Box Inc.
Third Quarter Fiscal 2022
Conference Call Remarks
November 30, 2021

Introduction

Good afternoon and welcome to Box's Third Quarter Fiscal Year 2022 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 Q4 and FY'22 financial guidance, and our expectations regarding our financial performance for fiscal 2022 and future periods, including our free cash flow, gross margins, operating margins, operating leverage, future profitability, net retention rates, unrecognized revenue, remaining performance obligations, and billings; and

- Our expectations regarding
    - the size of our market opportunity;
    - our planned investments 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;
    - the impact of our acquisitions on future Box product offerings;

- the impact of the COVID-19 pandemic on our business and operating results; and
- any 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, November 30, 2021, 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>Third Quarter Fiscal 2022 Overview</u>

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

We achieved strong third quarter results, marking yet another quarter of delivering both revenue and non-GAAP EPS above our guidance. We produced third quarter revenue growth of 14% year-over-year -- a *third* consecutive quarter of accelerating revenue growth -- operating margin of 21%, and RPO growth of 25% which is well in excess of revenue growth and an important leading indicator of the strength of our business.

Our results show the success of our growth strategy which is aligned with the three major trends that are driving the future of work. These trends are hybrid workstyles, the pressures of digital transformation on businesses, and the ongoing importance of data security, compliance and privacy. The old way of managing content just doesn't work anymore and that's where the Content Cloud from Box comes in. With Box, users are more productive, enterprises are more secure, and IT management is simplified and less expensive.

Our strong customer metrics are key indicators of the success of our product and platform strategy, as 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 third quarter:

- Our Net Retention Rate was 109%, up from 103% in the prior year and up from 106% in the second quarter.
- We had 97 deals over $100K, up 56% year-over-year, including a record number of our multi-product suite sales, which now includes our Enterprise plus plan, with 61 Suites deals in Q3 over $100K, up 177% year-over-year.
- We had a 63% attach rate of Suites on deals over $100K in the quarter, up from 35% in Q3 fiscal 21. In North America and EMEA, Suites attach rates were in the mid-70s in Q3. While our Suites attach rate declined sequentially in Japan, we are continuing to educate our channel partners around our multi-product plans in order to improve attach rates in this region. We expect our overall attach rate number to improve in Q4.

We continue to leverage our leadership position in core content management and collaboration to expand the full content lifecycle by focusing on our three key product pillars which are enabled by our highly scalable enterprise grade infrastructure. These three pillars are focused on:

1. Delivering the best security and compliance around content
2. Enabling seamless collaboration and workflow; and
3. Integrating into every app our customers leverage, including the ones they build themselves.

We embarked on our expanded vision of the Content Cloud over two years ago and have advanced major parts of the entire content lifecycle. The launch of Box Shield and Box Relay broadened our reach into the data security and workflow automation markets. This year we expanded our content ingestion and migration services with Box Shuttle and integrated more deeply with Microsoft, Salesforce, Slack and Zoom, as well as other leading platforms.

Building on success of these offerings, we launched Box Sign to bring native eSignatures to Box. eSignature is one of the fastest growing markets Box has ever entered and we are seeing great momentum with customers. Our initial US-based roll-out in October was followed quickly by the global launch of Box Sign, which also included new security and admin features. These new features include password-protection for documents sent for signature, SMS-based 2-factor authentication to verify the identity of the signer, localized Box Sign user interface to enable senders and signers to transact in over 20 languages, and robust admin reporting to provide enterprise-wide visibility and tracking of documents sent for signature.

Just weeks after launching our offering, we were pleased to be named a Major Player in the IDC MarketScape Worldwide eSignature Software 2021 Vendor Assessment which we view as validation of our Box Sign solution. In the report, Box was recognized "As one of the first multi-tenant SaaS vendors to offer a cloud content management solution" delivering "continuous innovation and continuous deployment of content life-cycle capabilities in addition to its feature-rich collaboration and file sharing."

