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Freshworks, Inc. (FRSH)

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MANAGEMENT DISCUSSION SECTION

Scott Berg
Analyst, Needham & Co. LLC

All right. I guess we can get started. Excellent. Well, thanks, everyone, for joining us today. For those that don't know me, my name is Scott Berg. I lead our SaaS and enterprise software research here at Needham. Today with us, we have Freshworks. I don't even have to read your name from my list here. So inside baseball, I always put the Amazon on the questions because when you're running from stuff, you don't want to have the mind blank. But today with us, we have the company CFO, Tyler Sloat. Thanks so much for joining us. Those are probably now, I think you and I go back now 13 years or 14 years [indiscernible] (00:00:38).

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

Yeah. [indiscernible] (00:00:39).

Scott Berg
Analyst, Needham & Co. LLC

That's why I definitely don't need the name. That's all right. So well, why don't you give an overview of Freshworks for the few people that might not be familiar with it?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

Yeah. Well, presumably everybody knows who we are, but yes, Freshworks, we're really a – we've had a little bit of a pivot over, I call the last couple of years, but we are an AI-enabled unified service operations platform software company. So, what does that mean? Our main product is an EX offering selling into CIOs. That really now spans across multiple functions with our ESM offerings, allowing every single kind of employee to be more productive in their jobs. And that is Freshservice and what we often refer to as EX. And it's a $540 million product growing at mid-20 digit growth rates and just doing incredibly well, right now, with some acceleration and growth this past quarter.

We also have a CX offering, which is our Freshdesk product, which is a $390 million desk offering customer support. I really focused on kind of that mid-market to high SMB customer base really ranging kind of like 50 to 500 employee businesses. That one is growing at kind of low single-digits is what we talked about and a very profitable business for us.

QUESTION AND ANSWER SECTION

Scott Berg
Analyst, Needham & Co. LLC

Q

So pardon me, let's go to product and start on the EX side of the business. You mentioned organic growth rate above 20%. It's accelerated 25% last quarter, constant currency terms. I guess what's improving with this segment because it's at scale $540 million of ARR that you talked about. We don't see a lot of businesses at $500 million actually accelerating. So, what's going well there? Is it moving into other segments? Is it just resonating well? Is it moving larger customers? Is it probably a combination of all that? But if you kind of look back at last 12 months, why is it a better business today than 12 months ago?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. EX to me, it's kind of a combination of three different things that's happening. The first is, it starts with product and product depth. We now have the capability to go in and service an enterprise organization, we're really not focused on super large enterprises. Let's call it kind of the low-end enterprise or up to 20,000 employee organizations. And number one, get them implemented really quickly. Number two, have a very intuitive and easy to use product. But three, most importantly, have the depth of product in there that they need. That depth is not just on core ticketing and workflow, which is our Freshservice, but now with the offerings or the adjacencies starting with ITAM. So, IT Asset Management really a requirement to go service a large enterprise company, they have to have that. And we bought the company Device42, two years ago. We've now kind of [ph] rewritten (00:03:31) the entire team to be within Freshservice and now can go offer that capability to our customer base, which really gives us the right to go, engage, and offer enterprise what they need.

So, first is product depth. Second is an enterprise sales motion that you can have the product. But if you don't know how to engage or even get in, you're not going to be able to sell it. And this is something we've been building out for the last couple of years really put a lot of the pieces in place last year and now you're starting to see the fruits of that labor. For us to be able to go in, have the brand recognition, have the relationship with the CIO, but also be able to go close the deal. We talked about in Q1 how we close the two biggest deals that we have in company history on the EX side.

And I don't think that's going to be anomaly. I think you're just going to start to see a repeated pattern that we're just trying to engage with larger organizations. The third thing on EX is really the breadth of portfolio. So, the depth of the product offering and then the enterprise capabilities and feature functionality, [ph] but now the breadth (00:04:29). So, it's a really a four pillar strategy anchored with Freshservice. Then we move to ESM, which is a capability to go serve other functions, primarily HR. Third is ITAM, where we announced the launch of our cloud offering on advanced ITAM, the initial one where it's going to be three releases and the last will be at the end of the summer to get fully featured with our on-prem product.

