



HubSpot, Inc.

Second Quarter 2020 Earnings Conference Call

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P R E S E N T A T I O N

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the HubSpot Q2 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. To ask a question during the session, you will need to press star, one on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press star, zero.

I would now like to hand the conference over to your speaker today, Chuck MacGlashing, Head of Investor Relations. Thank you. Please go ahead.

Chuck MacGlashing

Thanks, Operator. Good afternoon, and welcome to HubSpot's Second 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 third 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 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 used or discussed, and a reconciliation of the differences between such measures, can be found within our second 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 Halligan

Thanks, Chuck. Good afternoon, folks. Thank you for joining us today.

The world's been through a lot in the last few months. Collectively, we're still weathering the storm, but I'm happy to share progress HubSpot's made over the last quarter.

Constant currency revenue growth was 26% in Q2, and non-GAAP operating margin was 9%. Total customers grew 34% year-over-year, surpassing 86,000, while multi-product adoption continued to grow nicely, representing over 38,000 customers.

We were fortunate back in Q1 to have some wind at our backs after a strong start to the year. Nevertheless, the onslaught of the global pandemic was felt throughout our Company and our customer base, and much of our spring was focused on helping our customers and partners respond to the economic downturn. Today, I'm thankful to say that the disruptive headwinds we faced early in Q2 have eased, and might have even begun to shift a bit in our favor, helped along by some nice execution and some important plays we ran.

We've had a strong product year so far, that's raised the power of our Enterprise Tier, while also adding new products to the mix. This began in Q1 with the introduction of an entirely updated version of Marketing Hub Enterprise. With this relaunch came a ton of advanced features, including revenue attribution reporting, AI-powered A/B testing, and account-based marketing. Marketers can now start with us at an early stage and grow with us into a large scale-up, now that we've released this product. Marketing Hub Enterprise is really resonating nicely for us in the market.

In Q2, we introduced a new product line, CMS Hub. This was the completely reimaged version of our previous CMS add-on, with advanced features, making up a Pro and Enterprise Tier. We have found strong product market fit in the mid-markets between simple, but limited, website products and overly complex content management systems. CMS Hub gives companies the benefit of advanced features, like dynamic content, adaptive testing, and 24x7 security monitoring, without all that heavy maintenance and design needs that come with legacy content management system solutions. Companies and organizations, like ClassPass, World Wildlife Fund, and Randstad, have now built sites on the new CMS Hub. The formalization of our CMS Hub, through the addition of these tiers, led to a really nice rate in acceleration in growth in that product line.

You see, your traditional enterprise SaaS playbook is to cobble together a product through acquisition. This approach has led to a pretty rough enterprise front end for a lot of product married to a pretty solid enterprise back end. HubSpot has skewed that traditional approach. We've chosen, instead, to handcraft our product in-house. You see, underneath HubSpot, there's only one view of that customer and a consistent user experience across that front end. We've married a consumer-like front end with new enterprise power, and this is giving us a real advantage in the marketplace. I think our patient approach and our slight obsession with Apple is starting to really pay off.

Now, we haven't just been working on that Enterprise Tier. To help more businesses make the transition from offline to online after the crisis hit, we reduced the first year price of our Starter Growth Suite by more than 50% and increased email sending and call limit. Additionally, we released greater editing controls of our ad campaigns across Google, Facebook and LinkedIn in Marketing Hub Starter. All of this resulted in a 400% plus increase in our Starter install base growth, as free users upgraded and many new businesses moved fully online for the first time. We coupled this on-ramp to HubSpot with a surge in educational content and we've seen record engagement in HubSpot Academy as a result. In fact, in Q2, we saw nearly a 150% increase year-over-year in Academy sign-ups, and similarly strong growth in the number of people getting certified on HubSpot. Really great stuff.

I'm incredibly proud of the way the entire HubSpot Team continues to deliver on our product roadmap and pivot to help our customers amid rapidly changing times. Companies in nearly every industry have had to move their teams or go-to-market strategies and the entire customer experience online. What might have been a gradual digital transformation for some businesses has now been dramatically accelerated by the impact of the pandemic, and we've become the platform to support that transformation in the mid-market.

I'm encouraged by the traction we saw in the second quarter and we see evidence of a continuation of that performance in the early part of Q3, but this short-term-demand environment is still quite fluid, so we're watching things very closely.

Now, I'll hand things over to Kate to take you through our Q2 financial and operating results in more detail.

Kate Bueker

Thanks, Brian. Let's turn to our second quarter financial results and our guidance for the third quarter and full year 2020.

Second quarter revenue grew 26% year-over-year in constant currency and 25% as reported. Q2 subscription revenue grew 26% year-over-year, while services revenue declined 3% year-over-year on an as reported basis. Domestic revenue grew 20% in Q2, while international revenue growth was 36% year-over-year in constant currency and 32% as reported. International revenue represented 42% of total revenue in Q2, up two points year-over-year. Deferred revenue as of the end of June was \$241 million, a 22% increase year-over-year. Calculated billings was \$202 million, up 21% year-over-year, both on an as reported basis and in constant currency.

HubSpot ended the second quarter with over 86,000 total customers, which was up 34% year-over-year. Net customer additions exceeded 7,800 and set a Company record, driven by strong demand across our entire product portfolio, but particularly in our Starter Growth Suite. Average subscription revenue per customer of nearly \$9,500 was down both sequentially and year-over-year, as a result of the strength we've seen at the low end of the portfolio, combined with elevated levels of customer downgrades.