Since our GA roll-out in October we have seen early success in customer adoption and use of Box Sign. Third quarter customers include:

- A premier commercial real estate finance company that expanded its use of Box with a six figure ELA and purchase of Enterprise Plus, with additional Box API and Box Sign services. With Box, the organization has centralized all their content and built a custom deal management portal that deeply integrates with Salesforce and Mulesoft. Box Sign will be replacing their incumbent signature solution, allowing them to digitize more paper-based use cases and expand e-signature use to the broader organization.

- A leading IT services vendor to the US Government rolled out the Box for Salesforce integration to power their onboarding use case. They previously used an incumbent signature vendor, but to help reduce spend and streamline the onboarding process for their contractors and partners, they have now enabled Box Sign enterprise wide.

- And, earlier this month, we announced that the General Services Administration has selected Box Sign technology for its native e-signature capability. Contracts and business agreements are critical in the work that GSA oversees, so deploying e-signature technology was necessary to digitize their paper-based manual workflows for enhanced productivity and security.

And we are just getting started with our eSignature product roadmap. We plan to continue rolling out advanced e-sign capabilities over the next several quarters to our customers.

As we have been discussing over the last several quarters, security remains a critical driver of our biggest deals. Customers are increasingly focused on Box's security capabilities. To that end, in October, we announced new malware deep scan capability in Box Shield to combat ransomware, as well as enhanced alerts and auto-classification updates. Box Shield will be able to help customers reduce the risk of ransomware by scanning files in near real-time as they are uploaded to Box. Our natively embedded malware detection in the Box Content Cloud delivers a seamless end user experience and near real-time alerts for IT security teams, while helping them avoid multi-solution, multi-vendor complexity.

Finally, an integral part of our product strategy is our ability to integrate deeply across the SaaS landscape, and we are pleased that our interoperability has enabled us to build strong partnerships with leading technology companies. At BoxWorks in early October, Kirk Koenigsbauer, CVP and COO of Experiences and Devices Group at Microsoft, spoke about the importance of openness and interoperability and Box's ongoing collaboration with Microsoft, which included strengthened integrations with Microsoft Teams, Office, and more.

Further, in the third quarter, we enhanced integrations with Slack that will enable Box to be a content layer within the Slack environment, launched our integration between Box Sign and Salesforce, and announced our Box app for Zoom to make it even easier for our users to work together securely and effectively, across distributed teams. We believe that our neutral platform will remain a critical reason customers select Box, especially as they want to work across Microsoft, Salesforce, Google and other platforms.

We are incredibly focused on bringing innovation and in-demand features to our platform rapidly, and we will continue to double down on the product capabilities and investments that we know are working. Going into next year, we see significant opportunity to expand our Content Cloud platform into differentiated and important areas that continue this strategy: like further ransomware protection features, new ways to publish content to teams and departments, content analytics, improved native collaboration features, enhanced workflow automation, further integrations with products like Salesforce, platforms like Microsoft, Google, IBM, and many others, further platform enhancements, and much more.

Switching to go-to-market, the strength in our third quarter results is also the result of a number of initiatives that we have implemented over the past several quarters. Our land

and expand go-to-market model delivers optimized pricing and packaging offerings as we continue to double down on key verticals such as Life Sciences, Financial Services, the Federal Government, and other sectors.

Since rolling out our new simplified Suites offering called Enterprise Plus, we have seen even more new and existing customers recognize the full value of the Box platform. As we have discussed on previous calls, we know that when a customer adopts our multi-product offerings, we see greater total account value, higher net retention, higher gross margin, and a more efficient sales process.

You can see the success of our GTM efforts clearly reflected in our Q3 customer expansions. For instance:

- A large bank in the United States did a six figure expansion with the purchase of Enterprise Plus to replace their core security system and take advantage of Box's security posture, integrations and user experience. With Box, the organization can now securely collaborate on critical content with customers, vendors, and partners.
- An agency of the U.S. government expanded its use of Box with a six figure ELA and the purchase of Enterprise Plus. They selected Box to reduce threat exposure through greater network controls and to deploy Box Relay to streamline approval processes for new official policy and governance documents.
- And finally, a multinational pharmaceutical and biotech company purchased a 3 year ELA with Box and expanded its use of Box Governance to power secure collaboration company-wide and with external parties as they continue ground-breaking research of Covid-19.