And then lastly ITOM, which is a company that FireHydrant that we bought at the beginning of the year. I don't – we haven't announced when that fully integrated product will be, hopefully by the end of the year. But that is going to be incident response and allow us to go kind of start to go play in the periphery more with the technical operations side of the house of IT. That breath allows us to grow across EX as well. So, it's really the three things that's allowing us to go play in that space and really be the leader in that kind of low enterprise market.

Scott Berg
Analyst, Needham & Co. LLC

Q

Staying on the theme around ESM, because you mentioned it. At your Analyst Day last fall, I believe you laid out a target for $100 million worth of ARR coming from ESM as a category. Why is that such a natural expansion sell for those customers?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah.

Scott Berg
Analyst, Needham & Co. LLC

Q

Today, and there's a large competitor of yours that's had success with that. It's been pretty natural. But you guys are pretty jazzed and pretty certain you can make that ARR target.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. Two years ago, we spent about a year re-architecting the product to allow for seamless kind of expansion across other functions, all on the same platform. And so, today, we can go sell into HR, which tends to be the closest adjacency and really they're using Freshservice, but they're using a workspace within Freshservice dedicated to HR that now has security parameters and things like that. That allows for one common platform used across other functions. What you're going to see, and it's doing really, really well, because it has all the capabilities that has a shell [ph] from what (00:06:28) a function needs.

What you're going to see is us adding depth to that. For example, on Thursday, we have our Refresh event, which is our user conference that's really 100% dedicated to EX. And we're going to be announcing some new products there. One of them is EX AI Agent Studio. But within EX AI Agent Studio is going to come pre-built with a bunch of integrations, one of them, say to Workday [ph] that's your (00:06:51) HRMS, because onboarding and off-boarding is one of the biggest use cases for HR in terms of workflow, but it's tightly aligned with the IT needs as well. So, imagine issuing computer or access control and things like that. This is one example of how the adjacencies selling into another function makes it really seamless when you're talking about the same product and just being able to add a user on to that product. It's not – it won't start/stop with HR though. It's going to be, typically finance functions like procurement, like workplace resources, like finance [indiscernible] (00:07:21) or payroll, anything that has some type of ticket in a workflow where you have an employee need that comes in and then it needs to be kind of routed to the right parties. It's just a natural expansion, and I think we've just started.

Scott Berg
Analyst, Needham & Co. LLC

Q

Well, I'll be there Thursday. Looking forward to seeing the product there. You mentioned the acquisition of FireHydrant. If I dial the calendar back to when you acquired Device42, you thought that was super important on the competitive nature because other competitors had that ITAM functionality, right? And this was going to help your win rates, especially as you move up market a little bit. Does ITOM have or with FireHydrant, does that have the same kind of strategic rationale that it should help your win rates because you have some competitors that might have that function?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah, absolutely. And it's a little bit on the adjacency because the buyer for incident response is oftentimes your tech ops buyer, not your CIO buyer, which is somebody who's running the service. If you're offering, say, a cloud service of some sort. But it is an adjacency that flows right into incident management, which then is run by the IT org [indiscernible] (00:08:25) whether it's fixing, say, an asset management, so having Device42 is really important having asset management with incident response because oftentimes the incidents are related to something that's going down on the asset side.

FireHydrant is going to be able to expand out not just on incident response, but also will get us into other adjacencies in the future like AIOps and Security Ops, which is areas that we have not grown into. I don't think it's quite the same as Device42, where it was a required element to just land on the IT side. Where we weren't able to go engage with enterprise customers without advanced ITAM. And now we are. This is more of an adjacency that's on the side.

Scott Berg
Analyst, Needham & Co. LLC

Q

Okay. Moving to the CX side just a little bit. How do I say this in the nicest way? Invest – public investors kind of hate the customer service environment right now, as you know. Right? It's not just you. It's other companies that I cover in, there are at least that segment. And they were just worried about massive amounts of AI disruption and seat displacement, et cetera. But you've had some nice traction with Freddy AI. And just like some other vendors in the space, so I think investors ultimately will have wrong. I think they'll have the story wrong about what you guys are doing there. But what are you seeing from customers around their adoption of Freddy AI relative to the spend that they might have had historically in CX? Is that been a one plus one actually equals better than two? Or they consuming Freddy at a rate that they're maybe displacing your CX business. Trying to understand that's just an offset or that's actually in a [indiscernible] (00:10:00).

