



Will Wong, RingCentral, Inc. – Vice President, Investor Relations

Thank you. Good afternoon and welcome to RingCentral's third quarter 2022 earnings conference call. I'm Will Wong, RingCentral's Vice President of Investor Relations. Joining me today are Vlad Shmunis, Founder, Chairman, and CEO, Mo Katibeh, President and Chief Operating Officer, and Sonalee Parekh, Chief Financial Officer. Our format today will include prepared remarks by Vlad, Mo, and Sonalee, followed by Q&A.

We also have a slide presentation available on our investor relations website that will coincide with today's call, which you can find under the Financial Results section at ir.ringcentral.com.

Some of our discussions and responses to your questions will contain forward looking statements, including our fourth quarter and full year 2022 financial outlook and our assumptions underlying that outlook. These statements are subject to risks and uncertainties. Actual results may differ materially from our forward-looking statements. A discussion of the risks and uncertainties related to our business is contained in our filings with the Securities and Exchange Commission and is incorporated by reference into today's discussion. RingCentral assumes no obligation and does not intend to update or comment on forward-looking statements made on this call. Unless otherwise indicated, all measures that follow are non-GAAP with year over year comparisons. A reconciliation of all GAAP to non-GAAP results is provided with our earnings release and in the slide deck. Please visit our Investor Relations website to access our earnings release, slide deck, our GAAP to non-GAAP reconciliations, our periodic SEC reports, a webcast replay of today's call, and to learn more about RingCentral. For certain forward-looking guidance, a reconciliation of the non-GAAP financial guidance to the corresponding GAAP measure is not available as discussed in detail in the slide deck posted on our Investor Relations website.

With that, I'll turn the call over to Vlad.



Vlad Shmunis, RingCentral, Inc. – Founder, Chairman, and CEO

Good afternoon and thank you for joining our third quarter earnings conference call.

We had a solid quarter and exceeded our guidance on every key metric. Total revenue of \$509 million was up 23% versus last year and above our outlook of \$502 million. We achieved these results despite an increasingly difficult macro environment. While it is hard to predict the exact timing of an economic recovery, we are confident that RingCentral will continue playing a prominent role as businesses rationalize their spend and strive to be more efficient via digital transformation efforts. We serve a mission critical need and provide customers value as they migrate from legacy systems to the cloud.

Additionally, we delivered a record quarterly operating profit margin of 13.5%, up 300 basis points versus last year. This was significantly above our guidance of 12.5%. Looking ahead, I am confident in our ability to deliver strong operating results, which includes meaningfully expanding profitability. To this point, we are now targeting operating margin expansion of at least 350 basis points in 2023. This puts us on an accelerated path to achieving our prior commitment of at least a 20% operating margin.

Now, let me share the reasons why RingCentral is winning in the UCaaS market.

First, we win because we believe we have the world's best cloud phone system. Innovation is part of our DNA. We will continue to make targeted investments in key growth areas such as AI, analytics and contact center and provide differentiated intelligent and connected experiences to our customers as they proceed with their digital transformations.



These investments will further add to what we believe is the most complete cloud PBX solution in the world, with features for every type of user and use case. With over 8,500 private and public applications and an ecosystem of over 75,000 developers, we enable customers to innovate on our platform. This includes over 150 pre-built telephony apps, over 330 pre-built apps for UC and CC, and the most advanced integrated contact center experience.

One integration example is with Salesforce. Our integration lets customers make and receive calls, schedule RingCentral Video meetings, and quickly assign call dispositions, all without having to leave Salesforce. Customers are also able to make and log customer calls from anywhere in the world. With advanced features such as offline and multi-call logging that no other provider has, users can save time, which they can allocate to revenue generating activities. This integration and the hundreds of other integrations we've developed – including with Microsoft, Google, ServiceNow, HubSpot, Zendesk and others– have helped us become an industry leader.

But that's not all. Other key differentiators include our outstanding 99.999% reliability, which we achieved for the 17th consecutive quarter, as well as our global reach, with full availability in over 45 countries and a presence in over 100 countries. We also support a wide range of endpoints, including from our strategic partners such as Mitel, Avaya, Atos and Alcatel Lucent Enterprises, and have a fully integrated IMS cloud architecture that enables fixed mobile convergence that is a key requirement from some of our GSP partners.

