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

Good afternoon and welcome to RingCentral's first quarter 2023 earnings conference call. 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 discussion and responses to your questions will contain forward-looking statements regarding the Company's business operations, financial performance, and outlook. These statements are subject to risks and uncertainties, some of which are beyond our control, and are not guarantees of future performance. Actual results may differ materially from our forward-looking statements and we undertake no obligation to update these statements after this call. For a complete discussion of the risks and uncertainties related to our business, please refer to the information contained in our filings with the Securities and Exchange Commission, as well as today's earnings release.

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. 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.

RingCentral

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

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

We had a solid start to the year. Q1 results demonstrate that our strategy of driving healthy, profitable growth is paying off.

Total revenue grew 14% to $534 million, above the high end of our guidance range, and ARR grew 14% to $2.2 billion.

Operating margin rose almost 700 basis points year over year to 17.2%. This was also above our guidance and was once again a quarterly record. Our higher margin was driven by continued cost discipline, improved operational efficiencies and the benefits of the actions we took last year. Those actions position us to emerge stronger and more focused when the macro environment improves.

While the macro remains uncertain, we continue to be laser focused on what we can control. This includes driving continued innovation and maintaining our disciplined approach towards increasing profitability and free cash flow.

Sonalee will provide more color on our profitability shortly.

You've heard me talk about trust, innovation and partnerships being the cornerstone of our success. As to Trust, we achieved 99.999% availability for the 19th straight quarter. With respect to partnerships, Mo will provide more color on our progress with the channel, strategic partners and Global Service Providers.

I will now highlight some of our key innovation accomplishments this quarter. We believe these innovations over time will increase our customer value proposition and create additional expansion opportunities within our large customer base. These include:

- RingCentral for Teams 2.0, our next generation Microsoft Teams Embedded App
- RingSense, our new AI platform, and its first commercial application, RingSense for Sales
- RingCentral for Frontline Workers, which combines new Push to Talk functionality with RingCentral Video and Messaging, and
- In partnership with Vodafone Business, we have released RingCentral Overlay, which enables our messaging and video collaboration capabilities on top of legacy voice services.

Let me now provide more details.

First, we recently announced RingCentral for Teams 2.0. This solution brings RingCentral's world class cloud PBX capabilities into Microsoft Teams with a fully native experience, without requiring a second application. This means that end customers can now enjoy RingCentral's renowned 99.999% reliability, global availability, advanced analytics, industry leading features and third-party integration capabilities entirely within Teams' single pane of glass.

Second, RingSense. In the past, I've talked about four megatrends driving our business. These are:

1. The shift to hybrid work
2. Ongoing adoption of mobility by businesses
3. Increasing reliance on distributed workforces, and
4. The desire for an integrated, cloud-based UC and CC solution from a single provider.

A fifth megatrend has now emerged that is truly revolutionary, and that is AI. With RingSense, we now have the ability to inject AI capabilities across the entire RingCentral portfolio. As one of the world's largest UCaaS providers, we are in a unique position to offer our customers powerful insights into their conversations. With RingSense for Sales, our first offering in this portfolio, we'll be able to offer sales teams features such as engagement scoring, keyword analysis, and AI generated recommendations. We are currently transitioning our own sales team from a third-party conversational intelligence solution to RingSense for Sales, as well as testing it with a number of customers in closed beta.

Third is RingCentral for Frontline Workers. This powerful solution combines new push to talk capabilities with RingCentral Video and Messaging. Gartner estimates there are 2.7 billion front line workers, more than two times the number of desk-based workers. With our solution, frontline workers across all industries can use any smart mobile device to seamlessly and efficiently connect with their front and back-office teams. It is available in beta today as either a standalone solution or as an add-on to RingCentral MVP. Mo will provide more details.

And fourth, RingCentral Overlay, which enables RingCentral messaging and video collaboration capabilities for legacy customers. This innovation, in partnership with Vodafone Business, enables hybrid workforces and serves as a stepping stone for those customers to move to our complete UCaaS communications solution in the future.

In summary, it was a solid quarter across growth, profitability, and innovation. We continue to innovate, enhancing our differentiation. We are also laser focused on efficiency, which we expect will generate robust free cash flow going forward. This sets us up well for the future, and is why I am so excited about the opportunity in front of us.

Now let me turn the call over to Mo to go over the quarter in more detail.

RingCentral

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

Thanks Vlad. We had a solid quarter, with healthy growth across the portfolio.

An example of a win contributing to this healthy growth is a Fortune 500 company that purchased five thousand seats of UCaaS and five thousand seats of CCaaS. They selected RingCentral for three main reasons:

1. First, our ability to integrate seamlessly into Teams - providing 99.999% reliability and deep integrations into ServiceNow, Salesforce, and other key aspects of their employees' workflows.
2. Second, our integrated UC and CC platform. Beyond the simplicity of having a single vendor to manage, the entire organization can now use a single communications platform. This results in increased customer satisfaction and potential new revenue opportunities. For example, if no one at a local branch location picks up after a certain number of rings, the call can now be easily forwarded to its contact center.
3. And finally, the company is projecting to save millions of dollars by standardizing on a single platform, removing maintenance costs, shadow IT, and telco fees.

Reducing costs is a key value proposition for all of our customers, especially in today's environment. We continue to see good traction within our core business because of our ability to help customers save money.

Forrester, a third party research firm, recently published a new report on the total economic impact of using RingCentral MVP and Contact Center together. This report concluded that customers are seeing a 211% return on investment, with an average payback of under six months. In addition, Forrester concluded that using RingCentral UCaaS and CCaaS together had three key benefits. First, call handling time was reduced by 45% versus 20% for a standalone contact center. Second, internal contact center and UCaaS IT support tickets were reduced by 30%. And third, time to close each ticket was reduced by 60%.

