Box Inc.
Second Quarter Fiscal 2023
Conference Call Remarks
August 24, 2022

Introduction

Good afternoon and welcome to Box's Second Quarter fiscal 2023 Earnings Conference Call. I am Cynthia Hiponia, Vice President Investor Relations. On the call today, we have Aaron Levie, Box co-founder and CEO and Dylan Smith, Box co-founder and CFO. Following our prepared remarks, we will take your questions.

Today's call is being webcast and will also be available for replay on our Investor Relations Web site at www.box.com/investors. Our webcast will be audio only. However supplemental slides are now available for download from our website. We'll also post the highlights of today's call on Twitter at the handle @BoxIncIR.

On this call, we will be making forward-looking statements including:

- Our Q3 and full year fiscal 2023 financial guidance, and our expectations regarding our financial performance for fiscal 2023 and future periods, including our free cash flow, gross margins, operating margins, operating leverage, future profitability, net retention rates, remaining performance obligations, revenue and billings, and the impact of foreign currency exchange rates; and

- Our expectations regarding
  - the size of our market opportunity;
  - our planned investments, future product offerings and growth strategies;
  - our ability to achieve our long-term revenue and other operating model targets;
  - the timing and market adoption of, and benefits from, our new products, pricing models, and partnerships;
  - our ability to address enterprise challenges and deliver cost savings for our customers;

- the impact of the macro environment on our business and operating results; and
- our capital allocation strategies, including M&A and potential repurchase of our common stock.

These statements reflect our best judgment based on factors currently known to us, and actual events or results may differ materially. Please refer to our earnings press release filed today and the risk factors in documents we file with the Securities and Exchange Commission, including our most recent Quarterly Report on Form 10-Q for information on risks and uncertainties that may cause actual results to differ materially from statements made on this earnings call. These forward-looking statements are being made as of today, August 24, 2022, and we disclaim any obligation to update or revise them should they change or cease to be up-to-date.

In addition, during today's call, we will discuss non-GAAP financial measures. These non-GAAP financial measures should be considered in addition to, not as a substitute for or in isolation from, our GAAP results. You can find additional disclosures regarding these non-GAAP measures, including reconciliations with comparable GAAP results, in our earnings press release and in the related power point presentation which can be found on the Investor Relations page of our website. Unless otherwise indicated, all references to financial measures are on a non-GAAP basis.

With that, let me hand it over to Aaron.

<u>Second Quarter Fiscal 2023 Overview</u>

Thanks Cynthia. And thank you all for joining the call today.

We continue to deliver strong results in FY23, with second quarter revenue growth of 15% year-over-year. Our sharp focus on profitability drove non-GAAP operating margin of 21.7%, up 110 basis points from 20.6% a year ago. Gross margins remained strong at over 76% and our net retention rate increased both sequentially and year over year. Our current execution and business momentum gives us confidence in increasing our

EPS guidance while maintaining our revenue guidance for the full fiscal year, despite the higher impact of FX.

Our results show the success of our Content Cloud strategy, which powers the full lifecyle of content in a single platform. Our strategy is aligned with the three major trends that are driving the future of work: 1) hybrid workstyles, 2) the urgent need to digitally transform every business process, and 3) the ongoing pressures of data security, compliance, and privacy on all enterprises. More customers are turning to the Box Content Cloud to deliver secure content management and collaboration built for the new way of working. In the second quarter:

- Our Net Retention Rate was 112%, up from 106% in the prior year, driven by strong customer expansion rates.
- For our large deals, over $100K+ revenue annually:

    We had 86 new deals, up from 60 in the prior quarter and 74 in the year ago period, with 62 of these $100K+ deals being on multi-product Suites, up from 44 Suites deals in the prior quarter and 54 Suites deals a year ago, in this $100K+ segment.

Our fiscal Q2 results reflect healthy customer metrics, particularly in the complicated macro environment that enterprises are experiencing today. I have spoken with dozens of CIOs in the past couple of months across nearly every industry and in different geographies. What is clear is that enterprises today are looking to work with strategic technology platforms that can help overcome the multitude of challenges that they're facing.

The Box Content Cloud is ***the*** platform that enables CIOs to offer secure, cloud content management for the most critical workflows of the business from anywhere employees, partners or customers are working. In a hybrid and digital world, the value and volume of content is greater than ever before. Whether it's streamlining how government employees work across a distributed organization, simplifying a financial services company's onboarding workflows, or a large semiconductor company collaborating with a global supply chain, content is more mission critical than ever for enterprises.

