are at home, and their customers at home. And it sort of – it was kind of a compelling event to speed people up to really digitize their go-to-market. And HubSpot was very well-positioned for that.

As we've built a platform that helps people digitize their entire go-to-market to create a modern flywheel, to create a really terrific customer experience. So, I don't think it should be that surprising that we've done really well. I do think we were very well positioned. I think we're very well positioned going forward, too, like, the advances we've made on the products and the improvements we've made on the go-to-market have been substantial over the last year, and I think we're getting nice returns on those.

Samad Samana

Analyst, Jefferies LLC

Q

Great. Thanks for that. And it's good to see all of the investments paying off. Have a great night, guys.

Operator: Your next question comes from the line of Stan Zlotsky from Morgan Stanley. Please go ahead.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Perfect. Thank you so much, guys. When I was reading the press release, one thing that really kind of stuck out at me was that the – some of the benefits that you're seeing right now is, the way you guys put it was from the ongoing digital transformation of the mid-market. That means that particular mid-market is a statement. Is that the way that you guys are viewing yourselves now as an, yes, you definitely have a very strong solution for the mid-market – I mean, for the SMB and that's your [ph] router (00:28:06) certainly in that space. But the mid-market is that really where you guys have been focusing, and that's where you're seeing the most traction these days as far as I think the incremental bookings, billings that are coming into the company?

Brian Patrick Halligan

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

A

That's a good question, Stan. We break our – we roughly break our segments up, Stan, 2 to 20-employee companies. We call that small, 20 to 200 employees at mid; 200 to 2,000, we call that enterprise. We have perfect product markets fit and perfect product go-to-market fit in that middle, that 20 to 200, we do extremely well in there. I think what you're seeing this year is nice improvement on product markets fit and go-to-market – and go-to-market fit in the small and [ph] mid enterprise (00:29:10).

On the small side, we did that. We repackaged basically that starter suite. So it's \$50 per month. And boy, that's done really well. We're very happy with what's going on there. Customers are signing up. They're being retained nicely. They're upgrading. And at the same time, we've seen a lot of improvements to our product line up in that 200 to 2,000. And so, I see at this time of [ph] gist (00:29:35), we're for a start-up and scale ups and what I don't

like to describe HubSpot as for, is small business. Like, I don't think that's really us, it's not we're like little tiny companies, a little shop. Maybe I have a flower shop near my house and they make smoothies and it's like two people. It's not for them, it's for a real business that's going to grow. We want to be the number one CRM for scaling companies. And so, that's kind of where we sit in the market.

It's a little bit similar and [indiscernible] (00:30:08) when I use this analogy, so it's a little bit similar to where NetSuite used to sit in the market. I think NetSuite's TAM is a lot smaller in the grand scheme of things than our TAM, but it's for that start up and scale up company between 2 and 2,000 employees.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Perfect. Thank you. And then, if I could sneak in a quick follow-up. So, the – help us kind of better understand how you guys are thinking about Q4 guidance, because on one hand, we're very clearly seeing extremely strong results in Q3. And Brian, you talked about the tailwinds that you've been seeing through the summer and then into all the way through October, but at the same time, we are seeing COVID cases are spiking. And you guys – you mentioned in your prepared remarks, that is a consideration. So, how did you guys reflect that in your Q4 guide? Maybe that's a question for Kate. Thank you.

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. I mean, I think we've been trying to take a very consistent approach for many years in terms of how we think about guidance. In the short-term, our model is pretty predictable and we're providing guidance now just for the next three months. And so we – well, I mean we are a month in, so the next two months. And so, to us, it's a bit of a balance just looking at business performance and then looking at potential outcomes. And we're confident in the numbers that we put forward.

Stan Zlotsky

Analyst, Morgan Stanley & Co. LLC

Q

Got it. Thank you so much.

Operator: Your next question comes from the line of Walter Pritchard from Citigroup. Please go ahead.

Drew Foster

Analyst, Citigroup Global Markets, Inc.

