



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

Thank you. Good afternoon and welcome to RingCentral's second quarter 2023 earnings conference call. Joining me today are Vlad Shmunis, Founder, Chairman, and CEO, Tarek Robbiati, incoming CEO, and Sonalee Parekh, CFO. Our format today will include prepared remarks by Vlad, Tarek 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.



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

Good afternoon and thank you for joining our second quarter earnings conference call. This has been a busy quarter for RingCentral.

I know you've likely seen the exciting news that Tarek Robbiati has been appointed as RingCentral's next CEO, effective August 28th. I will be transitioning to Executive Chairman on that date. I'd like to extend a warm welcome to Tarek, and we'll talk more about this later on the call.

I also want to take a moment to say a few words about Mo Katibeh, who will be leaving the company in the coming weeks to pursue other opportunities. Mo has played a pivotal role building out our team, evolving our product roadmap, expanding our partner ecosystem, shaping our winning culture, and driving meaningful efficiencies in the business. On behalf of myself, the Board and the entire team, we wish Mo all the best in his future endeavors.

On the corporate development side, last week we announced the acquisition of the Events and Session product lines from Hopin, a leading provider of online audience engagement technology. Hopin Events allows users to easily set up complex virtual and hybrid events, and fits well with our video strategy of delivering more personalized and engaging video meetings and event experiences for customers, all at a competitive price point. The technology from Hopin provides us with a complete video portfolio that now includes meetings, webinars, rooms and virtual and hybrid events. I would like to welcome Hopin Events and Hopin Session's talented teams to the RingCentral family.

Now let's turn to the quarter.

This is my 40th earnings call as the CEO of RingCentral. On our first earnings call nearly 10 years ago, we reported \$161 million in ARR. Today, this number stands at over \$2.2 billion. Ten years is a long time, and I am proud to say we have not ever missed our financial guidance during this period. And today is no exception.

Q2 was another solid quarter, as we continue to execute against our plan of delivering sustainable, profitable growth and continued innovation.

For the second quarter, total revenue grew 11%, above the high end of our guidance range, and ARR grew 12%. Operating profit margins increased 8 percentage points versus last year to 19.4%, another quarterly record and well above our outlook. These improvements demonstrate the leverage in our model, and our disciplined approach to spending. The profit improvement also translated to another quarter of record free cash flow. We are delivering this increased profitability while also continuing to invest in innovation, which is the lifeblood of our company.



RingCentral was founded and grew on the complementary megatrends of connectivity, mobility and cloud computing. RingCentral has been an early pioneer, leveraging and contributing to all these important innovations. But now there is a new megatrend emerging that may prove to be the most impactful of all, and that is Conversation Intelligence. RingCentral again expects to be a beneficiary of and a contributor to this major innovation.

Conversation Intelligence is highly relevant for business communications as it has the potential of enhancing employee productivity, improving customer service, and positively impacting business outcomes.

We saw the potential of Conversation Intelligence several years ago. In December 2020, we acquired DeepAffects, a Conversation Intelligence company, which is now the foundation of our RingSense AI platform. In March of this year, we announced our first commercial product, RingSense for Sales.

Since March, we have introduced significant new updates to RingSense for Sales. And earlier today, we announced two new products: RingSense for Phone and RingCX, our new native, intelligent omnichannel contact center. A few words about these products.

First, RingSense for Sales. We've been innovating at a fast pace. We have added many features to address customer feedback and improve our competitive positioning. Some of these enhancements include:

- 10 integrations with leading third-party applications such as Salesforce, HubSpot, Microsoft Dynamics, Outlook Calendar and Gmail Calendar.
- Deal scoring, which makes it easier for leaders to track pipeline health, and see whether deals are progressing or are at risk.
- AI coaching, which helps sales agents improve interactions based on AI-analyzed customer sentiment and effectiveness of their pitch.
- AI driven win / loss analysis, which provides effective selling insights from conversations to improve win / loss rates.

Second, RingSense for Phone. Leveraging Conversation Intelligence, RingSense for Phone enables organizations to apply AI to their voice conversations and leverage deep insights to boost productivity and collaborate more efficiently. A few key highlights include:

- Live transcription and closed captioning.
- Post call summaries, insights, and sentiment analysis.



