Box Inc.
Second Quarter Fiscal 2025
Conference Call Remarks
August 27, 2024

Introduction

Good afternoon and welcome to Box's Second Quarter Fiscal 2025 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 website at www.boxinvestorrelations.com. 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 the X platform at the handle @BoxIncIR.

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

- Our third quarter and full year fiscal 2025 financial guidance, and our expectations regarding our financial performance for fiscal 2025 and future periods, including our 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 deferred tax expenses; 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;
    - the proceeds from the sale of our data center equipment;
    - 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 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 27, 2024, 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 turn the call over to Aaron.

Second Quarter Fiscal 2025 Overview

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

We delivered a strong second quarter with operating results at the high-end or above our guidance. This includes revenue growth of 3% year-over-year, or 6% in constant currency, and record gross margin of 81.6%. Our focus on operational discipline drove operating margin of 28.4%, up 360 basis points from a year ago, while our continued investments in growth are reflected in our Q2 accelerated billings growth of 10% year-over-year and RPO growth of 12% year-over-year.

Our results show the continued success of building out the most powerful AI-enabled platform for secure content management, collaboration, workflow automation, and intelligence. In Q2 we saw customer demand for Box AI continue to grow, driving both upgrades and new logo wins in Enterprise Plus, in order to gain access to Box AI.

Customer examples in Q2 include:

- A large U.S. based law firm and a new Box customer that purchased Enterprise Plus in a six-figure deal. They plan to leverage Box Hubs and Box AI to create easily searchable repositories for their attorneys and other staff. They will also leverage Box Sign, replacing an existing e-signature vendor, to help Box serve as their attorney-client collaboration layer.
- A leading consumer convenience store in Japan upgraded to Enterprise Plus and expanded its use of Box companywide to boost productivity by enabling all employees to use Box AI. They chose Box as their content platform to leverage AI and reinforce their security posture.

These wins illustrate what has become clear in my conversations with customers: that almost every enterprise is working to figure out how to use AI to enable more productivity from their employees by automating more work, improve their data security, and deliver improved experiences for their customers. And at the center of all of this is enterprise content.

You have heard me talk about how 90% of an enterprise's data is unstructured, with most of that unstructured data being enterprise content. Historically, enterprises have not been able to truly get the value from this enterprise content due to years of investment in disparate technologies, where content is scattered across many repositories in the enterprise among numerous applications, and not built for a modern way of working with AI.

At Box, we are fundamentally transforming how companies leverage their enterprise content with Intelligent Content Management. Instead of enterprises investing in fragmented, legacy ECM technologies, workflow products, e-signature tools, and security solutions, and attempting to bolt on AI on top of the systems, Box is delivering a singular platform that can power the end-to-end lifecycle of content with intelligence built right in. And building on our leadership in secure content management and collaboration, we are now extending our value into workflow automation and intelligence. With Box AI we can change the equation and enable enterprises to fully leverage their content to gain insights and dramatically increase productivity.

And critically, instead of legacy ECM systems that cost a fortune and can only be used in relatively rigid ways, Intelligent Content Management from Box extends well beyond the use cases of traditional ECM systems by offering modern user experiences, integrating with every app, having security and compliance at the core, building in enterprise-grade AI, and being entirely in the cloud. We are seeing more and more customers turn to Box to replace their legacy ECM solution and choose us as a more flexible, multi-tenant, lower cost and more powerful intelligent ECM solution.

With Box on a single platform, customers will be able to power everything from their secure collaboration externally with clients to internal use-cases including: how they manage their most important digital assets in marketing or sales, how they automate workflows with their contracts or financial documents, and ultimately how they govern and protect their sensitive records over the long run. Because we can now support vastly more use-cases across the enterprise than traditional ECM – and for customers of all sizes – this represents a dramatic expansion of our market opportunity, similar to when Salesforce disrupted CRM or ServiceNow disrupted ITSM.

In a strategic move to significantly expand Box's Intelligent Content Management platform, we recently announced the acquisition of the AI-powered, Intelligent Document Processing, or "IDP" technology and team from Alphamoon. Alphamoon's technology combines leading large language models from OpenAI and others with proprietary image and document processing technology to intelligently structure documents at scale. Once natively integrated into Box, Alphamoon's technology will further expand the capabilities of the Box AI platform to revolutionize IDP and address the longstanding challenges of metadata creation at scale and empower our customers with unprecedented new automation capabilities. Once metadata is applied to content within Box, customers can more easily automate workflows like contract management, digital asset management, invoice processing, client onboarding, and so much more. Combined with the technology from our Crooze acquisition earlier this year, Box will be able to transform critical content-centric business processes for enterprises of all sizes.

And, critical to our success in Intelligent Content Management, is our ability to enable Box customers to be on the leading edge of innovation with enterprise-grade Box AI.

In June we announced that Enterprise Plus customers now have unlimited end user queries for Box AI in Notes, Documents and Hubs, making it even easier for customers to roll out Box AI across their enterprise. Customers can now focus on leveraging AI to drive value without having to worry about usage caps. In Q2 we also unveiled a new set of features in Box AI which include access to GPT-4o for products such as Box Hubs, as well as support for new file types including images and spreadsheets in Box AI. We expect these features will be available later this year and will be included in Enterprise Plus plans.