Q

Hi. This is Drew Foster and thanks for taking the questions. I have two. During your Analyst Day you highlighted some customers were a key factor in deciding to go with HubSpot. Was that – they were able to consolidate systems with you? So to what extent is the desire to consolidate front office technologies going to reliably be a growth driver for you, Brian? And I'm wondering if you've noticed that trend in any specific demographics of customers as a common theme, and whether you've drawn up any specific plays around addressing that opportunity across different combinations of your hubs? And I have a follow-up.

Brian Patrick Halligan

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

A

That's a really good question, Drew. There's a great tweet and there's been a bunch of articles about it. But there's an ad cutout of like a 1998 newspaper. It's an ad for RadioShack. And in the ad, there's like 50 different devices in there from an alarm clock, to a compass, [ph] to – you name in there (00:32:47).

And then next to it is an iPhone. And the iPhone does all that stuff now. And I think that really – that ad is really good. And that's sort of like HubSpot. People have all this stuff that they've kind of cobbled together over time. It doesn't [ph] weed (00:33:03) together very well. And so we're seeing people just kind of consolidating their whole tech stack on HubSpot and then plugging – our integrations are very elegant, they're kind of like Apple's integration's. They're much tighter. And so it's a little bit similar to that.

We're seeing a fair amount of [indiscernible] (00:33:21), particularly as you move from marketing to full CRM platform. The CRM platform, that's a very broad thing for managing from a total stranger that never heard of you all the way to a delighted customer. People can have hundreds of applications dealing with that, and then they come to [indiscernible] (00:33:40). We'll manage this experience through HubSpot, we'll plug a few applications into it and get it to really roll. So, that's kind of how I think about that. That old RadioShack ad.

Drew Foster

Analyst, Citigroup Global Markets, Inc.



Okay. Got it. And as I'm thinking about ARR growth for your newer hubs, Brian, and compare that to the growth curve of where marketing was at this time, obviously, to the newer hubs have had the benefit of the cross-sell vector that marketing didn't have for some period of time. So, if we kind of do a qualitative exercise and back out the benefit of cross-sell through those newer hubs and observe the success of those hubs in their own – on their own merits, so what evidence or trends give you confidence that you're sort of shaking things up in those markets the same way that you did with marketing?

Brian Patrick Halligan

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



No, it's a good question. I kind of – I think back when we released our Sales Hub product several years ago now, it started to [indiscernible] (00:34:39) signal. And man, it's just been getting better and better and sort of got a lot better a month ago with the Sales Hub Enterprise release. And if I look at that product, like most of the early sales are really cross-sell sales.

But if I look at that product now, it's as much a front door to HubSpot as it is a side door from Marketing Hub. So, it's a lot – people come in on Sales Hub, and then they buy Marketing Hub or there's an existing Marketing Hub customer, then they buy Sales Hub. That took a while to develop, but that's common right now. That's a good side, business is growing fast.

I think we're going to see the same thing on Service Hub and the same thing on CMS Hub, where a lot of it now is you're selling into your existing customers, but those products are getting a lot better. And I think those will become front doors over time as well.

Drew Foster

Analyst, Citigroup Global Markets, Inc.



Really helpful. Thank you.

Operator: Your next question comes from the line of Tom Roderick from Stifel. Please go ahead.

Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.



Hi. It's actually Parker Lane in for Tom. Thanks for taking my question. So, Brian, you just launched marketing contacts during the quarter. I'm just wondering how much of that was in response to sort of feedback, I guess, from your customers? And what do you think that means for attention going forward if customers really don't have that upper bound on how many contacts they can store in the platform, what does that mean for attention and engagement with the platform? Thanks.

Brian Patrick Halligan

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

A

Hey, Parker, that's a great question. We have a terrific board member, Parker, named Jay Simons and he was president for a long, long time of the company called Atlassian that we admired a lot. In Atlassian, they track bugs in their products and they try to fix bugs. They also track bugs in their entire go-to-market in the entire buying using experience including their pricing model. Whenever they find a bug that creates some friction or create a cringe in that process, they file it and they try to fix it.