RingCentral hosts billions of minutes of voice traffic for many millions of users. RingSense for Phone will allow them to be more effective on live calls, as well as gain important insights via post call analysis. Together, we believe it will lead to more efficient and productive conversations so as to drive improved business outcomes.

Last but not least, RingCX. We have seen great success selling RingCentral MVP with RingCentral Contact Center that is powered by NICE. With our CCaaS business that is now well in excess of \$300 million of ARR, we have conclusively proven the case for UCaaS and CCaaS integration. Our joint solution with NICE is well differentiated as it integrates our respective Magic Quadrant leading products into a unified offering from a single provider. We continue to invest in this partnership and see significant continued potential. However, in listening to our customers, we've recognized an additional need for a native intelligent contact center solution that would also be better suited to simpler use cases. That is why we are now introducing RingCX. RingCX is a powerful product that offers a:

- Native, integrated 20+ omnichannel experience for agents and administrators
- It also includes AI-powered transcripts, summaries, and conversational insights, as well as
- Workforce engagement management via an OEM partner integration.

We believe RingCX will also be well received because of:

- Its ease of use
- Ability to be quickly deployed
- Its disruptive pricing.

RingSense for Sales, RingSense for Phone and RingCX are all currently in controlled availability, with expected general availability by the end of this year. It is early, but we are getting good initial feedback.

In summary, it was another solid quarter, highlighted by our strong innovation and operational execution.

Now back to the CEO succession.

When I founded RingCentral over two decades ago, we were a tiny, unfunded startup with an ambitious mission to improve how businesses around the world communicate internally and with their customers. From those humble beginnings, we have become a recognized leader in our space and one of the largest pure-play SaaS companies in the world.



September 2023 marks the 10th anniversary of our IPO. Given the strong position we are in today – operationally and financially – I believe this is the right time for a CEO succession, and Tarek is the right person for the job.

Tarek is a highly accomplished, senior business leader. He has been a key member of our Board since January, which has given him an opportunity to get to know our business, our team and our culture. I believe he's in a unique position to hit the ground running on day one.

As for myself, my plan is to stay actively engaged in the business, focusing on what I love most – strategy, innovation and product development. I am incredibly proud of what we have accomplished together and am energized about the future.

With this, I will now turn it over to Tarek for some additional remarks.



Tarek Robbiati – Incoming CEO

Thank you, Vlad, I consider it a distinct privilege to be RingCentral's second ever CEO. And on behalf of the Board, let me express our immense gratitude for all you have built.

You took this company from an idea to a multi-billion-dollar, global enterprise, serving approximately 6 million paying end users and bringing together an expansive 15,000 partner ecosystem.

I believe our potential is vast and we have an enduring foundation on which to build our future. Vlad and I are aligned on RingCentral's core principles – people and customers first, ever-present drive for innovation and a commitment to delivering results for all our stakeholders.

These will continue to be cornerstones of our operations as we drive greater performance and profitability through the focused execution of our strategic initiatives.

And importantly, on behalf of the Board and from me personally, I would like to thank Mo for the contributions that he has made during his tenure and wish him the best of luck.

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



Sonalee Parekh, RingCentral, Inc. – CFO

Thank you, Vlad. I'm very much looking forward to continuing our partnership in your new role. Tarek, I'm equally excited to be working with you again.

I'd also like to thank Mo for his valued contributions and partnership and wish him the best of luck going forward.

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

Subscriptions revenue of \$514 million was up 11% year over year and above our guidance range. ARR rose 12% versus last year to \$2.22 billion.

Growth was driven by strength within key industry verticals where our products are mission critical, such as professional and financial services, healthcare, retail and public sector.

Additionally, Contact Center ARR was roughly \$330 million, up from roughly \$300 million at the end of 2022. The strong traction we are seeing in Contact Center is driven by continued demand from customers for a leading, integrated UCaaS + CCaaS solution.

An example of the power of our platform is our recent competitive win with Republic Airways, one of the largest regional airlines in the U.S. The company's legacy tools required frequent maintenance. Their on prem phone system also did not integrate well into their contact center, which Republic Airways relies on to quickly reach its pilots and flight attendants to provide them with any urgent scheduling changes. RingCentral's industry-leading 99.999% reliability for the past 20 quarters, advanced call routing, and integrated cloud contact center will help Republic Airways solve these challenges, all while saving them money. Importantly, Republic Airways plans to utilize our new RingCentral for Teams 2.0 Embedded App, which continues to see great traction in the marketplace.