As we highlighted last quarter, we took some proactive measures in late March to help alleviate the impact of COVID-19 for our customers and partners. These included offering flexible payment terms and customer-friendly downgrade alternatives to our most impacted customers, and prepaying some partner commissions. As a result, we expected retention rates to trend lower in Q2, due to the weaker economic environment, as well as the impact from our customer-friendly programs. While we did, in fact, see pressure on our retention rates in Q2, we maintained a net revenue retention rate of 90%, with the majority of the decline continuing to come from customer downgrades. It's still quite early, but we have seen encouraging performance from the first cohort of customers coming off these short-term discounts and moving back to more normal pricing. I want to stress that the near-term economic environment is still uncertain, but we're cautiously optimistic that the plays we've put in place helped our customers and partners adapt in these difficult times.

The remainder of my comments will refer to non-GAAP measures.

Second quarter gross margin was 82%, flat year-over-year, subscription gross margin was 86%, while services gross margin was negative 8%.

Second quarter operating margin was 9%, up slightly, compared to the same period last year. Operating margins in the quarter exceeded our expectations, as a result of strong revenue performance, as well as reduced travel and other discretionary expenses related to our shift to work from home. While we plan to maintain a disciplined approach to investment through the remainder of 2020, we expect our planned return-to-work initiatives and continued investment in R&D to largely offset these expense savings.

At the end of the second quarter, we had 3,769 employees, up 29% year-over-year. We expect total headcount growth to moderate in the second half of the year, as we start to compare against our strong hiring quarters from 2019.

Net income in the second quarter was \$17 million, or \$0.34 per diluted share.

Cap ex, including capitalized software development costs, was \$14 million, or 7% of revenue, in the quarter. We continue to expect cap ex as a percentage of revenue to be about 7% in 2020.

Free cash flow in the second quarter was \$800,000, driven by strong business performance and better than expected customer cash inflows. As a result, we are increasing our expectations for full year 2020 free cash flow to approximately \$40 million.

HubSpot ended the quarter with over \$1.2 billion of cash and marketable securities. At the beginning of June, we successfully executed a \$460 million convertible bond issuance with the concurrent repurchase of roughly 70% of our existing convertible bond due in 2022. As we look to the future, we remain confident that our strong balance sheet will provide us with the financial flexibility to invest for the long term.

With that, let's dive into guidance for the third quarter and full year of 2020.

For the third quarter, total revenue is expected to be in the range of \$210 million to \$211 million, up 21% year-over-year at the midpoint. Non-GAAP operating income is expected to be between \$7.5 million and \$8.5 million. This range includes a one-point headwind to operating margins from our Inbound event in September. Non-GAAP diluted net income per share is expected to be between \$0.11 and \$0.13. This assumes 48.8 million fully diluted shares outstanding.

For the full year of 2020, total revenue is now expected to be in the range of \$828 million to \$832 million, up 23% year-over-year. Non-GAAP operating income is now expected to be in the range of \$52 million to \$54 million. Non-GAAP diluted net income per share is now expected to be between \$0.92 and \$0.96. This assumes 48.5 million fully diluted shares outstanding.

Our guidance reflects a view of the business that we are comfortable with today, given the current economic environment, and also factors in heightened future uncertainty caused by the pandemic.

As you adjust your models, keep in the mind the following:

As a result of the recent weakening of the U.S. dollar, we see a meaningful reduction in the headwinds related to foreign currency for the remainder of the year. At current spot rates, we now expect a one-point FX tailwind to Q3 reported revenue and a neutral FX impact to reported revenue for the full year 2020.

In Q2, we elected to begin tax affecting our non-GAAP net income, which we believe better aligns with SEC guidance. Our updated non-GAAP EPS guidance for Q3 and the full year of 2020 includes the impact of this change. Importantly, this change does not impact our historical reported GAAP financials. Please refer to the table included in our press release for the historical impact to prior period non-GAAP earnings.

In Q2, we excluded the accounting impact of our convertible debt repurchase from our non-GAAP net income and free cash flow. Please refer to the non-GAAP net income and free cash flow reconciliation table included in our press release for more information.

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

Brian Halligan

The story of 2020 has thus far been one of adversity. As a society, we faced the public health crisis and economic crisis and a crisis of conscience. When the dust settles, the world will be changed. We're trying to lean into the future ourselves and help pull our customers and partners with us. On the conscience side of that equation, at HubSpot, we've been working to advance diversity, inclusion and belonging in our culture and representation. We have a long way to go, so it's become one of our top strategic priorities. It's also become important for me, personally, to learn, evolve and speak out against racial injustice in the ways that I can. My hope is that what started as a story of adversity this year will become one of resilience, and resilience relies on diversity.

Thank you for your time. I look forward to seeing many of again at our first ever virtual Analyst Day as part of Inbound '20 on September 22. We've reimagined Analyst Day this year in more ways than one. We'll see you all there.

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

Operator

At this time, I would like to remind everyone, in order to ask a question, you will need to press star, one on your telephone. To withdraw your question, press the pound or hash key. Please stand by while we compile the Q&A roster.

Your first question comes from Stan Zlotzky from Morgan Stanley.

Stan Zlotzky

Perfect. Thank you so much, guys, and I hope everybody is staying well, and congratulations on a very strong quarter. Maybe the thing that really stood to me was the strength of the Starter package that you guys reported in the quarter and the contributions to the overall customer growth in the quarter. As you look across and maybe try to slice-and-dice the strength there, any similarities within the customers that are adopting the Starter package in the current environment, and then I have a quick follow-up?