We have completely borrowed that idea here at HubSpot. And one of the bugs in the buying experience where HubSpot has been going on for a fairly long period of time has caused customers to cringe is marketing contacts. And you can imagine how this might happen. When we first started HubSpot, we priced it like a lot of other marketing vendors, where you buy the SKU and then the larger your database of contacts, the more you pay. Of course, that works great, but then you add Sales Hub and all of a sudden salespeople are adding thousands and tens of thousands of contacts into that hub and the bill for the marketer is going through the roof.

There is a lot of complaints about this over many years. This was something we wanted to fix for a long time. It was actually a large project that took, probably took a year to do it and we did it off and we did it over the summer. And it's come out really well. Very happy with the way we've implemented. We're getting terrific feedback from it. And I think that change will increase customer happiness. And I think we'll also make it easier for people to buy HubSpot. They'll also make it easier and more predictable to scale your pricing of HubSpot. So that's a big, big win for our customers and for HubSpot itself. And I think for investors over the long haul, that will be a driver of growth.

Jeffrey Parker Lane

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Yeah, it's great feedback. And then on the Sales Hub front, and one of the things you announced at inbound was the addition of some new tools there including CPQ, I was wondering if you could talk about the initial interest in the CPQ tools you have out there. And if that's mostly an enterprise play you think or if that's really broad base of the customer set? Thanks again.

Brian Patrick Halligan

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

A

Yes, we announced some early CPQ product with Sales Hub Enterprise. We're getting nice uptick on them. And this is just sort of I think of HubSpot as we want to be a very legit CRM company. We want to be the number one CRM for scaling company. And that means you kind of go all the way to the edges of the problem. And so part of the edges as people want to do a proposal and they want to be a quote. They want to connect it to their accounting system and have all that stuff closed off and close the loop. And we came out with an early version of that with Sales Hub Enterprise getting really, really good adoption. And keep your eye on that channel. There's more to come on that front. Customers really like that area that we're investing in. We're going to invest more.

Operator: Your next question comes from the line of Arjun Bhatia from William Blair.

Arjun Bhatia

Analyst, William Blair & Co. LLC



Hey, guys. Thanks. And I would [indiscernible] (00:39:13) my congrats on the quarter. Kate, if I can start off. I know we've touched on this a little bit last quarter, but – is there anything – any update that you can give us on this COVID cohort of customers that are coming in on Starter in terms of upgrade rates, churn, landing point? Anything on that front would be helpful now that we're 90 days removed from when we last had this conversation?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.



Yeah and I think the terms are very much the same as the ones that we talked about at Analyst Day and frankly, on the last earnings call. We continue to see those big Starter cohorts. They are – the vast majority of those Starter cohorts are new to HubSpot versus customers that are downgrading or moving from another SKU.

They are on balance similar in size to the customers that we saw signing up for our other Starter SKUs before this package was introduced. And they are upgrading at a rate that's similar, I would say maybe a little bit lower than what we had seen historically, but at a rate that's healthy enough that we're excited about the opportunity there.

Arjun Bhatia

Analyst, William Blair & Co. LLC



Great. That's very helpful. And Brian, maybe one for you, not to beat a dead horse on 2021, but just curious, obviously, this has been an odd year. Curious on what you're hearing from your customers in terms of how they're thinking about marketing budgets and how those might change next year. Do you think this elevated focus on digitizing marketing strategies go-to market continues? Or do you think we see that moderate a little bit going into next year?

Brian Patrick Halligan

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



It's hard – I'd say predicting the future is a very hard thing these days. I would just say in connecting with my sales leaders and service leaders just over the last couple of days, people are feeling pretty good. Demand is strong, customers are happy and buying more, and new accounts are coming in. [ph] Feel like (00:41:34) our products are more and more competitive. So, feeling pretty good. Yeah. Feeling pretty good. It's hard to know what happens if there's a giant lockdown, or God forbid, something really bad happens with this election. But feeling pretty good, I think, right here.

Arjun Bhatia

Analyst, William Blair & Co. LLC



Perfect. Thank you.

Operator: Your next question comes from the line of Ryan MacDonald from Needham.