Second, we win because of our unmatched partner ecosystem, which is made up of our strategic partners and multiple global service providers. We have a proven ability to partner with the world's leading on prem PBX providers, as well as leading service providers such as AT&T, BT, TELUS and Vodafone. I'm also very pleased to announce our new upcoming relationship with Charter Communications, where we will be launching a joint offering for both SMB and Enterprise Businesses. Be on the lookout for more details in the coming days. And last but not least, we have over 15,000 resellers spanning the globe. We believe this gives us unrivaled access to the large market opportunity ahead of us.



Finally, we win because we are known as a leader in our industry. We're proud to be a Gartner Magic Quadrant for Unified Communications as a Service, Worldwide leader for seven years in a row, with the last recognition occurring in 2021. Gartner also recognized RingCentral for being ranked #1 in all four use cases in the 2021 Gartner Critical Capabilities for Unified Communications as a Service, Worldwide report, updated August 1, 2022. Additionally, this quarter the Tolly Group, a leading global provider of testing and third-party validation and certification, conducted a feature-by-feature comparison of analytics capabilities in which RingCentral met 100% of the specification criteria outlined in 13 categories. The next-closest vendor only met 100% in 4 of the 13 categories. Lastly, Synergy Research Group recently recognized RingCentral as the leader in UCaaS, with over 20% market share based on paid seats, which is double the second and third place vendors.

Big picture is that voice remains as relevant as ever. A good reminder of this is a recent survey of key technology purchase decision makers, which highlighted that 90% of business leaders prefer to use the phone over other communication tools. This is true across companies of all sizes, with use cases ranging from internal calls and meetings to external client and vendor calls. Of note, we see this in our own customers as well, as more than 95% of our base actively use phone.

We are just at the beginning of the journey. There are 400 million telephony seats worldwide, and many of those seats are expected to move to the cloud, driven by a number of clearly visible megatrends. These include the shift to hybrid work, ongoing adoption of mobility by businesses, increasing reliance on distributed workforces, and the desire for an integrated, cloud based UC and CC solution from a single provider. Synergy recently concluded that just 21 million UC seats are in the cloud today, or a single-digit penetration rate. This highlights how early we are in the journey when comparing it to the number of seats that are still on prem and are yet to be migrated.



Looking forward, we will remain laser focused on delivering a best-in-class UCaaS offering by investing in innovation and driving profitable growth. Throughout the year, we have taken steps to expand our operating margins and drive efficiencies throughout our business. While we recently made the extremely difficult decision to further rationalize our workforce, we believe this will allow us to be more agile and better align our costs with our strategic priorities in the current macro environment. This decision was not made lightly, and we understand the impact this has on our people and their families. We are taking meaningful action to help ease the transition for our impacted employees. We want to underscore how grateful we are for their hard work and all their contributions. RingCentral would not be where we are today without them.

Finally, I want to reiterate how proud I am of what we as a company have accomplished. Building from 2 guys in a garage, we are now a \$2 billion recurring revenue business, with leading share and an unrivaled platform. I believe we are well positioned to emerge even stronger as the economic recovery begins.

Now let me turn the call over to Mo.



Mo Katibeh, RingCentral, Inc. – President and Chief Operating Officer

Thanks Vlad.

Q3 results were solid as we continued to execute despite a more challenging economic backdrop. We had solid new deal activity, highlighted by multiple \$1M plus TCV wins. We also saw good activity from strategic partners, and our contact center attach rate was again over 60% for our large deals.

Let me give you a few examples of our recent wins.

First, a win at HealthComp with our newest strategic partner, Mitel. HealthComp is one of the nation's largest third-party benefits administrators. They chose RingCentral to be their communications partner for both UC and CC as part of their enterprise-wide digital transformation. Our integration with Teams, which they currently use, was key in helping us win this deal. This is in addition to our leading voice and advanced eFax, SMS and integrated contact center capabilities, which Teams does not offer.

