Box Inc.

First Quarter Fiscal 2024

Conference Call Remarks

May 30, 2023

Introduction

Good afternoon and welcome to Box's First Quarter FY24 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 second quarter and full year fiscal 2024 financial guidance, and our expectations regarding our financial performance for fiscal 2024 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 revenue, operating margins 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 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 Annual Report on Form 10-K 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, May 30, 2023, 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 supplemental slides 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.

First Quarter Fiscal 2024 Overview

Thank you Cynthia, and thanks everyone for joining us today.

We are pleased to deliver first quarter operating results above our guidance. This includes revenue growth of 6% year-over-year, and 10% on a constant currency basis, in addition to a strong focus on profitability resulting in operating margins of 23%, up 220 basis points from a year ago. Achieving these results in a challenging macro environment is a testament to the value of our Content Cloud platform, and the operational discipline of our Boxers as we deliver substantial year-over-year bottom line improvements.

While the dynamic macro economy continues to pressure IT spend and headcount growth expectations from our customers – trends we've seen continue to play out most notably in EMEA and smaller businesses in the US – we are also seeing strong traction and stickiness of our platform in customers, and our message is well-aligned to the challenges they are facing today.

Over the last quarter I've had the opportunity to speak with hundreds of business and technology leaders, and it's clear that the dynamics enterprises face today are fully aligned with the pillars that underpin our strategy. Enterprises are focused on simplifying their IT environments, driving productivity across their businesses, and protecting their most sensitive data. And across nearly all my conversations in the last quarter, business leaders everywhere are looking to leverage the power of AI to help transform how they work, and get even more value out of their data. Box's Content Cloud platform is best positioned to help these customers solve these challenges, and our Q1 customer wins illustrate how we will remain mission critical for them. These wins include:

- A global manufacturing company that collaborates with defense and federal government agencies, who is a new customer who purchased Box in Q1 in order to meet Fedramp and ITAR compliance for content management, also realizing the value to streamline its tech stack and integrate Box with its Salesforce instance to power the underlying compliant content layer for their customer portal.

- A multinational retailer, expanded its use of Box with a six-figure ramped enterprise license agreement and purchase of Box Shield to protect the vast amount of personal identifiable information that is stored in Box.

Critical to our success is our continued execution of our product roadmap, which expands our TAM and adds value to our core platform with new product innovation. In Q1 we were pleased to announce the general availability of Box Canvas, which delivers a powerful new way for teams to unleash their creativity to take brainstorming and ideation to a new level, while leveraging the enterprise-grade security, compliance, and workflow automation capabilities of Box. Box customers now have access to unlimited Canvases included in their plans, which enables us to disruptively enter this market, and we're already seeing amazing use-cases emerge across our customers.

Since we launched Box Sign, Box customers are taking advantage of unlimited e-signatures included in their plans and have migrated use cases over from costly incumbents. In Q1 we released advanced e-signature features such as a dedicated Box Sign policy for Box Shield to provide users with the ability to seamlessly request signatures on documents subject to Box Shield's access policies. We launched a Box Sign-Relay integration that specifically enables post-signature actions to be orchestrated and enables our customers to build end-to-end e-signature workflows in the Content Cloud.

We also announced the next generation of Box's content migration solution, Box Shuttle, now built directly into the Box Admin Console. With Box Shuttle, content migration is a simple, accessible process, and organizations of all sizes can take full advantage of the many features and capabilities that the Content Cloud has to offer.

Finally, an integral part of our product strategy is our ability to integrate deeply across the SaaS landscape, including products like Microsoft Teams and Office, Webex, Zoom, Google Workspace, ServiceNow, IBM’s technology solutions, and much more. In Q1, in addition to delivering integration enhancements with Slack and Salesforce, we were pleased to announce a number of new technology partners that extend the value of Box, including Notion, Asana, Malwarebytes, and CloudFlare.

