Ryan Goodman, RingCentral, Inc. – Head of Investor Relations

Thank you. Good afternoon and welcome to RingCentral's first quarter 2019 earnings conference call. I am Ryan Goodman, RingCentral's Head of Investor Relations. Joining me today are Vlad Shmunis, Founder, Chairman, and CEO, David Sipes, Chief Operating Officer, and Mitesh Dhruv, Chief Financial Officer. Our format today will include prepared remarks by Vlad, David and Mitesh, followed by Q&A.

Some of our discussions and responses to your questions will contain forward-looking statements. 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.

I encourage you to visit our Investor Relations website at ir.ringcentral.com to access our earnings release, slide deck, our non-GAAP to 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.

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.

With that, let me turn the call over to Vlad.

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

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

We are pleased with the first quarter as we continue leading in the $50 billion unified communications as a service market.

Revenue, operating margin, and non-GAAP EPS all met or exceeded the high-end of our guidance. Mid-market and enterprise continued to lead the growth, helped by strong contributions from channel partners. We are also pleased with our targeted vertical market initiatives, which, in this quarter, contributed multiple seven-figure TCV wins.

I'm particularly excited to announce that, in the first quarter, we secured our largest seat count win ever. This is a 45,000 seat win with Waitrose & Partners, a leading UK retailer.

Let me cover some of the key metrics for Q1:

First, total revenues grew to $201 million. This is a 34% increase year-over-year, and above the high-end of our guidance range.

Second, mid-market and enterprise business continued to be a key driver of our performance. We define mid-market and enterprise as $25,000 or more in annual recurring revenue, or ARR. This grew 70% year-over-year and is now a $346 million business. Enterprise, defined as customers with $100,000 or more in ARR, nearly doubled year-over-year to $200 million.

Third, our channel ARR grew 75% year-over-year to $203 million.

Fourth, our targeted verticals industry program contributed over 40% of seven-figure TCV wins last quarter.

It is clear that the cloud is winning, and RingCentral is winning in the cloud.

RingCentral is the leading pure cloud unified communications as a service platform. We have invested hundreds of millions of dollars over many years into our core cloud PBX technology that is at the heart of our solution. We further differentiate with our global footprint, open platform – now used by over 20,000 developers, and integrated team messaging, video conferencing, and contact center. To that end, we recently executed multi-year extensions of our agreements with recognized industry leaders in cloud-based video conferencing and contact center.

We continue to rapidly innovate as we look to widen the gap between us and our competitors. In Q1, we had three key technology announcements:

1. We announced RingCentral Persist, a new solution that enables enterprise customers to maintain communications services in case of an internet failure at their location. Persist adds additional resiliency to RingCentral's high availability delivery infrastructure for the most demanding customer environments. An early adopter is the state-of-the-art Chase Center sports and entertainment complex, the new home of the World Champion Golden State Warriors, scheduled to open in September 2019.

2. We introduced RingCentral Embeddable. It enables developers to embed voice and SMS messaging into our customer's business applications with just a few lines of code. We already have over 200 companies in industries such as retail, healthcare, and insurance use RingCentral Embeddable.

3. We extended our open platform to help customers meet compliance and regulatory requirements. For example, customers from industries such as oil and gas, real estate, and healthcare use our new APIs to address their specific data retention needs.

More recently, we announced the integration of RingCentral Engage Digital with Google Dialogflow. With this integration, RingCentral Engage Digital customers can leverage the machine learning and AI capabilities of Google Dialogflow. This enables them to deploy chatbot virtual agents to manage automated digital customer interactions.

Our industry leading cloud communications and collaboration solution, combined with our world class customer support, is clearly resonating with customers. We are well-positioned to achieve our goal of exceeding $1 billion in revenue in 2020.

Now for some color, I will turn the call over to our Chief Operating Officer, Dave Sipes.

Dave D. Sipes, RingCentral, Inc. – COO

Thank you, Vlad. Our continued success in the market is driven by the breadth and depth of our cloud platform, our rapid product innovation, and continued expansion of our global go to market capabilities. Let me now expand.

Our unified communications and collaboration platform continues to be a key differentiator against legacy and cloud competitors. Key to our success is our proven ability to transition customers from legacy on-premise systems like Cisco and Avaya to RingCentral Office and Contact Center. Enterprise grade voice through the cloud is an absolute prerequisite for these migrations. And while voice is a dominant form of communications amongst our customers, a majority of our top wins continue to cite our unification of other modalities such as video and messaging, as well as our open platform and global footprint, as reasons for their choosing RingCentral.

Let me start with an example of our open platform differentiation. It was noted as a critical influencing factor in over 80% of our $1 million TCV wins in the first quarter. The open platform enables our customers to easily integrate RingCentral with their CRM systems, as well as other business applications to integrate enterprise workflows.

As a case in point, our 45,000 seat win in the UK is a great example of how we were able to deliver on unique custom workflow requirements. Waitrose & Partners, a leading UK retailer, has a strategic deployment of 'Multi-Functional Devices' across their business aimed at improving staff efficiency and customer service. RingCentral's communication platform will play an integral role in supporting their team of 45,000 employees by ensuring they are more efficient in the future and can therefore provide an even better service for their customers.

Euralis in Europe is another example of a win driven by the strength of our platform in mobility, global reach, and simplicity. Euralis is a leading France-based agricultural cooperative that supports about 12,000 farms across Europe. Our platform delivered on their requirements for mobility, coverage across 20 countries in Europe, and deep integrations with Google products. This was more than a 3,000 seat Office and contact center win, replacing multiple legacy on-premise vendors.