Relative to our contact center, HealthComp is now able to expand customer outreach to all channels, including voice, chat, email, social and 30+ digital channels. And importantly, we enabled HealthComp to save money by routing calls to the first available agent, which reduces agent idle time, as well as by enabling them to use analytics to determine productivity opportunities. We continue to see customers like HealthComp choose RingCentral due to our best-in-class, integrated UCaaS and CCaaS platform.

Second, in the current environment, cost savings are also an important catalyst in driving purchasing decisions. For example, a large Fortune 500 company in the logistics sector with operations in over 50 countries selected Avaya Cloud Office by RingCentral to help them consolidate disparate systems created over many years. Multiple IT teams were required to maintain these systems, which also ran on separate carriers, resulting in higher operating costs. Moving to RingCentral's cloud infrastructure will enable them



to quickly replace outdated equipment and improve collaboration and communication. All while showing an overall reduction in the total cost of ownership by 30%.

I also wanted to highlight a number of wins in the education sector, including a nearly 5,000 seat win at the University of North Dakota and an over 3,000 seat win at a large Midwest university. This continues the trend we have seen the last few quarters, with many thousands of seats being added across school districts and universities.

Now turning to our partners. Our strategic, channel and GSP partners also continue to be a key part of our go-to-market motion.

Both Mitel and Avaya again grew new seats sold quarter over quarter.

On the channel side, we saw a quarterly record number of leads generated, and we expect those leads to translate into opportunities and sales over time. Also, our channel partners continue to drive incremental new deal activity, and were part of over 60% of our \$1M plus TCV deals this quarter. Channel partners enjoy working with RingCentral because we offer flexible paths to market depending on their business needs and individual customer use cases, while also providing tools and training to help them succeed.

Regarding our GSP partners, we continue to see positive growth, are beginning to ramp with Vodafone in Europe, and as Vlad stated we are excited to begin working with Charter.

And finally, we continue to invest in expanding sales internationally. We landed multiple \$1M plus TCV deals outside the U.S., including with Healius, one of Australia's leading healthcare companies, and we expect more as we ramp in the coming quarters and years ahead.



Now let me provide you with an update on what we are seeing in the market today.

- 1) Leads, pipeline and win rates remain strong and stable.
- 2) That said, sales cycle times for up market customers, which reverted to pre-COVID levels last quarter, elongated incrementally in Q3, as customers required additional approvals before making purchase decisions. This also resulted in smaller initial purchases.
- 3) We anticipate this behavior will persist until the macro environment becomes less uncertain.
- 4) These factors, along with a stronger dollar, were headwinds to our business this quarter.
- 5) Of note, overall churn has remained stable throughout the year and overall ARPU remains stable and over \$30.

Sonalee will discuss in more detail how these trends are impacting our near-term financial outlook.

Looking forward, the market remains large and underpenetrated, and we believe our leading product, ability to drive cost savings, and unmatched partner ecosystem will continue to resonate with customers. And importantly, our focus on profitable, efficient growth puts us in a stronger position going forward to capture that opportunity.

To summarize, we had a solid quarter despite the current macro environment. Our leading product continues to differentiate us from others, and our focus on execution and driving profitable growth sets us up well for the future.

Now I'll pass it over to Sonalee to discuss our financials and guidance.



Sonalee Parekh, RingCentral, Inc. – Chief Financial Officer

Thanks Mo. I'll provide highlights from the third quarter, and then discuss our business outlook for the fourth quarter and full year.

I am very pleased with our Q3 results, which were above guidance across all key metrics.

Subscriptions revenue of \$483 million was up 25% year over year and above our growth outlook of 23 to 24%. On a constant currency basis, subscriptions revenue rose 27% year over year.

Once again, overall and new acquisition ARPU held steady. Customers value our differentiated offering, which was the primary factor in the continued resilience of our ARPU. Subscription gross margins remain in the top tier of software peers, and were again over 82%.

Moving to ARR. ARR grew 25% year-over-year to \$2.05 billion. On a constant currency basis, ARR grew 28%. Given the recent strengthening of the dollar particularly versus the British Pound, which is our largest exposure, currency represented a \$19 million headwind this quarter relative to the second quarter. As a reminder, we adjust our entire ARR base using currency rates on the last day of each quarter.