Brian Halligan

Hey, Stan, thanks for the question, and hope you're well. That's something we're actually watching relatively closely, and Kate and I were just talking about that. We've been, I would say, pleasantly surprised with that Starter Suite adoption. Just to refresh everyone on the call's memory, we lowered the price in Starter Suite, to get the marketing, sales and service product all together, by 66%, so it's \$50 a month now for the first 12 months, and we did that right when COVID started, and it worked, there's been really nice adoption of it. You can see that with lots of new Starter Suite customers in that 7,800 net new customers number. So, we're really with it, and we're watching those cohorts super-carefully. We're looking at the quality of those cohorts, like what is the size and the makeup of the company who's buying it, what is the retention rate calculation on those cohorts, and what's the upgrade rate, and so far so good, they look pretty good. They're similar sized companies that were buying Starter Suite before and retention rates looked pretty good. So, we're going to keep that first year at \$50 for now and see if we can use that as growth leverage going forward. We're pretty happy with it.

Stan Zlotzky

Perfect, and then maybe just one more. The geographic growth, U.S. slowed to 20% and international very strong at 36% constant currency. When you look across the various geographies, is it fair to say that U.S. seems to be the most impacted with all of the downgrades and international seems to be hanging in better? Any kind of qualitative commentary, as far as you know, where you're seeing the pockets of opportunity, as well as strength, in the various geographies? That's it for me. Thank you.

Brian Halligan

Okay. I guess, at a high level, the international business is going really well, and I think that's because we've made some big investments over the last five years and we're starting to get a return on those investments, like big investments in offices. In Europe, we have a large office in Dublin now. We have Paris. We have Berlin. We've got offices in Japan and in Singapore, and even one in Latin America now. So, those are big investments. We've invested heavily in translating not just our products in different languages, but the whole customer experience in different languages, and we're getting a nice return on that.

I think another reason international is doing so well is just the unit economics are really good, you're growing fast, and the cost to acquire a customer, relative to sort of lifetime value, is really solid, so they're a little faster there.

I guess, in terms of North America, I continue to be bullish about it. I mean, it's a huge market. We have great product market fit. We have tons and tons of happy customers, good word of mouth. The sales organization in North America is mature. Like, I think we're set up well for steady, strong growth in North America for several years to come here. I feel good about it.

Stan Zlotzky

Perfect. Thank you.

Kate Bueker

Stan, I would just add to Brian's comments. If you look, overall revenue growth decelerated from Q1 to Q2, and if you look at U.S. and international, what you saw in sort of the more mature, more developed markets is a very similar level of deceleration across those markets. Where we saw a bit of an outsized impact was really on some of the more emerging markets.

Stan Zlotzky

Got it, got it. Thank you so much.

Operator

Your next question comes from Christopher Merwin from Goldman Sachs.

Christopher Merwin

Hi, and thanks very much for taking my questions. I wanted to ask about CMS Hub. You talked a bit about it in the prepared remarks, but, in particular, where you're seeing success there, is that helping to onboard some brand new customers? Are you seeing some early success there with cross-selling that to the existing base? Just curious, any other color you could share about that product. Thank you.

Brian Halligan

Thank you for the question. I guess it's a little of both. I'm very excited about that new Hub. It's a funny industry, you know, the industry—down at the bottom of the industry, you've got like really strong SaaS players, like Wixon, and there's a company called Squarespace, that's private, that's doing really well down there in their SaaS product, but most of the market is buying kind of open source client server technology, and it's funny that way, and so we feel like this is a big opportunity to build a true SaaS product. We think we have a great advantage in this market, because we've built that CMS from scratch and we built our CRM from scratch, and so one plus one equals ten when you combine those two products together with the same user interface. You're just able to create a great experience for your customers to use them together. So, I feel really good about it. We're getting lots of new accounts through it and we're getting some upsell through it. We couldn't have launched it at a worse time, we launched it in April, but despite having terrible timing in launching it, it's done really, really well, and I think that's going to be a help for us, kind of like SalesHub is.

Christopher Merwin

Okay, great, and maybe just one quick follow-up on billings, a very solid number there. I mean, a little bit slower than the revenue growth. Kate, I think you called out some churn, which you had spoke to last quarter, so could you just give us a sense of magnitude there, just in terms of what you saw? I imagine it was in line or even better than your expectations given the outperformance in the quarter.

Kate Bueker

Yes, sure thing. Q2 billings came in probably a little bit better than what we had thought or hoped for. Most of that, frankly, is just driven by solid performance on the new business side, but one of the things that we talked about last quarter was that we also expected that we would see a decrease in billing term during the sort of period of economic turbulence, and we saw a little bit better performance on that regard in Q2. We continue to expect to see in our customer base some duration compression over time and that will cause billings growth to be a little bit shy of revenue growth in constant currency.

Christopher Merwin

Perfect. Thanks so much.

Operator

Your next question comes from Arjun Bhatia from William Blair.

Arjun Bhatia

Hi, guys. Thanks for taking my question. Brian, you talked about the partner channel and the agencies that you work with to kind of prepay some of the commissions. I'm just curious if you've seen kind of any change in how the partner channel contribution has been holding up over the past 90 days and how much—what the strength is of those partners after you had worked with them to keep them afloat and keep their business going?

Brian Halligan

Sure. Just to refresh everyone's memory on the call, when things first started hitting in kind of mid-March, one of several plays we ran was to advance six months of commissions to our partners, and I think that went over really well. I think that worked for us and worked for them. They were able to kind of stabilize

their business. I think it prevented layoffs in a lot of cases. So, I'm feeling very good about that call. I think our partners are generally weathering the storm quite well.