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. [indiscernible] (00:10:02) consider it a displacement. So, if you think about our Freddy products, you have an agent on the front end which is really priced as a usage component, which is sessions, session packs. Then you have a copilot, which is an add-on to an agent, which helps them be much more productive in their jobs. And then you have an insights product which is really about the managers being able to look at the business specifically the agents and how are they're doing. The attach rates for Freddy Copilot in particular are really, really strong, and they are – that was an 80% grower across the entire company on copilot growth in terms of the customer numbers on copilot.

The actual penetration into the existing installed base, it's kind of an anomaly because you have a ton of customers who still are, they're hesitant to adopt AI, and that's really the upside opportunity. For new customers, though it's really clear that it's table stakes at this point. You have to have great AI capabilities if you want to win business, and that's the way we're selling the product. Right? And so, that's why the attach rates on new business, specifically larger deals are really strong and really high.

Over time, you just going to continue to see more of that table stakes needed to be able to go compete. We feel that we're at the forefront of it and we're innovating like crazy on the AI side. But the reality is, specifically in CX, there's a ton of disruption, is becoming a fragmented space. And for us, we're being very, very prudent about it. We've replatformed our entire product. It took us a year to replatform the product on to really one new product, which is Freshdesk, that has two additions, Freshdesk and Freshdesk Omni. We're 80% through migrating all of our customers. They're on effectively five different products. In the CX space, migrating them on to the new product. All new customers are signing up for the new product. We will take us probably to the end of the year to get the remaining 20% of our customers, which tend to be the largest customers with the most complexity on to the new Freshdesk product line.

And then once we get there, we are – refocus our entire go-to-market motion for CX to be very, very focused on what we are calling kind of the high-end of SMB, kind of low-end of commercial. It's kind of call it a 50 employee to 500 employee organization, which that ideal customer profile we view that we have the right to win and we're already seeing it because ARPAs are over 2x higher for new businesses that are signing up than historically they have been. We're going to focus our go-to-market efforts. So, we're going to get our product organization to be much leaner and much more focused. And we're going to run that business incredibly profitably. And that's our goal for now.

Scott Berg
Analyst, Needham & Co. LLC

Q

In ARPA, that's 2x higher? That's a pretty big plus.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

For new customers.

Scott Berg
Analyst, Needham & Co. LLC

Q

For new customers. Yeah. So that means the expansion opportunity, even if they get rid of some seats on the human side, this could be pretty powerful over a period of time.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah, absolutely.

Scott Berg
Analyst, Needham & Co. LLC

Q

So...

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

I think, everything will play out on, when we talk about AI capabilities because yes, a lot of it will move to some type of consumption or resolution based pricing that's going to have some variable pricing to it. We have been pretty pragmatic and conservative on our iterations on pricing and packaging. We've seen a lot of our competitors come out with new AI pricing like every six months. I think that can be incredibly confusing for our customer. And so, we want it to be kind of innovators on the product side, not necessarily the innovators on the pricing side. And we also want whatever we're thinking about pricing, but we want to put up like measurements internally, kind of track it, and then come out with stuff. So, even EX AI Agent Studio, which we'll announce on Thursday, we're going to announce the pricing, but we're actually not going to charge for it to October. We just want adoption, we want usage. And then we're – and with predictability for our customers that over time have predictability because that's really, really important that you can't put something else out that's not going to be predictable.

Scott Berg
Analyst, Needham & Co. LLC

Q

So, in the last quarter, the CX segment grew 4% constant currency terms relative to 5%, I believe it was in Q4, and I think it was 7% in Q3, if I got my numbers right off top of my head. What should be the kind of more durable growth rate of that? Obviously, going through transition, the platform is probably going to help that because the existing customers are certainly going to adopt these things. But is the current growth rate the way that investors should think about that segment, I don't know for the next couple of quarters, couple of years or do you have some opportunity to improve that, do you think?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. I think, we're being very prudent with our external expectations. So, we actually said on the call last week, low single-digit growth for CX expectation for the remainder of the year. We have to get through this migration. We have to see what happens there. I'm cautiously optimistic internally and do we think we can bring it back to some growth? We do. But we're not modeling that in. And we actually don't think it's healthy to – for anybody to model that in, until it actually starts happening. We're going to be very focused on it and we also are going to run it very profitably. Where we think we can get this to kind of a really, really good operating margin and have a great contribution from a cash flow perspective to the business. But I think we have to prove it out first.