Ryan MacDonald

Analyst, Needham & Co. LLC



Hi, thanks for taking my question and congrats on an excellent quarter. I guess, Brian, first one for you, given that CMS Hub sort of fully launched sort of in the midst of the pandemic. It feels like Inbound was a bit of a coming-out party for the new product. Just curious to see sort of, as you're processing and going through sort of the responses and feedback from Inbound, what you're hearing in terms of interest in adoption for CMS Hub? And

what's sort of the mix you're seeing in terms of existing customers that may have been using the add-on functionality to Marketing Hub initially, wanting to upgrade versus net new customers into the platform?

Brian Patrick Halligan

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

A

Hey, Ryan. Hearing great things about CMS Hub, it's an interesting industry, the content management system industry, and people will probably – investors talk a lot about Wix and GoDaddy and Squarespace even they advertise a lot. But really the dominant players in our part of the market, even up from us are Open Source projects. And they're not as well known to investors, because there's no public company comp and they don't really advertise as much.

But that's where we compete and kind of compete in the mid-market with a large open source product called WordPress.

I think where we really win over the long arc of this thing, is there's tremendous power when you combine a content management system with its customer relationship management system. That's a one plus one equals three experience builder for your business. And those things are combined in really cool at HubSpot. But if you watch the arc of how those things will come together over time, the development environment for the content management system, the development environment to the CRM come in together, is going to be fantastic. It's going to be really, really cool.

So, reception on CMS has been really solid. Business is growing nicely. Our partners in particular are really excited about it. But over the long haul, there is a kaleidoscope of opportunities that will be created for our customers by really combining those two applications.

Ryan MacDonald

Analyst, Needham & Co. LLC

Q

Thanks. And as a follow-up, obviously, the environment or things evolving pretty quickly. But any sense or – are you hearing anything recently internationally with sort of over the past few weeks with Europe seemingly going back into lockdown [ph] are the (00:44:31) impact to the business at all? Thanks.

<A – [06XH5J-E]Brian Halligan – HubSpot, Inc.> Yeah. Ryan, we're asking the same thing. I just checked in with my European leaders. It seems all right. It's hard to say what happens two, three, four weeks from now. But demand seems pretty solid over the [indiscernible] (00:44:39). The execution has been really solid. Again, I just think our value prop is super strong. And so it's hard to predict what will happen in the future but feeling pretty good right now.

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

Q

Hi. This is [indiscernible] (00:45:12) on for Ken. Thanks for taking the question. Just two questions. First on retention, do you see a risk for that to track back down after if lockdowns start again or have your customers being able to figure out how to kind of work through the new normal? Or I guess on the flip side, is there more headroom to December to improve as we get further out from the short-term discounts?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah, Q3 was a very strong retention quarter for us. We said – or I said in the prepared remarks that revenue retention was comfortably north of 100%. I also said that absent the tailwinds that we see from customers coming off of those short-term discounts, we still would have been comfortably above 100%. We are through the majority of those. And so I think that the retention that we're seeing, we're excited about that. And I would particularly note that one point that we're excited about is actually the really strong retention that we're seeing on a customer-dollar retention basis. So this is sort of that gross retention number. More of our customers are sticking around with HubSpot.

Q

Great. That's helpful. And just adding onto that, so have the customers that previously might have contracted seats or maybe downgraded SKUs, have they expanded back up yet?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

It's hard to say. I think when you look at the overall net upgrade rate that we're seeing in Q3, it is dramatically larger than what we saw in Q2, which would lead you to believe that as a whole population, our customers are on net, upgrading more.

Operator: Your next question comes from the line of Kirk Materne from Evercore ISI.

Kirk Materne

Analyst, Evercore Group LLC

Q

Thanks very much. Brian, when you think about sort of just the opportunity with the Sales Hub, the Enterprise Sales Hub, I'd expect that the easier land is to sort of continue to grow with your customers that might have, historically, grown just sort of out of your technology versus going after sort of net new customers. But that might be wrong. So, just kind of thinking about when you talk to your sales leaders, was it about trying to go and rip and replace? Is it about expanding with existing customers already with you? I guess, how are you thinking about that balance, because I'd imagine the sales cycles are very different with those two conversations?