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

Our subscription gross margin was 82%, consistent with last quarter. Overall ARPU was again above \$30, as customers continue to value our differentiated offerings. Our solid ARPU supports our strong gross margin.

Operating margin rose 800 basis points versus last year to 19.4%, another quarterly record. The increase was driven by operating leverage and efficiencies generated across the business, most notably in sales and marketing, which was down 490 basis points versus last year. Sales and marketing expense improved due to the efficacy of our marketing spend as well as the headcount



actions we took last November. As a reminder, those actions did not impact customer-facing salespeople.

Our increasing profitability translated into record quarterly free cash flow of \$81 million on an adjusted, unlevered basis. The improvements to our free cash flow continue to be driven by operating leverage, efficiencies throughout the business, and improving our free cash flow conversion.

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

This quarter we were able to execute against all three of these vectors.

First, during the second quarter, we paid \$427 million to repurchase \$461 million in aggregate principal amount of our 2025 convertible notes. The repurchase was funded with cash on hand and \$400 million from our Term Loan A. We also entered into a swap agreement that fixed the floating interest rate on our Term Loan A. The fixed interest on our Term Loan A is approximately 6.6% and can step down modestly as we further de-leverage. This results in a weighted cost of debt of approximately 1.6% following the repurchase. Based on our second quarter results, our trailing twelve months net leverage ratio is 3.3x, and based on our 2023 outlook, we continue to expect our net leverage to be less than 3x as we exit the year.

Second, in the quarter, we repurchased approximately \$100 million of shares at an average price of approximately \$30. Additionally, during the second quarter, our board approved a new share repurchase authorization for \$125 million, effective through December 31, 2023.

Lastly, as Vlad mentioned, last week we acquired assets from Hopin to augment our video offering. While we are excited about the addition, we expect the acquisition to have an immaterial impact on our revenue and expenses in 2023.

Before I provide our third quarter and full year guidance, I'd like to provide you with additional details on the macro trends we are seeing in the market today.

Macro trends are largely consistent with last quarter. Sales cycles remain elevated versus last year, and customer buying decisions continue to go through additional layers of approval. We are also seeing less upsell within our existing base as customers have slowed hiring and rationalized their employee counts. Importantly, marketing driven lead flow remains consistently strong, demonstrating continued demand for on prem to cloud conversion.

Now, turning to guidance.



For the third quarter of 2023, we expect:

- Subscriptions revenue growth of 9% to 10%
- Total revenue growth of 8% to 9%
- Non-GAAP operating margin of 18.0% to 18.5%, and
- Non-GAAP EPS of \$0.75 to \$0.78

Note that we are re-investing a portion of the operating profit outperformance we delivered in the second quarter into innovation and go-to-market activities in the third quarter. Specifically, there are areas of strength in select verticals where investment, including in AI, are expected to drive greater product differentiation and incremental demand.

Now, moving to the full year 2023. We continue to expect:

- Subscriptions revenue growth of 11% and
- Total revenue growth of 10-11%

And we now expect:

- Non-GAAP operating margin of 18.5-19.0%. At the midpoint, this is up more than 600 basis points versus last year, and 25 basis points above our prior outlook.
- Non-GAAP EPS of \$3.11 to \$3.25. Note that this outlook is inclusive of interest expense from our Term Loan A, which our prior outlook of \$3.19 to \$3.25 did not include.

Additionally, last quarter we noted that we would be able to achieve \$280 million in free cash flow much earlier than our original target of 2024. I'm pleased to share that we now expect to achieve adjusted, unlevered free cash flow of \$270 to \$290 million in 2023, roughly a full year earlier than we had originally expected. We are well on our way, as we have already generated \$142 million in the first six months of 2023.

Our updated target demonstrates the power of the operating leverage inherent in our business. It also speaks to the progress we are making on our efficiency initiatives, all while continuing to invest in innovation and targeted go to market activities.

In summary, Q2 again demonstrated our ability to execute against our strategy of driving profitable, healthy growth with robust free cash flow generation. We believe our leading, differentiated product offerings and focus on innovation, coupled with our scale and attractive business model, positions us well for continued success.

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