Scott Berg
Analyst, Needham & Co. LLC

Q

And on the call, you also talked about not being aggressive in some of the expansion opportunities or until those customers are migrated, which totally makes sense. Why get aggressive on something and then have to change them and basically re-implement or redo whatever needs to be done? Do you have expectations on the go-to-market side that you will become more aggressive once the new platform is in the hands of all those customers?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

On the go-to-market side, I think, what we're going to see is number one going to have a very focused go-to-market that's going to be inbound only. And really playing against a very tight ICP. That means we're going to have customers that come in that are going to be outside that ICP, and will obviously still serve them, but are going to be very disciplined on what we say we're going to deliver from a feature functionality perspective. The same time, you're going to have a very focused product and engineering team that is going to be able to iterate a lot faster. They've been building across five different products. They're going to have one platform on the CX side that they're going to be able to go iterate on.

And so, I think that both of those teams are going to be – incredibly focused and just going to be kind of back to our roots a little bit there. That theoretically could absolutely lead to growth. Like, we will lean in if we think we can grow faster there, but we're going to be very prescriptive on what we do initially until we kind of prove it out.

Scott Berg
Analyst, Needham & Co. LLC

Q

So, the company just announced a 11% RIF as well, reduction in workforce. A common question I'll get from that. It just happened with another company in the quarters. How do you avoid some of the pitfalls around sales execution kind of waning in the short-term or having disruptions around that still make the quarters and still drive the growth rate that you all are talking about? As you think about the second and third quarters, just how do you put a wrapper around that so you maybe avoid that?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

A lot of our reorganization that we just announced last week was driven around go-to-market changes, and a lot of those changes are really around our focus on EX being really 100% field-based. Our 100% of our field is now EX focused. And a lot of our marketing priorities and outbound, and all of that brand awareness is going to be EX focused. And then like a lot of discipline around the CX focus. And so, as we went through all of that, yes, there's going to be organizational changes that happen as a result. And then we're really doing that kind of across the company where we then with the product and engineering, there's going to be a lot of focus there.

On the field side, on the EX opportunity, it actually is like if anything, we're going to be spending more. And so, it's not about what disruption would happen to the field. It's actually going to be kind of potentially the opposite. Right? We want to grow that field motion and the capabilities and the quota capacity and everything else to be able to go service what we view as a huge opportunity on the EX side. And I think you're going to see that over the coming quarters. As you perform, we're going to absolutely lean into grow faster.

Scott Berg
Analyst, Needham & Co. LLC

Q

So, you might not remember this. This was at your prior company's customer conference. You held the day after the conference for finance executives, and you were talking about the SaaS business model. And for those that don't know Tyler, he is very, very focused on the different metrics within the model, which I was impressed that day because you taught me couple of things that I hadn't considered before. So, I thought that was great.

But the next question revolves around some of the metrics of the SaaS business. Like, LTV, the CAC, and how you think about profitability of different segments? You're generally trying to move upmarket to a higher quality customer in general in both segments, right? We're seeing on the EX side. Can you talk about on the CX side, the high end of the SMB to maybe the mid enterprise or so is, but how much better are those metrics for the business over the long-term if you can successfully sell into those [indiscernible] (00:19:02)?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. So, I think about a couple of things. I think it's about, okay, what's your cost to acquire and then what's your cost to serve, and then what's your capability to grow? I – if I – if we look at the changes we've been making, when we announced kind of our strategy shift two years ago, this is when Dennis became CEO, and that we were going to prioritize EX. A lot of it. Number one started with what's the TAM opportunity on EX which is massive and it's in the area that we're serving, it's an underserved population. So, the capability to actually go start is huge.

Second EX is an incredibly profitable business to run, and it's really, really efficient. And the gross margin capabilities for EX is actually much better than CX. So, then it comes. And then third, the capability to grow once around EX, we now have a common platform that we now have a four pillar strategy. And so, once we land and the four pillars doesn't even include AI, we started Freshservice, ESM, ITOM, and ITAM. So, our capability to grow once we land even AI on top of it, is significant. And it's actually just going to continue as we continue to broaden that strategy. So, across all of those different things, everything makes sense. And LTV to CAC and our capability to bringing a customer efficiently is really, really good. So, the risk area is around building out your field motion because it is more costly to acquire initially if you have a more expensive field motion. And that's something that we've been pretty like prudent about. Okay, disciplined about how you spend. But the reality is some of our spend has been diluted across EX and CX, even on the outbound side.