Now moving to profitability. Operating margin was a record 13.5%, up 300 basis points versus last year, and a full 100 basis points above our prior outlook. This is the third consecutive quarter that we have solidly exceeded our operating profit margin outlook, which demonstrates our ability to execute on our strategy of driving efficient growth. Our margin improvement was and will continue to be driven by four main levers:

1. We are seeing the benefits of operating leverage as we scale above \$2 billion in recurring revenue.
2. We are prioritizing more efficient labor spend and taking further steps to improve the productivity of our workforce. As Vlad noted in his opening remarks, we have made the extremely difficult decision to reduce our full-time workforce by

approximately 10% to ensure our cost base is aligned with our strategic priorities in the current environment.

3. We are rationalizing program spend such as marketing and lead generation activities to ensure they meet our hurdle rates as well as being judicious around all discretionary spend.
4. We are consolidating vendors to simplify our procurement process as well as drive savings across all functions.

Now, moving to our balance sheet and cash flow.

We ended the quarter with \$305 million of cash on hand. This is inclusive of \$20 million of shares repurchased during the quarter.

We generated free cash flow of \$21 million in Q3 and \$88 million year to date. Note that our free cash flow includes one-time cash outflows related to third-party relocation efforts and efficiency actions we took in Q3. Excluding these one-time items, our year-to-date free cash flow would be \$119M, or a margin of 8%.

During Q3, we recorded a \$125 million non-cash charge related to our Avaya prepaid commissions balance given their recent public disclosures. Please refer to our third quarter Form 10Q for additional details. We will continue to monitor the Avaya situation and take financial actions accordingly. As Mo noted, the number of ACO seats that Avaya sold continued to grow quarter over quarter.

Now turning to guidance. This outlook is reflective of what we see in the market today. As Mo noted, leads, pipeline and win rates remain strong and stable. Overall churn also remained stable. However, sales cycle times for up market customers elongated incrementally in Q3 as customers required additional approvals before making purchase decisions. This also resulted in smaller initial deployments. While our SMB segment is proving to be resilient in the current climate, we believe enterprise customers are being more cautious given the current economic landscape, and we don't expect this to change in the near term. Taking this into account:



For the fourth quarter, we expect:

- Subscriptions revenue growth of 19% to 21%. Adjusted for constant currency, we expect subscriptions revenue growth of 22% to 23%.
- Total revenue growth of 17% to 18%. Adjusted for constant currency, we expect total revenue growth of 19% to 20%.
- Non-GAAP operating margin of 14.0%, which reflects 350 basis points of year over year improvement, and
- Non-GAAP EPS of \$0.59 to \$0.60
- Note our workforce reduction actions will result in GAAP only restructuring charges of \$10 to \$15 million related to employee severance and benefits costs, which we expect to incur in the next two quarters.

For the full year 2022, we are reiterating our subscriptions revenue growth outlook of 27% to 28%. Adjusted for constant currency, we expect growth of 29%.

- Additionally, we expect total revenue growth of 25%. Adjusted for constant currency, we expect growth of 26% to 27%.

Lastly, we are once again raising our operating margin and EPS outlook.

- We now expect full year non-GAAP operating margin of 12.4%, up from our prior outlook of 12.0%.
- And non-GAAP EPS of \$1.97 to \$1.98, up from our prior range of \$1.91 to \$1.95.

Throughout 2022, we have shown our ability to consistently deliver strong and improving profitability. At the start of the year, we guided to operating margins of 10.6% for 2022. We now expect operating margins of 12.4% for the full year 2022, or up 220 basis points. Further, we plan to exit Q4 with an operating margin of 14.0%, which is up a full 350 basis points year over year.

Looking ahead, we now expect operating margins to expand at least 350 basis points year over year in 2023, which accelerates our path to achieving our target of at least a 20% operating margin.



We expect to generate a significant amount of cash flow over the next few years. This will provide us with increased flexibility as we look at capital allocation going forward, including our capacity to make strong ROI investments and increased optionality on addressing our March 2025 converts.

To summarize, I am very proud of the quarter we delivered. RingCentral is well placed to navigate the current environment and we have the financial profile and flexibility to invest in the significant opportunity ahead of us while continuing to grow and expand profitability in a meaningful way.

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