If I look at the numbers through Q2, and even through July, they look pretty solid and stable. I don't see any big red flags. They seem to be weathering. I think some are doing a lot better than others, some are feeling more headwinds and some more tailwinds, but, generally, feeling pretty good about that partner channel right now.

Arjun Bhatia

Perfect, thank you, and then—

Chuck MacGlashing

Arjun, just from a percentage of revenue perspective, it ticked up a little bit in the quarter. I think it was 42%, 43% of revenue.

Arjun Bhatia

Perfect, thanks, Chuck. Kate, a quick follow-up for you. You did raise your full year kind of revenue guidance pretty meaningfully, above and beyond the beat in the current quarter. Could you maybe just talk about what you're seeing in the back half of the year that gives you a little bit more confidence in how the next two quarters will play out?

Kate Bueker

Yes. I guess I would just start by saying that we approached guidance with the same sort of foundational framework that we've always approached guidance. Our model is quite predictable, particularly as it relates to sort of short term. Much like we did last quarter, we sort of recognized that there is more forward-looking uncertainty and we ran a bit of a broader set of scenarios to look at the second half of the year and to try to understand sort of upside and downside outcomes, and, frankly, we feel really confident about the numbers we're putting forward.

Arjun Bhatia

Great, that's helpful, thank you very much, and congrats on the quarter.

Operator

Your next question comes from Ryan MacDonald from Needham & Company.

Ryan MacDonald

Hi, and thanks for taking my questions. First off, Brian, as we've kind of gone through the impact of the pandemic here, have you found any sort of pockets or verticals where you were surprised that you saw increased demand, that you didn't see sort of pre-COVID at all?

Brian Halligan

Not really. There's a thing about HubSpot that's kind of interesting, is—you know, there's some industries that have just been decimated, it's been brutal on a couple of industries. We just didn't have a lot of concentration in those some of those industries. Like, the restaurants and hospitality and travel, those are

pretty small for us. We've got a heavy concentration in B2B. The other side of that is, you know, people call is SMB software. We're more M than S. More than two-thirds of our revenue comes from companies that are over 25 employees. We're a little bit like NetSuite is to the back offices, is HubSpot is to the front office. So, we were definitely impacted. We felt a strong, strong headwind and demand was soft like a marshmallow in Q2, but feeling a lot better about things in June and July.

Ryan MacDonald

Excellent, and then just a quick follow-up. You mentioned last quarter that multi-product customers, you were seeing a bit better retention there than with single-product. Can you just talk about how that trended during second quarter and if you're seeing either improvements or maybe some deterioration there at all? Thank you.

Kate Bueker

Yes, sure. Multi-product customers do tend to retain better than single-product customers, and we continue to see that in the quarter, that has not changed.

Operator

Your next question comes from Brian Peterson from Raymond James.

Brian Peterson

Hi, everyone. I hope everyone's well, and congrats on a good quarter. Brian, just as we think about the pace of product innovation—and we can kind of look back at Mainsail and, obviously, you had CMS Hub come out this year—I'm curious how we should think about the Hubs being added to the platform over time, what that cadence should look like.

Brian Halligan

Well, we're certainly not done with Hubs, I can tell you that. I guess I might just sort of take a step back and think about HubSpot and kind of what's going on inside of HubSpot, is a year ago, when we were on this call, we talked a bunch about taking a step or two back so we could go three or four steps faster. We were super-patient about that, and that's paying off for us now, and you can kind of see it with us in January and February, we got off to just a killer start to the year. We've announced that CMS—or that Marketing Enterprise product did really well, and we're starting to get a real return on it.

The other thing around patience for us, we have a different approach to building our company and our product. Like, if you look across enterprise software in the CRM industry, there's lots of companies and enterprise CRMs, they're more like private equity companies with giant sales forces attached to them than they are like true software companies. They cobble their solutions together with M&A. We kind of handcraft it from scratch in-house, and I think over the very long haul that will set us up quite well to compete in the mid-markets, I think there will be a lot of value to that, and I think it's the new way of building one of these CRM companies and that all-in-one approach is really going to pay off.

The way we describe it internally these days—it just came to me the way we describe it—we call it our primary colors. So, underneath of HubSpot, you've got data, you've got automation, you've got reporting, you've got messaging, you've got these different kind of shared services underneath it, and then the Hubs, themselves—you know, our project managers and our developers and our designers, they're sort of creating these beautiful applications that are really easy to use on the front end, and increasingly this year, with Marketing Hub Enterprise, CMS Hub Enterprise, they deliver a really powerful punch on top of

it. So, feeling really good about that product board. There'll be more Hubs to come down the road, we don't feel like we've reached the edges of our vision for products we can build to help companies build great experiences in the front office here.

Ryan MacDonald

Understood, that's great color, Brian, and maybe as a follow-up, I just wanted to double-click on (inaudible) a bit. It sounds like things got better in June and July. Is that from a new customer logo perspective or is that also kind of from a retention perspective, as well? Any color you can add on that? Thanks, guys.

Brian Halligan

Yes, it's sort of a tale of three cities. January and February, wow, incredible, March through May, you know, marshmallow soft, and then June and July, it felt like we got back on track a little bit, and the question I've been asking myself, you know, what's going on, how much of this is HubSpot and how much is it COVID, and I kind of give credit to three things for the bounce-back.

One is, like, for a long time we've been espousing the vision of you need to move from offline marketing to online marketing, outside sales to inside sales, to build a flywheel, you know, great digitized front office, use digital transformation to rethink your front office approach, and the stuff that we thought was going to happen in the market over, like, six years really happened over six months now, it's really set up, so our vision sort of matches the time.