Moving on to our Teams practice. In Q1, seats within our Teams business more than doubled year over year. With our updated RingCentral for Teams 2.0 solution, which is available in beta today and will be generally available this summer, we are able to provide an even better user experience. And that's not all. Most Teams users are on E1 or E3 licenses, including many in key customer facing verticals such as healthcare, retail and professional services. Those customers chose RingCentral versus Teams Phone given our deep integrations, reliability, and advanced feature sets, all at a very attractive price point. For example, UKG, a leading provider of HR, payroll, and workforce management solutions, is currently using RingCentral with Microsoft Teams. We integrate seamlessly within their existing workflows, enhancing both their internal employee experience and their customer communications.

Now, let me give you an update on our go to market.

First, strategic partners. Avaya just emerged from bankruptcy a few days ago and we expect their contribution to ramp in the latter part of the year. Also, Mitel continues to perform in line with expectations, and closed a $1 million TCV transaction in Q1.

We are also seeing good traction with many of our GSP partners. Charter, one of our newest partners, performed well. We also launched with Vodafone Business in additional European geographies. Lastly, our new partnership with AWS, while still in early days, is developing well, and we expect to be on the AWS Marketplace later this year.

Now, Channel partners. They represent about 40% of our ARR base and continue to help us broaden our reach. The channel is an important part of our go to market, and we continue to ensure that incentives are aligned with the value that they bring. In fact, we recently launched our RingCentral Ignite program that enables partners to manage all go to market and customer lifecycle activities without RingCentral sales assistance, which in turn provides economic benefit for all parties.

Moving to international.

I'd like to highlight two international deals that we closed with our partners. The first is with a European athletic retailer with over 2,000 stores. They selected a RingCentral solution to help them streamline communications across their retail stores in France. They purchased thousands of MVP seats, and also added our new front-line push to talk capabilities. This will allow store members to easily and securely communicate through voice, video or messaging with the push of a button, and all without additional hardware.

The other is a regional government body in Europe that recently selected RingCentral to provide video and messaging to more than 55 thousand users. This was a great win and demonstrated the power and value RingCentral Video and Messaging can provide a large organization on a standalone basis.

Lastly, I want to discuss the current demand environment. The macro remains consistent with the trends we've been seeing over the last few quarters. Also, sales cycles remain elevated versus last year as customer buying decisions continue to receive significant internal scrutiny and additional layers of approval. We are also seeing less upsell within our existing base as customers have slowed hiring and rationalized their employee counts. However, win rates remain stable and lead flow remains consistently strong, demonstrating continued demand for on prem to cloud conversion.

With that, let me turn the call over to Sonalee to discuss our financials.

RingCentral

Sonalee Parekh, RingCentral, Inc. – Chief Financial Officer

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

Subscriptions revenue of $508 million was up 16% year over year and above our guidance range. On a constant currency basis, subscriptions revenue rose 17% year over year.

ARR rose 14% versus last year to $2.2 billion. On a constant currency basis, ARR rose 15%. We continue to expect ARR growth to outpace subscription revenue growth in 2023. This is due to our enterprise business being more back half weighted.

Moving to profitability. I'll be referring to non-GAAP results, unless otherwise noted.

Our subscription gross margin was solid, at 81.8%. Overall ARPU was again resilient and above $30, supporting our strong gross margin. Operating margin rose 680 basis points versus last year to 17.2%, another quarterly record. The increase was driven by efficiencies generated across the business, most notably in sales and marketing, which was down 420 basis points versus last year.

Q1 demonstrated good progress on our path to driving best in class profitability and free cash flow commensurate with our scale.

Regarding free cash flow, we generated $54 million in Q1 2023, which includes roughly $7 million related to one-time restructuring items. The improvements to our cost of customer acquisition, collections activity, vendor management and continued focus on driving efficiencies is leading to strong free cash flow conversion, and we expect continued improvement throughout the year.

Our focus on growing free cash flow generation allows us to employ a dynamic capital allocation strategy that includes evaluating organic and inorganic investments, repurchasing shares, and importantly, addressing our convertible debt maturities.

Regarding our debt, our free cash flow provides us many options in terms of how we address our convertible maturities. While our two converts both carry a 0% coupon and are not due until 2025 and 2026, still two and three years out, respectively, they are a top priority for us and for me personally. Based on our 2023 outlook and assuming our current capital structure, our net leverage will be less than 3X net debt to EBITDA for the trailing twelve months ending December 31, 2023, which we expect will continue to improve. Given the deleveraging profile, we believe we have a number of attractive choices to address our outstanding convertible maturities.

Now, turning to guidance. While we outperformed our Q1 revenue outlook, we are still early in the year. Given the macro uncertainty, we are remaining prudent in our guidance. Taking this into account:

For the second quarter of 2023, we expect:

- Subscriptions revenue growth of 10% to 11%
- Total revenue growth of 10%
- Non-GAAP operating margin of 17.5%, and
- Non-GAAP EPS of $0.74 to $0.76

For the full year 2023, we now expect:

- Subscriptions revenue growth of 11%, up from 10-11%
- Total revenue growth of 10-11%
- Non-GAAP operating margin of at least 18.5%, up from our prior outlook of at least 18.0%. Based on the midpoint of our revenue guidance, we expect operating profit dollars to grow at least 65%, up from at least 60%.
- Non-GAAP EPS of $3.19 to $3.25, up from our prior outlook of $3.04 to $3.10.

In summary, Q1 was a solid quarter. We exceeded guidance on both top and bottom line. We continue to see healthy growth in our business despite the current macro backdrop. We believe the market opportunity, our leading and differentiated product, and a laser focus on balancing growth with increased profitability positions us well for continued success.

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