So, a lot of the changes we made were really get very focused on EX, and make sure every dollar that we're spending is going to have the highest return possible. So, when we will look at all of that, I still think we have some work to do, but we're actually pretty proud of how we've – what we've done as a company specifically to the bottom line and our efficiency metrics. Right? Even for this year to be able to go from a point where we were burning cash, just a couple of years ago to now, mid-2020s cash flow margin just raised from $252 million to $265 million on free cash flow. For this year, I'm really proud of what we've been able to accomplish, and I think you're just going to see us continue to run a very efficient business while we try to accelerate growth.

Scott Berg
Analyst, Needham & Co. LLC

Q

[indiscernible] (00:21:18), and last time I checked, that doesn't happen very frequently in my space.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah.

Scott Berg
Analyst, Needham & Co. LLC

Q

So, very much looking forward to that. You touched on this a little bit earlier around the differentiation of the product. Easy to use, we've had a bunch of customer checks that we've published in the past and easy to use [ph] so the (00:21:34) platform always comes up. Doesn't matter if it's on the CX side or the EX. I remember the last customer checks we published, there was one on an EX competitor, took him eight months to nine months to implement, they moved you, they were fully implemented in three weeks or four weeks and what they thought was a much better technology. So that's been something that's resonated, ever since the first time I chatted with [indiscernible] (00:21:55) about the opportunity there.

But how do you maintain that ease of use as the platform does expand and add a lot more complexity into it? I think it's super simple when you're a single product company or maybe couple product company. But on the EX side specifically, you've got four, five, six large modules there. Can you maintain that effectively?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. I think that's one of the things that – like is – number one, super attractive about why I joined our Freshworks that, I've never seen a company that starts selling to big enterprise and then successfully moves down. But if you build for the SMB, but then you can keep that in your DNA, which building for the SMB means you have to have a great user experience. You have to have very, very easy onboarding and have a product that is seamless in terms of all of its capabilities. And then you add feature functionality that then makes you relevant to an enterprise at some point.

I think, Freshservice is a great example of that. Now what are the nuances? So, I described on ESM, it took us a year to kind of rearchitect the product to make it applicable to ESM, and I think about it, we essentially had to move the whole database layer down, so that you could add a workspace that had security parameters but be all on one platform. It just took us two years to do this for Device42, right? It's like you bought Device42 two years ago. Why do you take two years to get a cloud version of it?

We essentially just rewrote the entire CMDB in Freshservice over the last two years, but you do it very purposefully. So, now you have one platform now that has a cloud offering that you can just turn on. Right? FireHydrant shouldn't be that complex when we do it. But the discipline as opposed to just kind of bolting on a new solution on the side that makes it look like, oh! you have everything. But when you go into a user, they have very different user experiences because they're essentially having to have like a different admin portal or different UI because it's really a bolt-on product. That's what we've been trying to avoid.

I think, we've made maybe some of those missteps on the CX side. That's why I said we have like essentially five different products there. But on the EX side, a very disciplined approach with one platform that's a unified platform that's allowed us just turn on capabilities when we've done it right. And that's why there's so much power in that product.

Scott Berg
Analyst, Needham & Co. LLC

Q

Okay. The partner sales motion is also becoming, I think, more critical, especially on the EX side of the business today. The partners we've spoken with certainly will talk about that. How critical are they to the business going forward now? As you added that complexity to the platform and as you try to move up market even more?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. I think, the partner motion, I'd still say we're not great at it. But I think we – has a ton of upside. So, we've announced a couple of GSI relationships with really that kind of smaller GSI side. It's a little bit complex because for a lot of the big GSI's they rely on deep, heavy implementations to make their money. And our product isn't like that. You already mentioned that we can go into big enterprise and get them live really quickly. And so, for a partner, it has to be some type of business transformation or a full stack offering if they're going to make money on implementation. So, how do we, like what are we doing? And say, well, we work with a lot of regional partners and it's everything from lead flow all the way through to full stack offering specifically, and say, non-English speaking countries where the partners can lead and even provide support offerings or add on other services on top of, say, Freshservice. It's going to become more and more important. So, we have to get a little bit more sophisticated about how we approach it.