The plays we ran worked. We talked about the Starter play, that worked really well, but there was a whole series of plays that we ran to help our customers and partners weather the storm, and I think the team executed them really well. They were well received and well executed.

Then, the product I just talked about, we took two steps back last year so we could take four steps forward this year, and I think we're getting the return on that. We had two new product offerings this year with Marketing Hub Enterprise and the CMS Hub launch, and our Net Promoter Scores are sky-high, we broke a bunch of records with our Net Promoter Scores from our customers.

So, yes, I think it's been—we don't know what'll happen in the future. I mean, this has been a terrible tragedy for so many people and so many companies, and we don't know what'll happen to the economy or to our demand curve in the future, so I caveat it with that, but things did get better in June and July for us.

Ryan MacDonald

Good to hear. Thanks, Brian.

Operator

Your next question comes from Samad Samana from Jefferies.

Samad Samana

Hi, good afternoon, and thanks for taking my questions, and I'll echo the congrats on the strong performance. Brian, I wanted to ask, just because I think historically Hubs has done really well in B2B-focused SMBs, and I'm curious if maybe in this kind of renewed pivot from offline to online if there's been any differences in the type of SMB that you're getting, whether there's more B2C in there or just whether

they're smaller or larger, as you think about that offline to online cohort, in particular, and then I have one follow-up.

Brian Halligan

Not really. There's been a ginormous number of companies between, you know, five employees and 2,000, let's say, there's just a huge market there. We have a very, very small percentage of that market on HubSpot, and so we're a little bit focused and sticking to our knitting to build out a killer solution for that part of the market before kind of getting distracted with totally new value props. We've got our heads down. We think there's a huge market. We think our value prop is really strong. We're really differentiated relative to competition. So, we've got our heads down and cranking away.

Samad Samana

Got you, and then I know the kind of trends question's been asked, but maybe in a slightly different vein, if you think about countries that are maybe further along the reopening path, as you're seeing those countries reopen, have you seen a change in whether there are downgrades there or to upgrading again, or in terms of new deal activity? We're just trying to see if that's a leading indicator for what we might see in some countries, like the U.S., that are earlier in the reopening cycle.

Brian Halligan

It's a good question. Like, Australia opened up a little earlier and that started getting a little better a little faster, but really across the developed markets, they all kind of moved in tandem, quite honestly. Where they slowed a bit were in more of those emerging markets, like India and Latin America, places like that, and those markets are ones that we don't have a huge presence in, anyway. We're pretty focused on the bigger markets and we haven't rushed into those emerging markets, so we haven't been super-impacted. The thing we don't know is what will happen in the United States, what will happen in Europe, and what the path of this thing is going to do, so it's hard to predict the future, but I would say, you know, feeling cautiously optimistic relative to the last call we had with you folks last quarter.

Samad Samana

Well, that's great to hear, and we're certainly happy to see that, as well. So, thanks again and I'll hop out of the queue.

Operator

Your next question comes from Alex Zukin from RBC.

Dylan Reider

Hey, guys. This is Dylan Reider on for Alex. Thanks for taking my question, and congrats on a great quarter. Brian, I guess, just to start, clearly this is a very disruptive time for some of your customers and that's causing headwinds in some cases and tailwinds in other cases, and you've clearly been proactive in working with them to ensure they're getting guidance from HubSpot, and been effective in reducing churn and offering promotions on the Starter Suite. I guess, just throughout all these different conversations that you've having with customers and steps that you've taken to work with them, could you just speak to maybe some of the learnings and takeaways that you've had? As you think about your strategy coming out of COVID, anything new or different that you might take from an operational perspective from these conversations that you've had with customers? Thanks.

Brian Halligan

I think it's really just moving the future forward. It's some of the stuff we've been espousing from stages at Inbound and books and blog articles for 14 years, that it's just a better way to go to market, it matches the way people actually want to shop and buy, engage, and we built a platform for that and I think it sort of matches the time, but, no, no like huge thing. I think that we ran a number of plays that seemed to land when all this stuff started, and they've been executed pretty well and I think we're pretty good. But, no, we haven't done a big pivot. We talked about it about two or three weeks into this, "Like, this is going to be pretty bad. What do we need to change in our product roadmap to match it?" and we were like, "You know what? We've actually built a product that's well suited for this stuff, so let's keep our head down and keep cranking on it."

Operator

Your next question comes from Walter Pritchard from Citi.

Walter Pritchard

Hi, thanks. A question on the customer adds and how you're thinking about those upselling as time goes on, especially relative to the customers that you've added in the past, given the dynamics of the lower end product, and then I had another question on expanding the product line.

Brian Halligan

Yes. So, we have a lot more of these Starter Suite customers coming in, Walter, a lot more, that's done really well, and we're watching the size of those cohorts, we're watching the upgrades and we're watching the cancellations, and so we're watching it all very carefully, and we're watching by cohort. The size is about the same as previous cohorts on that product line, which feels good to us, that we didn't attract a bunch of kind of mom-and-pops in. The cancellations look real good. The upgrades aren't quite as good as previous cohorts, but they're still pretty solid from that Starter to Pro. So, early signs are really good, that we made a change there to our—the demand curve looked a little bit differently than we thought and we made a change to it, and at least for now we're going to stick with it.

Walter Pritchard

Then, any changes to how you're thinking about the additions to the product line via M&A? Any more confidence you have in your ability to do that to accelerate the roadmap, or do you feel like you have enough on your plate at this point that that doesn't make a lot of sense?