And yet the tools most enterprises have to work for their information just don't cut it. Enterprises today are dealing with a highly fragmented landscape of legacy enterprise content management, storage, e-signature, workflow, and collaboration tools that all serve to isolate workflows, increase security risks, and increase IT expenses. In fact, tens of billions of dollars are spent every year on this mix of fragmented technology within enterprises today. And the problem will only keep growing -- it's estimated that there will be 175 zettabytes of data by 2025, and a substantial portion of this data is going to be in the form of content.

The legacy approach no longer makes any sense given the new demands on businesses. With the Box Content Cloud, enterprises can reduce the cost and complexity of their IT environments, dramatically simplifying their business operations, lowering their spend on redundant technology, while keeping their information secure. Examples of Box delivering this value to customers in Q2 include:

- A leading homebuilder who has completely standardized on Box for cloud content management eliminated an estimated $1 million in process costs by utilizing Box workflows across on-site teams, vendors, and sales reps.

- A Fortune 500 financial services group purchased a six year, seven figure Enterprise Plus ELA in Q2 as Box has become a more strategic and integral part of its business. With Box, this customer anticipates saving more than $4 million in annual storage costs, including hardware, software, and maintenance as they eliminate on-premise servers and disparate systems.

From our business performance and customer wins, it's clear that enterprises are increasingly making strategic, long-term decisions on how to support a remote workforce and digital processes, while maintaining a high-level of security and compliance.

We continue to build out the capabilities in our Content Cloud to power the full lifecycle of content in a single platform and address major trends in the future of work. Our investments in expanding our product features will add substantial value to our customers as we address a $74B TAM.

In Q2 we rolled out additional capabilities to Box Relay, Box Sign and API enhancements. These capabilities are included in Box core subscriptions and bundles, allowing customers to benefit from getting new value from the Box platform instantly and provide additional upside as customers move up to higher tier plans for more features.

We are very pleased with the momentum we are seeing in customer adoption and use of Box Sign. Second quarter customers include:

- A real estate development and management company who purchased Box in a six-figure deal as the key technology in its content management strategy. As part of this strategy the company purchased Box Sign Premier Services to support the signing and collaboration around new development properties.
- A leading medical device company who was already wall to wall with Box Enterprise Plus purchased additional licenses to support new use cases for Box Sign as they work with physicians treating patients suffering from heart and lung issues due to Covid.

With data security, compliance and privacy increasing in importance for our customers, Box's security capabilities also remain a critical driver of why customers choose our Content Cloud. In the second quarter we attained authorized security status for StateRAMP, a cybersecurity framework that ensures service providers offering solutions to state and local governments are receiving adequate protection for their sensitive content.

We also announced updates to our Trust Partner Program, which brings together a select group of industry-leading security and compliance platforms to advance security in the enterprise. These updates include new and deepened integrations, including with Cisco and Splunk, among many others. We will continue to invest in key product areas like Box Shield that extend our leading security, compliance, and governance capabilities.

Finally, the ability to integrate deeply across the SaaS landscape is an integral part of our platform strategy, including our deep integrations with Microsoft Teams, Office365, Zoom, IBM, Slack, Webex, ServiceNow, and many more. In Q2, we rolled out enhancements to the Box for Salesforce integration on the Salesforce AppExchange that enables customers to use Box as the content management solution for signature-based processes and workflows in Salesforce.

As we look at the second half of FY23, we are going to continue to rapidly extend our platform by doubling down in security and compliance with major Box Shield and Governance advancements; workflow and collaboration with Box Sign, Relay, Notes, and the roll-out of Box Canvas; and our open platform and partner integrations. And critically, we'll continue to scale our infrastructure in the cloud so we can continue to help serve customers globally with their most complex use-cases. At BoxWorks, this October, we'll be making a number of announcements around major product updates and further share our vision for where the Box Content Cloud is heading.

What all these capabilities and platform improvements have in common is they reinforce the value of having content in a single platform; they help streamline and automate our customers' businesses; and they help retire more of their legacy systems, saving them a ton in the process.

We continue to execute on key initiatives to scale and support our land and expand go-to-market motion, where we've seen significant productivity improvements in the past couple of years. With organizations managing hundreds of applications and an increasing number of those apps related to content, we have increased our focus on showing customers how we can reduce the cost and complexity in their tech stack.

A key part of our optimized pricing and packaging is our multi-product Suites offering, Enterprise Plus, which we launched a year ago. In Q2 Enterprise Plus accounted for more than 80% of our Suites deals. Our Q2 customer expansions and new wins with Enterprise Plus include:

- An American multinational medical devices and pharmaceutical company expanded its use of Box with a six figure Enterprise Plus upgrade to support more sophisticated use cases, including managing content across regulated functions and supporting structured business processes.
- A large vehicle retailer based in the U.S. purchased Box with a six figure Enterprise Plus deal, enabling them to eliminate on-premises file servers and solve key reliability issues. They will also leverage Box Platform to power new customer experiences.