As we look forward into FY24 and beyond, our pace of innovation continues to accelerate. We are at the beginning stages of a new era of software. Similar to how cloud and mobile changed the technology landscape forever, AI has the opportunity to completely change how work gets done. As highlighted by the meteoric rise of ChatGPT, we've recently begun to see a huge breakthrough in the potential of Large Language Models (LLMs), which are now capable of bringing human-level reasoning to a large number of tasks. *However*, the real power of these new AI models is when you use their "intelligence" to help you work securely with your own proprietary data set.

For years we've been able to ask questions about our *structured* data, like the information that's in a database, ERP system, or CRM system. You can ask those systems for financial forecasts, sales pipeline results, inventory levels, supply chain details, and more. But we’ve had limited ability to ask questions of your unstructured data, like content, which is ~80% of corporate data*!* And now we can. By safely bringing leading AI models to enterprise data, enterprises can truly unlock the value that lies in their content.

To do this, we need a way to connect these models safely, securely, and compliantly to our enterprise content. As we announced just earlier this month, with Box AI we're taking the power of the world's leading AI models (starting initially with OpenAI's ChatGPT3.5 and GPT4) and securely letting customers leverage them for their enterprise content. With Box AI, customers can ask questions of their content or generate new information leveraging Box Notes. Imagine being able to instantly ask things like "how many days of parental leave can I take?" on an HR document, "please summarize this report and provide 5 key takeaways" on a quarterly earnings document, or "how would you pitch this product to a customer in the automotive industry" when looking at a product overview document.

But this is just the beginning. Ultimately, as a core platform capability, Box AI will be used throughout the product to continue to transform how we work with our content in a variety of ways. We can imagine in the future being able to use AI to automatically classify content in even more specific ways, automatically extract data using a Relay workflow, use platform APIs to interact with AI models from a variety of providers, and being able to ask a question of a larger set of documents on a specific topic.

And as a platform-neutral vendor, we will also be AI-neutral – which means as new AI breakthroughs emerge from more vendors over time, we'll be in a position to bring the full power of their technology to Box and our customers. In addition to our collaboration with OpenAI, we recently announced that we are building on our strategic partnership with Google Cloud to integrate Google's advanced AI models into Box AI to create new ways for joint customers to work smarter and more productively with generative AI. Like any new technology area, our approach with Box AI is to execute on this opportunity with a high degree of thoughtfulness. Initial customer access will be granted through a Design Partner Program and we are excited to keep you updated as we continue to innovate with Box AI to capitalize on the exciting new product opportunities this technology shift has created.

Now, turning to go-to-market, as we discussed at our Analyst Day in March, our optimized pricing and packaging initiatives have allowed us to see greater total account value, higher net retention, higher gross margins, and a more efficient sales process. Our strategy is to continue launching new multi-product offerings over time, increasing the value to our customers by bringing them the full power of the Content Cloud. Our latest multi-product offering, Enterprise Plus, continues to be well over 90% of our Suites sales in large deals, with Suites comprising 69% of deals over $100,000 in Q1. We saw consistent Suites attach rates in large deals across all of our geographies.

Our Q1 customer expansions and new wins with Enterprise Plus include:

- A US company that develops and produces building materials and services expanded its use of Box with a six-figure renewal and purchase of Enterprise Plus to gain the benefits of Shield and Box Governance. As more and more data is migrated into Box from old SharePoint sites and file servers, it was necessary for the company to implement the advanced security and compliance controls that Enterprise Plus provides.

- A leading U.S hospital system and research institute, expanded its use of Box in Q1 with an upgrade to Enterprise plus in order to enable Box Sign for their clinical trials. Box's security posture is also a critical component to their technology ecosystem.

In summary, our ability to deliver first quarter results above our guidance is a direct result of the compelling value of our Content Cloud platform and the execution we have been driving as a company. And with our latest Box AI efforts, we're building a powerful, platform-neutral approach for companies to securely bring AI to their content and transform how they work. I'm proud of the work that our Boxers do globally, and at Box, our employees are critical to our ability to serve our customers successfully and innovate rapidly. In addition to being named the #2 "Best Place to Work" by GlassDoor last quarter, Box was recently recognized by Fortune magazine as #27 in the 100 Best Companies to work for in 2023.