Our strategy is to continue to optimize our land and expand model to bring the full power of the Content Cloud to our customers, driving wider seat adoption, higher price per seat, and greater stickiness and retention by making our customers wildly successful with Box.

Internally at Box we kicked off Fiscal 22 as our "year of growth". It is a testament to our employees' hard work and dedication that Q3 was yet another strong quarter, with continued sequential revenue growth re-acceleration and operating margin improvements. As a result, we have raised our revenue and operating margin guidance for the full fiscal year 2022.

The confluence of remote work, digital transformation and cybersecurity challenges is causing enterprises to rethink how they work with their content and we believe Box is uniquely positioned to gain from this shift.

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

Q3 Financial Results and Q4 and FY22 Guidance

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

Q3 was a particularly strong quarter for Box across all metrics – marked by accelerating revenue growth, improvements in our net retention rate, and record gross and operating profit.

Revenue of $224 million was up 14% year-over-year, a third consecutive quarter of accelerating growth, and above the high end of our guidance.

Customer demand for our expanded content cloud offerings and strong sales execution are driving results, with $100K+ deals up 56% year-over-year, and $100K+ Suites deals growing 177% from the prior year. As our customers are increasingly adopting products with more advanced capabilities, roughly 30% of our revenue is now attributable to customers who have purchased Suites, a significant increase from the high teens a year ago.

We ended Q3 with remaining performance obligations, or RPO, of $948 million, a 25% year-over-year increase, and exceeding our revenue growth by a full 11 percentage points. Q3's RPO growth demonstrates the increasing value we're delivering to customers, leading to longer term agreements to support our customers' content strategies. We expect to recognize more than 60% of our RPO over the next 12 months.

Q3 billings of $231 million grew 25% year-over-year, and well ahead of our expectations to deliver a Q3 billings growth rate roughly in line with revenue growth. This outcome reflects the continued strong sales execution that we've been seeing in our Enterprise and SMB markets.

Our net retention rate at the end of Q3 was 109%, up from 106% in Q2 and up significantly from 103% in the year ago period. Strong suites momentum is accelerating customer traction and adoption, driving an improvement in our customer expansion rate and a strong and stable annualized full churn rate of 5%. We are proud of the increase in net retention that we've achieved this year, and we expect to deliver continued improvements in this metric on an annual basis.

Turning to margins – gross margin came in at 74.7%, up 130 basis points from 73.4% a year ago. Q3 gross profit of $167 million was up 16% year-over-year, exceeding our revenue growth rate by 200 basis points. Our strategy to optimize our data center footprint and public cloud infrastructure continues to deliver hardware and software efficiencies, and we're well positioned to deliver additional gross margin expansion over time.

We continue to improve our profitability and we are steadfastly committed to unlocking further leverage in our operating model. We are increasingly focusing our hiring in lower cost locations to expand our talent pools and generate additional leverage. Most notably, we're steadily scaling our engineering center of excellence in Poland, where we're now approaching 100 full-time employees.

Q3 operating income increased 32% year-over-year to $46M, or 20.7% operating margin, a 270 basis point improvement from 18.0% a year ago.

We delivered 22c of diluted non-GAAP EPS in Q3, above the high end of our guidance, and up from 20c a year ago. Our Q3 GAAP EPS result included a one-time seven cent impact from costs related to shareholder activism fees in the quarter.

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

In Q3 we delivered cash flow from operations of $46 million, up 2 percent from the year ago period and up 33% year-to-date. We also generated free cash flow of $31 million, a year-over-year improvement of 19 percent and a significant increase of 73% year-to-date. Capital lease payments, which we include in our free cash flow calculation, were $12 million, down from $15 million in Q3 of last year.

For the full year of FY22, we continue to expect CapEx and capital lease payments combined to be roughly 7 percent of revenue, as compared to 9 percent of revenue last year.