Brian Halligan

We look at deals. We're just picky, and we're picky for a few reasons. One, part of the reason we went in the marketplace is we built this thing with love in-house, gorgeous front end, consumer-like front end, (inaudible). It's a single view in the customer on the back end, not a bunch of different, you know, clunky systems kind of integrating together. Our Net Promoter Score word of mouth is going way up. Our product organization really took a couple steps back and is really cranking right now. So, we feel like we have the ability at scale to build great new products that customers love, and so our confidence is high there, higher now than it's ever been.

Were we sensitive on valuations? To a certain extent. We'd be super-sensitive on anything that messes with that core competitive advantage on our front end. So, we're just going to be very careful about M&A. If we do them, they're going to be good deals and they're going to be thoughtfully done and they're going

to be thoughtfully integrated, but we're unlikely to break our core value prop for some very short-term stuff.

Walter Pritchard

Great, thanks, Brian.

Operator

Your next question from Terry Tillman from Tri-S Securities.

Terry Tillman

Yes, thanks for taking my question, and congrats from me, as well. Brian, one thing I've always liked about HubSpot is just the testing and learning. You guys test a lot of things out, you learn and you iterate. You talk a lot about running plays. What I'm curious with CMS Hub is what are some of the early feedback and learnings you're getting. Because, where I'm going with this, it seems like the web's getting rebuilt, websites, clunky websites are not going to work anymore, and so do you see opportunities here with CMS Hub to actually be kind of the tip of the spear for the webs to go after new business as a way for folks to engage with HubSpot, or am I thinking about it the wrong way and it's really more about going into the sticky install base. That's the first question.

Brian Halligan

I think our sales organization will gravitate towards the lowest hanging fruit, and that's likely within our install base, and the same with the partner organization, but I think over the fullness of time that'll be a front door we bring lots and lots of customers in, and by the way, I think you're right. I think the idea of a website—you know, on a website, you want to build a customer experience, and that customer experience should be light and it should be modern and it should be delightful, and you need a new type of CMS to pull that off and you need to treat it like a first-class citizen, and that CMS has to be married to your CRM in a one plus one equals three. So, I feel really good about the CMS product. The product organization delivered and I think it's going to be big business for us.

Terry Tillman

Got it, and just a follow-up related to looking at kind of the durability of your Marketing Hub business. What I'm curious about with the Marketing Hub Enterprise product—you know, you've got the A/B testing, you've got the revenue attribution in ABM. Are any of those features really resonating more than others, in terms of either helping with new business or replacing legacy marketing automation platforms? Thank you.

Brian Halligan

All of them are. Attribution reporting has been huge for us. The testing has been very solid and account-based marketing has been huge for us, and they were very thoughtfully done. They weren't bolted onto an acquisition, they were built with our primary colors. They're just beautifully executed inside the user interface, and that product's resonating really, really well. We're getting lots of new customers, but we're getting, I would say, a lot of rip-and-replace and more legacy marketing automation vendors.

The other thing I would say about HubSpot's Marketing Hub, it's not just marketing automation. Like, I think of marketing automation as a way people would describe almost that old-school, middle of the funnel, where you've got the leads, you score the lead, you segment the lead, you do automation off that

lead. HubSpot's Marketing Hub, of course, does all that stuff, but in a really elegant way. It does search engine optimization, you can do your advertising through it, you can do your social media through it, you can marry it with your website, you've got template-driven landing pages and your blog. It's much, much more than your garden-variety marketing automation platform. But, the Product Team, the Marketing Team, they really innovated and cranked on it. The nice thing about that marketing industry, it's a big industry, there's a lot of money being spent in that industry, there's a lot of value being delivered, there's a lot more innovation coming ahead for us there.

Terry Tillman

Thanks a lot.

Operator

Your next question comes from Ken Wong from Guggenheim Partners.

Ken Wong

Great. This first question's for Brian. The 7,800, roughly, net customer adds, significant uptick in the pace from what you saw a year ago in Q1. Can you help us understand how much of that might have been just an initial surge to meet immediate demand, or is there a new sustainable run rate that we should be thinking about from a customer adds perspective?

Brian Halligan

I'm going to let Kate take that one.

Kate Bueker

Yes, thank you. We were obviously very happy with this 7,800 adds. I think we were also very happy that the adds particularly in that Starter Growth Suite were pretty consistent month-over-month. We think it's sort of a bit of a new normal for us, which we're excited about.

The other thing that was a positive from our perspective is that it was not just in Starter Growth Suite where we saw some strength. The new customer adds were pretty strong across the board and we think that, as Brian highlighted, says a lot about the value that our product is delivering.

One thing that I would point out, we obviously saw the ARPC (phon) drop quarter-over-quarter, not surprisingly. We talked about the fact that that was likely going to be the case on the last earnings call. I think that you are seeing that for a couple of reasons. One is that really significant traction that we're seeing at the low end of the portfolio is going to have sort of a natural mix impact there. The other thing is that we have seen elevated downgrades throughout Q2 as a result of some of the plays that we're running around the COVID situation.

Ken Wong

Got it, and then maybe a quick follow-up. As far as the net retention, you mentioned, I think, 90%. Last quarter, you guys were talking about how things would potentially trend lower from the low 90s, but likely should be dropping in Q2. Should we view that 90% as the trough going forward?

Kate Bueker

Yes, I would say what we sort of led you down the path of trend here starting in January and February, that 100 plus, which is a strong performance for us, and then in March the retention dropped to the low 90s. It did hang in there at 90% in Q2, which was a bit better than we had expected. Look, as Brian said, who knows what the future brings, but I am cautiously optimistic that we've seen the bottom here. We did see retentions strengthen month in, month out throughout Q2.