Finally, along with continuing to build out a strong culture, we remain steadfastly committed to driving a continued balance of growth and increased profitability in this very dynamic market, while investing in growth drivers for the future, like with Box AI. While currency headwinds and the IT spend environment are putting pressure on our topline results for this year, we continue to drive improved bottom line results through a culture of operational excellence and focused discipline on our spending while, doubling down on new product development that will lead us to increasing long term revenue growth.

And with that, let me hand it off to Dylan.

Q1 and Fiscal 2024 Financial Results; Q2 and Fiscal 2024 Guidance

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

Q1 was another strong quarter for Box, with revenue, EPS and operating margin results all above the high end of guidance, despite the challenging macroeconomic environment. We continued investing in profitable growth while optimizing our underlying cost structure, resulting in a resilient long-term financial model. Our balanced business model allows us to invest in innovative new products such as Box Canvas and Box AI, generate continued gross margin and operating leverage, and consistently return capital to our shareholders.

In Q1 we delivered revenue of $252 million, up 6% year-over-year, above the high end of our guidance, and representing 10% year-over-year growth on a constant currency basis.

We now have nearly 1,680 total customers paying more than 100 thousand dollars annually, an increase of 14% year-over-year. Our Suites attach rate of 69% in large Q1 deals demonstrates the value our Content Cloud Platform is delivering to our large customers. 47% of our revenue is now attributable to Suites customers, a significant 10 point increase from 37% a year ago. Even in this dynamic environment, Box's value proposition is resonating with customers as they look to Box to transform, simplify and secure their IT environments.

We ended Q1 with remaining performance obligations, or RPO, of $1.2 billion, a 17% year-over-year increase, or 19% growth on a constant currency basis. This strong growth was driven by continued lengthening in customer contract durations, as well as an uptick in the volume of early renewals in recent quarters, as customers look to more quickly adopt the full value of our Suites offerings. We expect to recognize roughly 60% of our RPO over the next 12 months.

Q1 billings of $192 million grew 11% year-over-year, ahead of our guidance of a mid-single digit growth rate, and representing 15% growth in constant currency. Our strong billings outcome in Q1 was due in large part to a high volume of early renewals, pulling forward billings of roughly $6 million that had been scheduled to renew later in the year.

Our net retention rate at the end of Q1 was 106%, in-line with our expectations. Our annualized full churn rate was 3%, versus 4% in the prior year, demonstrating the criticality and stickiness of our product offerings even in the current environment. We expect full churn to remain at roughly 3% throughout this year. For the remainder of FY24 we expect our net retention rate to stabilize in the range of 104 – 105%, as we manage through the macroeconomic environment resulting in lower seat expansion rates, particularly in our US Commercial and EMEA customers.

Gross margin came in at 77.9% in Q1, up 160 basis points from 76.3% a year ago and well above the 76% range we had expected for the first half of this year. Our Q1 gross margin reflects the optimizations we're delivering as we execute on our public cloud migration strategy. We expect our duplicative public cloud and data center expenses to peak in Q2, leading to our gross margin expectations in the 76% range for Q2. As we look to the second half of the year, we fully expect gross margins to rebound to the high 70's.

Q1 gross profit of $196 million was up 8% year-over-year, exceeding our revenue growth rate by 200 basis points.

We once again delivered leverage across the entire business in Q1 with a 17% increase in operating income, to $57M. Our 22.8% operating margin was up 220 basis points from the 20.6% we delivered a year ago.

We delivered diluted non-GAAP EPS of 32c in Q1, up 39% from 23c a year ago and a full 5 cents above the high end of our guidance, which includes an impact of negative 5 cents from FX. I would also note that Q1 marked the third consecutive quarter in which we delivered GAAP profitability.