Let's now turn to our Capital Allocation Strategy. We ended the quarter with $709 million in cash, cash equivalents, restricted cash, and short-term investments. Over the last couple of years, we have been able to significantly improve our profitability and cash flow generation, while continuing to make prudent investments to extend our leadership position and reaccelerate growth.

We remain committed to opportunistically returning capital to our shareholders. As such, our Board of Directors recently authorized a new $200 million common stock repurchase program. Combined with our previously announced $500 million buyback authorizations, we now intend to opportunistically return $700 million to our investors in the form of stock buybacks. Including shares purchased to date we have approximately $260 million of remaining buyback capacity.

In addition to our robust stock repurchase program, we intend to leverage our strong balance sheet and consistent cash flow generation to invest in key growth initiatives and to fund strategic M&A opportunities that will enhance and accelerate our product roadmap. Our SignRequest acquisition earlier this year highlights our disciplined approach to M&A, as it accelerated our product innovation and enabled us to more rapidly deliver highly demanded features to our customers.

With that, I would like to turn to our guidance for Q4 and fiscal 2022.

For the fourth quarter of fiscal 2022:

We anticipate revenue of $227 to $229 million, representing 15 percent year-over-year growth at the high end of this range, and a fourth consecutive quarter of revenue growth acceleration.

We expect our non-GAAP operating margin to be approximately 21 percent, representing a 270 basis point improvement year over year.

We expect our non-GAAP EPS to be in the range of 22 to 23 cents, and GAAP EPS to be in the range of negative 6 to negative 5 cents, on approximately 158 million and 150 million shares, respectively.

We expect our Q4 billings growth rate to be in the high single digit range. Q4 billings will be negatively impacted both by currency exchange rates, as well one of our largest customers moving from annual billings to semi-annual billings upon their Q4 invoicing. Combined we expect these factors to result in a cumulative one-time downward impact of roughly 4 percentage points of billings growth. We continue to expect to deliver FY22 billings growth at a rate above our revenue growth rate, with roughly 15% year-over-year billing growth in FY22, a full 6 percentage point improvement from the prior year.

For the full fiscal year ending January 31st, 2022:

As a result of our strong Q3 results, we are raising our revenue, operating margin, and EPS guidance for the full fiscal year.

We expect FY22 revenue to be in the range of $868 million to $870 million, up 13% year over year at the high end of this range. This is an increase from last quarter's full year guidance of $856 to $860 million, and represents a 200 basis point acceleration from last year's revenue growth.

We expect our non-GAAP operating margin to be approximately 20 percent, representing a 460 basis point improvement from last year's result of 15.4%, and an improvement over our previous guidance of 19.5 percent.

We now expect our FY22 non-GAAP EPS to be in the range of 83 to 84 cents, on approximately 164 million diluted shares and up from 70 cents in the prior year. Our GAAP EPS is expected to be in the range of negative 35 to 34 cents, on approximately 156 million shares.

Finally, we continue to expect our FY22 revenue growth rate, combined with our FY22 free cash flow margin, to be at least 32%, a significant 600 basis point improvement from last year's outcome of 26%.

Our strong Q3 performance clearly demonstrates that our content cloud platform is resonating with customers as we execute on our strategy to drive long-term profitable growth. This year we're on track to deliver 4 consecutive quarters of revenue acceleration while generating operating leverage across the business. We are well on our way to deliver against our target of generating revenue growth plus free cash flow margin of 40% in FY24, 2 years from now.

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

Closing Comments

Thanks Dylan.

And thank you again everyone for joining us today. Please "Save the Date" on Wednesday March 16th for our Investor Day 2022. We will be providing more details on this event in the coming weeks but we look forward to seeing you there.

Overall, Q3 marked another significant step forward in the evolution of our Content Cloud Strategy. As enterprises are now making increasingly strategic, long-term decisions on how to support a remote workforce and digital processes, they need to maintain a high-level of security and compliance. Our continued product innovation and our go-to-market initiatives are positioning Box as a leader in the Content Cloud market.