Ken Wong

Great. Thanks a lot.

Operator

Your next question comes from DJ Hynes from Canaccord.

Luke

Hey, guys. This is Luke on for DJ. I wanted to dig a bit in more on your CMS Hub, and specifically whether or not the current environment has actually enhanced interest in that offering. Traditionally, brick-and-mortar businesses look to beef up their online presence. So, any commentary there on the traction you're seeing, specifically, in that context of accelerating e-commerce adoption? Thanks.

Brian Halligan

I don't think that's a huge factor, quite honestly. Most of our customers are B2B. A lot of B2B companies are doing e-commerce. They have a nice integration to Shopify, and we have a bunch of customers using that, but I think the CMS Hub product is just better and a lot more people are buying it. I think whether we were in COVID times or not in COVID times, I think we'd get a similar bump on that.

Operator

Your next question comes from Peter Levine from Evercore.

Peter Levine

(Inaudible) I hope you can hear me. Just to start, Brian, could you just talk a little bit about the adoption of the Starter pack? Is there any delineation between the Europe and U.S.? I mean, just based on your customer growth in Europe, it would seem that it's taken off perhaps faster in the U.S., but I was just kind of curious if there is any differential and how you're seeing that adoption from a geographic perspective.

Brian Halligan

No, it's been pretty steady across Europe and the United States, and the ratios are pretty similar. It seems like it landed, and it's landed in a similar way across all geographies. Maybe a little softer in developing markets, but really solid across the developed markets.

Peter Levine

Okay. Then, Kate, on the customer downgrade comment, it sounds like you feel like you're kind of getting through the book of those conversations at this point in time, and I don't want to put more words in your mouth on that front, but does it feel like the amount of customers that are coming to you to talk about that is slowing, and that obviously helps in terms of visibility and, obviously, NRR (phon) going forward. I just

wanted to make sure I'm clear on that point. because that's what it sounds like, but again, I will put words in your mouth

Kate Bueker

Yes, I think you're right as it relates to that. We put in place a number of plays at the end of March designed to really help our customers weather a short-term impact here, and I think, as Brian highlighted, they worked largely how we wanted them to. The volume of requests has continued to fall. As I said in my prepared remarks, the first cohorts are starting to kind of come out the other side. Frankly, it's really early in that process, we have a long way to go, but the early signs are positive.

Operator

Your next question comes from Jennifer Lowe from UBS.

Jennifer Lowe

Great, thank you. Actually, maybe just to finish up on that thought, Kate, when you talk about customers coming out the other side, does that mean that they're starting to move back up to where they were previously or they're getting current on payment terms? What exactly does that look like when they come out the other side?

Kate Bueker

It's, frankly, all of the above, Jennifer. I think there is a variety of plays that we've put in place. Short-term discounts, as one example. Many of the short-term discounts are 90 days in length, so customers would be starting to come up, and we have seen many of them progressing on a path toward more normal discount levels. Another play that we ran was around more flexible payment terms, and that would mean that our customers are coming up and have a payment due, and we are also pleased with the performance of those customers.

Jennifer Lowe

Great, and one more for me. If I look at the customer base, and particularly at the more enterprise side of your base, I'm just curious—as companies have to move faster and maybe they want a solution that's simpler, given that things are changing so fast, I'm just curious if that's created any differences in the conversations that you have or the win rates that you have when you're in a competitive situation, where maybe buyer needs look a little different because the world looks a little different, or what they're prioritizing is a little different. Any color there would be interesting.

Brian Halligan

A really good question, Jennifer. If I think of the legacy SaaS providers, they're hard to buy, they're hard to set up, they're hard to use, they're hard to own. We're kind of yin where the rest of the market is yang, and we're trying to make it easy to buy, easy to set up, easy to use and easy to own, and I think it's just resonating well. I think our Marketing Hub Enterprise we did in January worked and I think that CMS Hub Enterprise that we did in April is working. We've always been really easy to use, and we've invested massive amounts in user research and design, that's really paying off, and then we've added a bunch of power, and that's kind of the magic trick. We just don't see that combination of a consumer front end really easy to use with that power on the back end. This year we've added a bunch, and there's likely more to come.

Operator

Your next question comes from Siti Panigrahi from Mizuho.

Siti Panigrahi

Thanks for taking my question. I just want to double-click on that comment on ARPC down 5%. You talked about new customers taking the Starter Suite promotion. What percentage of existing Starter Suite customers also took advantage of that \$50 promotion? Then, I saw that your promotion was supposed to—you know, price go up \$75 in August, which has now extended to September. How should we think about the ARPC for the rest of the year?

Kate Bueker

I'll start and then, Brian, if you want to add anything.

Brian Halligan

Yes.

Kate Bueker

The first thing that I would say, is that the vast majority of customers that are adopting the Starter Growth Suite are new to HubSpot, so that's what's really driving the growth of that product. As Brian said, we were a bit, frankly, surprised that this pricing change resonated as much as it did with the market and we've seen really strong adoption here. We talked a lot about what to do about the pricing and we are obviously looking very closely at the performance of those cohorts, and for now we're going to keep it. We will continue to look closely, but at least for the near term here it's going to remain at \$50.

Operator

Your next question comes from Michael Turn from Wells Fargo.

Michael Turn

Hey there, thanks. Good afternoon. Maybe stepping outside of the financials for a moment, HubSpot's known for its company culture, your (inaudible) scores are consistently off the chart, so I'm just wondering how the pivot to remote work has been for the team, given that close knit community you have built, and maybe any observations you have around maintaining that culture with new hires likely coming on remotely as well, might just be insightful here, as well.