Our leading product offering is complemented by a strong go to market strategy. Areas of focus on the GTM front include our targeted vertical industry initiative, land and expand, and channel growth.

On last quarter's earnings call, we highlighted our vertical market initiative, focused on education, healthcare, and financial markets. In Q1, we continued to make progress in all of these verticals.

Education was a particularly strong vertical as we built on our success with Columbia University, which chose us last quarter for our integrated enterprise grade voice, video, and messaging capabilities. In Q1, we signed Texas Christian University, or TCU, where we secured a win for more than 3,000 seats. TCU needed a mobile-first solution, as well as an open platform to easily integrate with Microsoft and other applications. We had multiple wins at other major universities, such as Baylor Medical, for example. Having large referenceable higher education customers like Columbia and TCU continues to strengthen our position in this key vertical.

In financial services, we saw meaningful expansion with a Fortune 500 insurance company. This customer started with a pilot in Q1 of last year. The customer wanted to modernize its communications infrastructure across more than 500 independently owned field offices. Mobility was a key focus, combined with strict compliance requirements. We're pleased to report this customer is now over 3,000 seats.

Land and expand continues to be a key part of our go to market strategy for both seat expansion and product cross sell. Let me highlight a couple of notable examples.

Our recent seat expansion with Panda Express restaurants, a leading national restaurant chain, demonstrates success of our land and expand strategy well. After experiencing our high-reliability, voice quality, ease of use, and analytics first hand, in Q1, they agreed to approximately triple their deployment to over 1,000 locations. We've seen similar results in the past with other leading restaurant chains' expansions such as Chili's and Red Lobster.

For an example where product cross sell fueled significant land and expand, recall that in Q4, we secured a 1,000 seat contact center win with a large cloud applications provider. In the first quarter, we expanded this deal to include more than 5,000 Office seats. The customer was facing challenges with its legacy PBX system in terms of reliability, integration capability, and analytics. Our contact center relationship opened the door, and our leading mobile-first open platform secured this win.

Last, but not least, our channel execution remains solid. We expanded our channel network by about 25% year-over-year. We also recently announced a partnership with PCM, a leading technology solutions provider. Channel accounted for over 70% of our $1 million TCV wins, including the 45,000 seat win at Waitrose and Partners and the win at TCU. We are also proud to have CRN award us a 5-Star rating in its 2019 Partner Program Guide.

To wrap up, I'll give a brief update on RingCentral Engage, our digital customer engagement solution. This quarter, M1, a large telco operator in Singapore, chose to complement their traditional voice-centric contact center with RingCentral Engage Digital. Our broad digital channel support, ability to evolve with future needs, and speed to deploy were all key to securing this win.

In summary, our product innovation and GTM efforts are bearing fruit, and our land and expand strategy is creating sustainable long-term tailwinds to growth. With this momentum, we look forward to extending our market leadership in 2019 and years beyond.

Now for the financials, I will turn the call over to our Chief Financial Officer, Mitesh Dhruv.

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Mitesh Dhruv, RingCentral, Inc. – CFO

Thanks, Dave, and good afternoon everyone.

We are pleased with our results on all key financial metrics. Total ARR grew to $777 million, up 32% year-over-year, and ARR for RingCentral Office grew to $694 million, up 36% year-over-year.

Key drivers continue to be mid-market and enterprise, with strong contribution from channel partners.

Mid-market and enterprise ARR grew to $346 million, up 70% year-over-year. As we discussed last quarter, we have moved to a dollar-based metric to provide more transparency to investors, reflecting our expanding product portfolio.

We continue focusing on mid-market and enterprise customers, as they deliver higher lifetime value deals with lower churn and better land and expand potential. In Q1, mid-market and enterprise contributed around 60% of new bookings. This is up from over 50% last year. As to land and expand, we again saw solid performance in new bookings from our existing customers. This represented over 40% of the new business mix in the quarter, consistent with recent trends.

Channel partners again made a significant contribution to our growth. Channel ARR is now over $200 million, up 75% year-over-year.

Quick update on AT&T: While these are still early days, we are pleased with progress to date. Teams are working well together, and we see good initial traction in the field. We are still not baking in any meaningful contribution in 2019, but we expect AT&T to be a long-term growth driver.

Upmarket and channel led to strong financial performance in the quarter.

Total revenue grew 34% to $201 million, which included an unexpected small benefit in other revenue driven by timing of professional services.

Subscription revenue grew 33% to $183 million.

Subscription non-GAAP gross margin was 82%, consistent with our expectations. This includes puts and takes from scale and contact center growth and is a reasonable target to assume, plus or minus.

Non-GAAP operating margin of 8.1% was at the high-end of our guidance and non-GAAP EPS of $0.17 was above the high-end of our guidance.

Now let’s turn to our outlook.

We are raising our 2019 guidance.

We expect total revenue to be between $862 million and $866 million for an annual growth of 28% to 29%. We expect non-GAAP EPS of $0.71 to $0.75.

In summary, we are pleased with our performance, led by traction in mid-market, enterprise and the channel. Looking ahead, we are well-positioned in the $50 billion UCaaS market. We expect to continue taking market share from legacy on-premise vendors, and further distance ourselves from cloud competitors. We expect channel and upmarket tailwinds to continue, bolstered by an expanding international footprint, and our targeted vertical go to market programs.

Now, let me turn the call to the operator for Q&A.