We are pleased with the accelerating adoption of our multi-product offerings, which provides increased efficiencies in our sales process, higher total account value, net retention and gross margins.

It's clear that our mission of powering how the world works together has never been more important for our customers, as enterprises face a growing set of challenges around hybrid work, digital transformation, and cyber security threats. Our platform is in the best position to solve these challenges while reducing complexity and cost for our customers.

Before I hand it off to Dylan, I want to take a moment to acknowledge the focus and hard work of our Boxers. Across Box, we continue to invest in our people and talent, and our strong culture is what enables us to stay ahead of the competition and deliver for our customers. Boxers have an opportunity to define what work looks like in the future both with our platform and how we operate and scale as a business. As we continue to build an enduring business for the long run, we remain hyper focused on driving growth while also continuing to deliver even greater profitability.

With that, I'll hand it over to Dylan.

Q2 Fiscal 2023 Financial Results; Q3 and Fiscal 2023 Guidance

Thanks Aaron. Good afternoon everyone, and thank you for joining us.

Q2 marked another quarter of strong business momentum, with revenue and EPS at the high end of our guidance. Our focus on delivering profitable growth is working, demonstrated by gross margins of more than 76% and a net retention rate that was up both sequentially and year over year. Even amid this complicated macro environment, we remain on track to achieve the three key financial objectives for FY23 that we laid out at the beginning of this year - accelerating annual revenue growth, expanding operating margins, and prudently allocating capital to optimize shareholder returns.

In Q2 we delivered revenue of $246 million; up 15% year-over-year and at the high end of our guidance. Strong deal pacing throughout the quarter enabled us to offset the negative 3 percentage points of FX headwind that we experienced in Q2.

Our content cloud platform continues to generate high demand from our customers. In Q2 we closed 86 deals worth more than $100 thousand dollars annually, up 16% year over year, with a Suites attach rate of 72% on these large deals. As Box is increasingly viewed as a critical partner to our customers, we're seeing strong adoption of our products with more advanced capabilities. Roughly 40% of our revenue is now attributable to customers who have purchased Suites, an exceptional 12 percentage point increase from 28% a year ago.

We ended Q2 with remaining performance obligations, or RPO, of $1.1 billion, a 14% year-over-year increase, which includes an impact of negative 7 percentage points from FX. We expect to recognize more than 60% of our RPO over the next 12 months.

Q2 billings of $235 million grew 10% year-over-year, well above our expectations of mid-single digit range growth. Our billings growth rate was negatively impacted by 6 percentage points due to currency headwinds.

Our net retention rate at the end of Q2 was 112%, up 100 basis points sequentially and up 600 basis points from the prior year. We continue to see strong customer expansion and an improvement to our annualized full churn rate of 3%, versus 5% in the prior year. We still expect our net retention rate to remain roughly consistent, and for our full churn rate to be in the range of 3 to 4 percent, throughout the remainder of FY23.

Gross margin came in at 76.2%, up 170 basis points from 74.5% a year ago. Q2 gross profit of $187 million was up 17% year-over-year, exceeding our revenue growth rate by 200 basis points. Going forward, our public cloud migration strategy will unlock additional leverage to improve our long-term gross margin profile.

Once again, we demonstrated the leverage in our business and our commitment to delivering higher profitability with a 21% increase in Q2 operating income, to $53M. Our 21.7% operating margin was up 110 basis points from the 20.6% we recorded a year ago. We're also proud to have achieved our first quarter of positive GAAP net income of $1 million, up from negative 9 million a year ago.

We delivered 28c of diluted non-GAAP EPS in Q2, up 33% from 21c a year ago. Q2 Non-GAAP EPS includes a negative impact of 3 cents from currency headwinds.

I'll now turn to our cash flow and balance sheet.

For the first half of FY23 we generated free cash flow of $109 million, up from the first half of last year, and ahead of our expectations. As we mentioned last quarter, our Q2 cash flow was impacted by strong collections in Q1. In Q2 we delivered cash flow from operations of $28 million, versus $45 million in the year ago period. We also generated free cash flow of $18 million, versus $30 million in the year ago period. Capital lease payments, which we include in our free cash flow calculation, were $8 million, down from $13 million in Q2 of last year.

For the full year of FY23, we continue to expect CapEx and capital lease payments combined to be roughly 5 percent of revenue, and roughly 5 percent of revenue for Q3, as compared to 6 percent in the prior year.