Brian Halligan

I can take that. That's a great question. When COVID first hit, obviously, we had to get all our employees out of all our offices and in their homes and set up. That was challenging, but I think it went pretty well. I give a lot of credit to our People Ops Team and to our Facilities Teams. All our Ops Teams did a great job of that. I think part of the reason it went pretty well was we were leaning towards remote. Remote was our third biggest office when COVID hit and we were trying to make that a more attractive option for new employees and existing employees and we were on top of that.

I do think our culture is very strong, I think it's a real advantage for us. I think one of the things that we also saw—I mean, it's been certainly an interesting and challenging six months between the health crisis

going on and the economic crisis. It's sort of been a crisis of conscious, as well, with all the stuff going on with Black Lives Matter. We're leaning hard in there. We feel like our employees really care about diversity and inclusion, as I do too, and we would like to make progress there. So, we've been rolling out an initiative internally to not just talk about that in the short term, but try to really move the needle on that stuff.

Our culture is still very much in our forefront. We feel like we've built two products. We built a product that attracts great customers and retain them and we've a product that attracts great employees to retain them. We just call that product culture.

Operator

Your next question comes from Brent Bracelin from Piper Sandler

Brent Bracelin

Great. Thanks for taking my question. Maybe I'll start with Kate and end with Brian. Kate, as you think about the new cohort of customers coming online here, with the mix of billing terms between kind of monthly versus annual, are you seeing that shift a little bit more towards monthly, just given the current environment? Any color there would be helpful relative to the new cohort versus the traditional cohorts you're seeing.

Kate Bueker

Sure. The significant additions that we're seeing at that Starter tier will have monthly billing terms, and so that is probably the most notable shift. With respect to customers who are coming onto our Professional Enterprise products, as I noted in my billing comments, we had thought that would see a pretty significant reduction in the billing terms. That has sort of hung in there a little bit better than what we had thought.

Brent Bracelin

Okay, that's helpful color. Then, Brian I don't know if you're able to answer this or not, but I'll ask it anyway. I think a lot of the questions that have been asked and answered are focusing around this idea of how much of the momentum you're seeing in June to July is tied to the promotional activity versus this idea there's something more durable happening in the industry around the shift to kind of online, the shift to digital, even remote work, where perhaps you need to have a more modern kind of marketing sales approach in the mid-market. So, as you think about those two drivers of what you're seeing in June, how much should we weigh just around company specific promotions driving the momentum here versus what could be a more durable trend?

Brian Halligan

I think it's more durable. I don't think that—I think that promotions worked, and worked for them. I think they work, they're well designed, they work. But, we've been talking about digital transformation for 14 years. We've been talking about moving from offline marketing to online, from outbound marketing to inbound marketing, from outside sales to inbound sales, from funnels to flywheels. I mean, we've been screaming it from the hills. Our vision of the future for our customers, we thought would take five or six more years. There's a lot more urgency around it. I think digital transformation is a massive wave that's been going on for a long, long time. It just picked up a little steam here. Our products are well suited, our vision's well suited, our services organization is serving them well, we've got a big community around us. I think HubSpot's well positioned for a nice run here. Feeling good.

Brent Bracelin

Encouraging to hear. Thank you.

Operator

Your next question comes from Parker Lane from Stifel

(Inaudible) Parker

Hi. It's actually—it's Parker on for Tom Broderick, sorry. Thanks for taking my question. I was just wondering if you could talk a little bit more about the PieSync acquisition from late last year and how that business is tracking from an integration standpoint, a go-to-market standpoint and just any other details you've got there.

Brian Halligan

PieSync is going great. The team is doing terrific. They're working on some awesome stuff. The business itself, it's a smaller business relative to HubSpot, but it's growing faster than we thought and it's going really well. I think what's interesting about PieSync is their capability and what they're super-focused on and they're really like fantastic at, if somebody's got one application and they want to synch their data, keep it synched together with another application, they eat, sleep, drink, live that problem. It is a sticky, hard problem. It actually was not a problem we were particularly good at, it wasn't one our primary colors, and so it's the perfect type of acquisition for us, where we kind of added that primary color to it. So, stay tuned for that. That capability is going to show up in other places, it's going to power some new capabilities down the road, and I'm really feeling good about that piece.

Operator

Your next question comes from Koji Ikeda from Oppenheimer.

Koji Ikeda

Hey, guys. Thanks for taking my questions. Great quarter, congratulations. I just wanted to ask a question, another question on net revenue retention trends. Just thinking about the future a little bit, fast forwarding into the future, thinking about how the discounts today, as those kind of normalize out, and the renewals—the annual discounts that you have, as those come up for renewal, is the right way to think about net revenue retention, will anniversarying of those discounts and normalization of the discounts act as a tailwind for net revenue retention trends to maybe boost it back up to over 100% in the future?

Kate Bueker

Yes, I mean, if I turn back the clock and talk about retention in a way that we were doing before the onset of COVID, I think that what you would remember is that we would say that we believe we can have net revenue retention at a hundred plus over the long term, and I think we still fundamentally believe that is true. You are highlighting a trend that is real. We obviously saw some sharp headwinds due to the downgrade activity in Q2, and as the customers come off of short-term discounts and move toward more normal discounts, that is a tailwind to retention that will show up over the next few quarters, so from a near-term perspective that should help.

Operator

That was our last question. At this time, I will now turn the call back over to Brian Halligan, CEO for closing remarks.

Brian Halligan

Thanks, everybody, for joining today. Hope you stay well and we'll see you at Inbound.

Operator

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