Brian Patrick Halligan

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

A

Yeah. There is a few layers to it. I think the lowest layer on the cake is retaining those customers longer. We have customers that outgrow us. These reasons [indiscernible] (00:48:03) growth, things like custom objects is a big reason why someone would outgrow us. And so, retaining them as a goal from 200 to 2,000 is a good one than just winning more deals.

People hesitate to buy HubSpot if they think they're going to really scale up [indiscernible] (00:48:20) HubSpot for scaling companies. And I think the answer is yes now, between what we're doing on the functionality side and what we're doing in the business model side with custom objects which is much, much more attractive. And then maybe the third layer on that cake is ripping and replacing. That's a harder thing to do. It's certainly happening. And I hear about them when they happen. It's exciting when that happens. But it's probably the third layer on the cake.

Kirk Materne

Analyst, Evercore Group LLC

Q

Okay.

Brian Patrick Halligan

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

A

But that is going really well. People are really excited about our customers, our partners and sales reps. It's getting us in a lot more conversations.

Kirk Materne

Analyst, Evercore Group LLC

Q

That's helpful. And then one sort of more maybe higher-level question for you, when you talk to others in the sort of broader CRM space and maybe at the enterprise level. This concept of a customer data platform continues to come up and we see M&A around this. Does sort of CMS plus your marketing technology sort of solve the customer data sort of centrality discussion for you all, meaning, I don't know why a small company wouldn't want to know their customers just as well as a big company. So is that conversation coming up and do you guys – are you able to kind of get at that with your existing technology now or is that something that you're willing to partner with others on?

Brian Patrick Halligan

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

A

People do think of HubSpot as their – that's where the central [indiscernible] (00:49:42) to all their data.

Kirk Materne

Analyst, Evercore Group LLC

Q

Okay.

Brian Patrick Halligan

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

A

And over time, we want to make it as attractive as possible to integrate all your systems into HubSpot, [indiscernible] (00:49:50) back and forth. That's one of the reasons we acquired PieSync a while back. And then we'll have them report on all that. So, yeah, I see HubSpot over the long haul, if you want to use the term CDP, as a CDP for their customers, and I want HubSpot to be their center of gravity to enable them to really create off experiences whether it's in our tools or other tools that they use that they're plugging in, anything from Zoom, to Google AdWords, to little startups building stuff on top of the HubSpot.

Kirk Materne

Analyst, Evercore Group LLC

Q

That's helpful. Thanks and congrats on the quarter.

Brian Patrick Halligan

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

A

Thank you.

Operator: Your next question comes from the line of Koji Ikeda from Oppenheimer. Please go ahead.

Koji Ikeda

Analyst, Oppenheimer & Co., Inc.



Great. Thanks for taking my questions. Congratulations on a really great quarter. First off, I wanted to thank Brian for bringing up that RadioShack ad. I can picture that ad in my head right now. So that was definitely nostalgic, I think. So thank you for bringing that up.

I wanted to ask you too about the sales enterprise version, especially more specifically on the customer object. It sounds like it's a real game changer for that version. I guess could you talk a little bit about what custom object means from a customer lens? Does it enable them to maybe replace any existing applications or does it enable the customer to maybe stay within the HubSpot ecosystem longer as the business scales before they have to maybe look outside the HubSpot Box for additional features?

Brian Patrick Halligan

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



The way I would describe it is, let's just say you were a university coach, and you're using HubSpot, you're just kind of shoehorning your student – you call your prospective student leads inside the system and then you call your students that are paying you, and you call them customers. And it just is an unnatural. You're kind of jamming your business model into HubSpot. Pretty rigid object model.

What you want to do is go to a university and match the way your whole front office system works, your CRM system works with the way your business works. And that means you've got a student and a student is an unusual model. It's different than a typical customer, because the student comes in and lasts for four years. So if they cut some object inside of HubSpot, you want to report on that in certain ways, you want to create workflows around that in certain ways. So, it just enables you to do a whole heck of a lot more.