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

In Q1 we generated free cash flow of $108 million, a 19% increase from $91 million in the year ago period. We delivered cash flow from operations of $125 million, a 16% increase from $108 million in the year ago period. Capital lease payments, which we include in our free cash flow calculation, were $10 million, down from $12 million in Q1 of last year.

Let's now turn to our Capital Allocation Strategy. We ended the quarter with $518 million in cash, cash equivalents, restricted cash, and short-term investments. In Q1 we repurchased 1.7 million shares for approximately $44 million dollars. As of April 30, 2023, we had approximately $97 million of remaining buyback capacity under our current share repurchase plan. We remain very committed to returning capital to our shareholders through stock repurchases, and we expect to actively repurchase additional shares in Q2.

With that, I would like to turn to our guidance for Q2 and fiscal 2024.

The U.S. dollar has continued to strengthen resulting in a larger than expected FX headwind for Q2 and the second half of the year versus our initial FY24 guidance. As a reminder, approximately one third of our revenue is generated outside of the US, primarily in Japanese Yen. The following guidance ***includes*** the expected impact of FX headwinds, assuming current exchange rates.

For the second quarter of fiscal 2024:

We anticipate revenue in the range of $260 to $262 million, representing 7 percent year-over-year growth at the high end of this range, or 11% in constant currency.

We expect our Q2 billings growth rate to be in the low single digit range on an as reported basis, reflecting an expected 100 basis point headwind from FX, as well as the impact of the early renewals that contributed to our exceptionally strong Q1 billings result. We once again expect our Q2 RPO growth to be higher than our anticipated Q2 revenue growth rate.

We expect our non-GAAP operating margin to increase to approximately 24 percent, representing a 230 basis point improvement year over year.

We expect our non-GAAP EPS to be in the range of 34 to 35 cents, representing a 25% year-over-year increase at the high-end of the range, and GAAP EPS to be in the range of 1 to 2 cents. Weighted-average diluted shares are expected to be approximately 150 million, flat with Q1. Our Q2 GAAP and non-GAAP EPS guidance includes an expected headwind from FX of approximately 5 cents, primarily due to fluctuations in the yen as discussed previously.

For the full fiscal year ending January 31st, 2024:

We now expect FY24 revenue in the range of $1,045 million to $1,055 million, representing 6% year over year growth, or 10% on a constant currency basis. This revised range reflects both the recent strengthening of the US dollar versus the yen and the IT spending environment we discussed earlier. We now expect FX to have a negative 350 basis point impact to our FY24 revenue growth rate versus our prior expectation of 300 basis points.

We expect FY24 gross margin to be roughly 77.5%, 50 basis points above our previous expectations. As we continue to execute on our important transition to the public cloud and unlock additional leverage in our model, we will be exiting FY24 with an even stronger gross margin profile.

As a result, we are raising our FY24 non-GAAP operating margin guidance by 50 basis points to approximately 25.5% percent, representing a 240 basis point improvement from last year's result of 23.1%.

We are also raising our FY24 non-GAAP EPS expectations to be in the range of $1.44 to $1.50, representing a 25% increase at the high end of the range versus $1.20 in the prior year, and we expect FY24 GAAP EPS to be in the range of 17 cents to 23 cents. Weighted-average diluted shares are expected to be approximately 151 million. Our FY24 GAAP and non-GAAP EPS guidance includes an expected annual impact from FX of approximately 20 cents.

For the full year of FY24, we now anticipate currency headwinds to impact our billings growth rate by a little more than 100 basis points. We expect our FY24 billings growth rate to be in the mid-single digit range on an as reported basis.In summary, we are pleased with our execution in Q1. We once again demonstrated our disciplined and balanced model of investing for long-term growth while expanding both operating and free cash flow margins. We remain committed to achieving our FY24 revenue growth plus free cash flow margin target of 35%, or 39% in constant currency. In this dynamic macroeconomic environment, the Box Content Cloud is the platform that enterprises need to transform their business while lowering their costs.

With that, Aaron and I will be happy to take your questions. Operator?