Let’s now turn to our Capital Allocation Strategy. We ended the quarter with $394 million in cash, cash equivalents, restricted cash, and short-term investments. Our strong balance sheet and increasing free cash flow generation enables us to maintain a disciplined M&A strategy to accelerate our product roadmap, while also allocating the majority of our free cash flow generation to enhance shareholder returns via our stock repurchase programs. In Q2 we repurchased 4.6 million shares for approximately $118 million dollars. As of the end of Q2, we had approximately $29 million of remaining buyback capacity under our current plan.

Our disciplined equity issuance approach, combined with our robust share repurchase program, has allowed us to reduce total shares outstanding for 3 consecutive quarters. As a result, over the past 3 quarters we’ve reduced our basic and diluted total shares outstanding by roughly 8 million and 10 million shares, respectively. Note that this share count reduction excludes the shares we repurchased through last year’s tender offer.

With that, I would like to turn to our guidance for Q3 and fiscal 2023.

As you know, since our prior earnings announcement on May 25, 2022, the U.S. dollar has strengthened even further versus the currencies in which we transact our international business, resulting in a larger than expected FX headwind to both Q3 and the full year of FY23. As a reminder, approximately one third of our revenue is generated outside of the US. The following guidance reflects the strength and momentum of our underlying business, and also ***includes*** the impact of any expected FX headwinds, assuming present foreign currency exchange rates.

For the third quarter of fiscal 2023:

We anticipate revenue of $250 to $252 million, representing 13 percent year-over-year growth at the high end of this range. This includes an expected FX impact of approximately 4% to our Q3 revenue growth rate.

We expect our non-GAAP operating margin to be approximately 23 percent, representing a 230 basis point improvement year over year.

We expect our non-GAAP EPS to be in the range of 29 to 30 cents, and GAAP EPS to be in the range of 1 cent to 2 cents, on approximately 151 million diluted shares and 143 million basic shares, respectively.

For the full fiscal year ending January 31st, 2023:

We are maintaining our FY23 revenue estimate in the range of $992 million to $996 million, up 14% year over year at the high end of this range. Including the impact from FX headwinds we anticipated when we gave our initial FY23 guidance, we now estimate the full currency headwind to FY23 revenue growth to be approximately 4 percentage points.

We are prudently focusing our investments on compelling long-term growth opportunities, and our disciplined cost savings initiatives are generating efficiencies across the business.

We expect our FY23 non-GAAP operating margin to be approximately 22.5 percent, representing a 270 basis point improvement from last year’s result of 19.8%.

We are raising our FY23 non-GAAP EPS expectations to be in the range of $1.13 to $1.16, on approximately 152 million diluted shares, and up from 85 cents in the prior year. Our GAAP EPS is expected to be in the range of negative 3 cents to zero cents, on approximately 145 million shares. Our FY23 GAAP and non-GAAP EPS guidance includes an expected impact from FX of approximately 19 cents.

For the full year of FY23, we anticipate currency headwinds to impact our billings growth rate by approximately 6 percentage points, or 2 percentage points more than the impact to our revenue growth rate. As such, our FY23 billings growth rate on an as reported basis is expected to lag slightly behind our FY23 revenue growth rate, although we expect these growth rates to be roughly inline in constant currency. We expect our reported billings growth rate to be in the high single digit range for Q3, and to be in the mid to high teens range for Q4. We continue to expect our FY23 RPO growth to exceed our anticipated full year revenue and billings growth rates.

As Aaron mentioned, we are proud of our Boxers and the continued strong execution of our growth strategy while remaining focused on improving profitability year-over-year. The business momentum we are seeing is a direct result of our Content Cloud platform resonating with customers, as they look to reduce the cost and complexity in their tech stacks, while keeping their content secure. We are well on our way to delivering against our FY23 revenue growth plus free cash flow margin target of 37%, a 400 basis point improvement from last year's outcome of 33%.

Before we conclude, I'll hand it back to Aaron for a few closing remarks.

Closing Remarks

Thanks Dylan.

Before we open it up to questions, we wanted to share that on October 6th and 7th, we will be hosting tens of thousands of attendees virtually at BoxWorks. This event will be available to the investment community to attend. This year will be another incredible event where we'll share more on our vision for the Content Cloud and will showcase major product advancements and partnership announcements. Attendees will also be hearing from an outstanding slate of speakers, including the CEOs of IBM, Zoom, HubSpot, PagerDuty, and CrowdStrike, as well as IT leaders from enterprises like NHL, Shriners Hospitals, USAA, and World Fuel Services, among many others.

We are also hosting an Investor Product Briefing on October 6th at 1pm PT. We hope you can join us.

Dylan and I would be happy to take your questions. Operator?...