And what we've noticed is when a company comes in, Koji, let's say there's a 20-person company comes in, they buy HubSpot sales product, marketing product and they're super happy with it, because like [indiscernible] (00:52:25), I'm just going to use everything they got here and just plug it in and run. But as that company moves in and it's a 500 employees now or 600 employees, their business model gets complicated and they get irritated, because they have to kind of jam it in the HubSpot. And so out of their business model of all, HubSpot was evolved with them and scale with them. That's sort of the way it works. Did that make sense?

Koji Ikeda

Analyst, Oppenheimer & Co., Inc.



Yeah. Yeah. No, it totally makes sense. Thank you for that. And I wanted to just ask you one more follow-up here. On the CMS Hub, you mentioned Open Source and WordPress, but what about Drupal? Can you compete with Drupal right now or is it maybe the longer-term vision for the CMS Hub to be competitive against Drupal deployments? Thanks for taking my questions.

Brian Patrick Halligan

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



No problem. We're [indiscernible] (00:53:18) Drupal at both, like, big open-source projects. They've been around a while, and they're powerful product. But they kind of aligned with each other. We took a very different approach where our pure [indiscernible] (00:53:33) out of the box is a very modern approach to building it. I kind of in my [indiscernible] (00:53:38) positioned Drupal pretty far up market like the White House runs on Drupal and – huge enterprises run on Drupal. More where we live in kind of the mid-market is more WordPress. And we integrate really nicely with WordPress. If somebody loves WordPress, they can keep it. But I do think that power of having

the CRM and having the CMS together is going to enable developers and ask people to do amazing stuff over the next couple of years. So I think that's where our core competitive advantage is going to come from.

Koji Ikeda

Analyst, Oppenheimer & Co., Inc.

Q

Got it. Thanks for taking my questions.

Brian Patrick Halligan

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

A

Sure.

Operator: Your next question comes from Siti Panigrahi from Mizuho. Please go ahead.

Michael Berg

Analyst, Mizuho

Q

Hey. This is Michael Berg on for Siti Panigrahi. Congrats on a great quarter once again. I wanted to dive in quickly on International. You saw a nice acceleration in the quarter. Can you point to anything in particular that is driving success abroad? And moving forward, can we expect international to maintain this type of strength even with the ongoing shutdown?

Kate Bueker

Chief Financial Officer, HubSpot, Inc.

A

Yeah. Thanks so much for the question. It's interesting that you called that out. I actually think that performance is pretty broad-based. And so, yes, we saw some acceleration or reacceleration in the international growth. We also saw reacceleration in domestic growth. So, I think it's across hubs, across geographies, we saw really strong performance.

Operator: Your next question comes from the line of Brent Bracelin from Piper Sandler. Please go ahead.

Q

Hi. This is [indiscernible] (00:55:21) on for Brent. I was wondering in terms of the traction in the enterprise and professional customers this quarter, on that higher end sort of customer, how long were they in the funnel? Wondering whether these customers were looking at a digital engagement product or even since the early pandemic, they kind of finally converted in Q3, or these new customers that are you're engaging with in quarter and converting in Q3 alone? Just trying to understand if there are customers out there that are kind of enduring the pain of a traditional go-to-market and then they have to make the change now kind of entering the back half of the year?

Brian Patrick Halligan

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

A

Honestly, it's a little bit of both. There's a lot of people who have been looking at people – a lot of people are looking at HubSpot for a long time and they finally bought. And there's some – what we call short cycle MRR here.

The short cycle MRR is up. By short cycle I mean they came into our funnel within the month and they purchased within the month. It's not up a lot. I think it's a little bit more broad based than – like I kind of said earlier, I think part of our momentum is certainly all the stuff going on in the world is really people are thinking about digitizing their go-to-market. I also just think even with all this – if this was of normal year when the nights with nothing happening in the world and just [indiscernible] (00:56:42), I think we've been having a really good year. We were really set up well. So I think it's a little bit of both. That would be my take on.

Operator: And that was our last question. At this time, I will turn the call over to Brian Halligan, CEO and Chairman for closing comments.

Brian Patrick Halligan

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

Thanks to all of you for joining today. Looking forward to talking to you soon.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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