We're working on it. I think that we're doing that in parallel as we build out an enterprise sales motion. You did see us two years ago, say, we're actually going to refocus outside of a lot of those geographies and really get focused on some geographies that matter to us, which is really Americas, Europe, and certain parts of Asia. And we're still doing that because the TAM opportunity is huge and we have everything we need to grow at a much faster while growing now just by servicing that. But over time you're going to see us get a lot more sophistication on the partner side.

Scott Berg
Analyst, Needham & Co. LLC

Q

Okay. So, we have the CFO with us, which means I have to ask at least a couple of financial questions, right? With the change in workforce that you recently announced, you've also talked about high 20s operating margin in fiscal 2027 or exiting fiscal 2027. I should clarify at least this confidence level that you can drive that target, where should we expect to see that leverage come out of, my guess is it's semi broad-based in the organization. But is there an area too that might get a little bit more focus than maybe we can see on the surface?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Yeah. I think, we're getting like more focus across every single function. The organizational change we made last week actually impacted every single function. We are a little bit different than maybe a lot of our companies out there announcing reorgs or whatnot. It started with the EX, CX focus, and then we looked at the org and maybe because of our roots in India, we've tended to solve problems by hiring people as opposed to truly solving the problems on infrastructure and systems and the right people. But we've been making those changes over the last couple of years, and so we've invested a ton in infrastructure. Now we get to see the fruits of that labor and a lot of it was like in areas that we had built up manual processes that we don't need to have anymore.

I think going forward we're just going to see the same – you're going to see the same rigor on efficiencies, on how we run the business. And yes, the internal use of AI is changing things for every company, every day kind of make it a priority, which we are and we're going to continue to do that. And so, I do have a lot of confidence on our capability to run a very efficient business while also trying to fuel growth. And that is a – it's a dynamic that it's sometimes hard to manage. We are going to absolutely optimize for the growth side, and we'd be very open about it in terms of disclosure and everything else if anything would change on the profit side, because we would be spending more for growth. But we'd only be doing it if we think we could really grow a lot faster.

Scott Berg
Analyst, Needham & Co. LLC

Q

Okay. So, on the faster growth side, from your Analyst Day, you had set out targets to accelerate your organic growth rate this year. We'll call it a point. Same thing in next year in 2027, right? My guess is some of the AI functionality that you have released since then or will continue will be a partial driver to all that. A key question I've been getting a lot over the last quarter or two is around gross margin degradation as companies like Freshworks can, they sell more and have their customers use more, they add functionality. Will we see some degradation around gross margins because they might not be able to recapture from a pricing side? How do you think about that within your model with what's around there? Because we're not seeing it yet in the model. But is there an opportunity for that to maybe happen?

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

So, we're not seeing it yet in the model, right. We're mid-80s gross margin, which for a company of our size, I think is quite frankly exceptional. And every single quarter I caution, hey, don't expect this. In fact, you're going to see some little bit of variance there. Yeah. We haven't really seen it yet. Even though Freddy adoption is increasing significantly. I think, I would expect both from internal use as well as the product use that, yeah, token cost will come up. But so far we've been able to absorb it through other savings in other areas and just by running the company efficiently. I think, over time, the token costs are going to look a lot like a – your cloud service providers. I think, though, over time, as long as there can be a couple of different vendors that it'll become a little bit more commoditized and you'll be able to switch.

We have built a product so that we can switch between LLMs and then even use lower cost models for certain things as opposed to everything paying in the most higher cost model, which runs costs up. You want to see as much AI usage as possible and we're trying to drive for that and drive for adoption. And so, we try to model out what the impact of that will be. And it's something we constantly monitor. I think you're going to see maybe margin degradation for companies, but they're going to become much more efficient and as maybe some other line item, so that the overall operating margin stays the same or better.

Scott Berg
Analyst, Needham & Co. LLC

Q

Okay. With that happy to open it to the audience for any questions if there are any. We got about 4 minutes or 5 minutes. Well, with that, we'll give everyone 4 minutes or 5 minutes left.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

A

Awesome.

Scott Berg
Analyst, Needham & Co. LLC

Thanks so much for the time.

Tyler Renwick Sloat
Chief Operating Officer & Chief Financial Officer, Freshworks, Inc.

Scott, thanks for having us.

Scott Berg
Analyst, Needham & Co. LLC

Thanks, everyone, for joining us.