Box AI for Metadata is also available in our API in beta for customers on the Enterprise Plus plans. Developers are able to integrate Box AI with custom applications using new Box AI for Metadata API functionality to automatically extract key information from documents at scale. When combined with Box's workflow automation tools, customers will be able to automate processes based on file metadata, extract key fields from unstructured content, and save information to external applications such as Salesforce.

We also continue to roll out advancements across security and compliance. Over the last several months we launched Zero Trust 2.0 enhancements for admins and GxP validation sandbox management, and we are on track to meet FedRAMP High compliance in the coming quarters to expand our use cases in the Federal government.

Finally, our flexible and interoperable platform is a major differentiator for Box. We are supporting deeper integrations with Salesforce, Microsoft Teams, Microsoft Copilot, IBM Technologies, ServiceNow and our customers' custom-built applications. Just last month we announced an expanded partnership with Slack that brings secure AI to enterprise content. Joint customers of Slack and Box can access unlimited Box AI queries directly in Slack, allowing users to ask critical questions and uncover timely insights from their Box files.

Now, turning to Go-to-Market, as I mentioned earlier, we continue to see strong adoption of Enterprise Plus, our multi-product Suites offering with unlimited access to Box AI. In Q2, Suites comprised 87% of our deals over $100,000, up from 78% a year ago, with Enterprise Plus comprising over 95% of those deals. We saw solid Suites attach rates in large deals across verticals and all geographies, including record attach rates in Japan.

With 57% of our Q2 revenue coming from Suites, compared to 48% a year ago, we still have a large opportunity to drive Enterprise Plus adoption. Our Q2 customer expansions and new wins with Enterprise Plus include:

- One of the largest marketing companies in the world upgraded to Enterprise Plus with a six-figure upsell as the organization looks to leverage Box AI metadata and Box Hubs to create client-centric hubs with workflow to reduce the time for teams to come up to speed on new engagements with clients, partners, vendors, and securely collaborate across their ecosystem.

- A UK based event, design and production company purchased Enterprise Plus with a 3-year enterprise license agreement with a key focus on replacing legacy ECM tools, like SharePoint, in order to enhance and streamline their collaboration efforts as they create engaging experiences for their clients.
- An organization that regulates and creates policies for the construction industry, purchased Box with a six-figure deal to replace an antiquated on-prem ECM system. With Box as their modern Intelligent Content Management solution, they expect to save costs associated with their on-prem solution, including hardware, storage, maintenance, upgrades, and support costs. The organization also has plans to integrate Box to their contractors permitting system, and utilize Box AI with their contracts team.

As we power more advanced workflows in partnership with key system integrators, in Q2 we saw a number of wins with large customers across critical focus industries with the help of these strong SI partners, including the replacement of many legacy ECM systems.

Looking forward, our go-to-market engine will continue to drive Enterprise Plus expansion, catalyzed by gaining access to Box AI. And we plan to expand our efforts with critical GTM partners, like system integrators, that can expand our penetration in key prospects and accounts and get Box embedded into more customer workflows and retire legacy ECM systems.

We are also incredibly excited to host BoxWorks, our flagship customer conference, this year on November 12th in San Francisco, which will also be live streamed to tens of thousands of customers globally. At BoxWorks this year we expect to unveil major new product enhancements, as well as highlight major partnerships across the AI landscape and systems integrator ecosystems. In conjunction with BoxWorks, we are hosting a virtual IR Product Briefing for investors to discuss these major updates.

Now, in the last few months we have been pleased to announce the appointment of some fantastic leaders with decades of enterprise software experience to our leadership team. This includes Samantha Wessels who has joined us as President of Box EMEA. Samantha has led successful teams at high-performing SaaS and software companies – like Elastic and Snyk – and large scale systems integrators in EMEA. Another new leader, Tricia Gellman, has joined as our Chief Marketing Officer. Tricia brings over two decades of experience in driving growth and innovation for leading technology companies, including high-growth startups and industry giants like Salesforce and Adobe. These leaders will help us to drive our evolution as the leading Intelligent Content Management platform, delivering AI-powered collaboration, workflow automation, security, and intelligence.

Finally, we are also pleased to welcome Steve Murphy to our Board of Directors. Steve is the CEO of Epicor Software and has had an extensive career in the software industry, a track record of operational excellence and expertise in the content management market.

Overall, we are incredibly pleased with our strong performance and execution in Q2. Our acceleration in RPO growth will continue to drive momentum in the second half of this year and beyond.

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

Q2 Fiscal 2025 Financial Results; Q3 and Fiscal 2025 Guidance

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

We are very pleased with our strong Q2, delivering accelerated billings growth, as well as record gross margin, operating margin, and EPS. These record results demonstrate both our proven business model, and early signs of success from the investments we're making in our Intelligent Content Management platform. Consistent with our key financial priorities, we're continuing to generate operating leverage and execute on our disciplined capital allocation strategy.

In Q2 we delivered revenue of $270 million, at the high end of our guidance, up 3% year-over-year, and 6% in constant currency.

We now have more than 1,800 total customers paying us at least 100 thousand dollars annually. Our Q2 Suites attach rate in large deals was 87%, a new high watermark, and up from 78% a year ago. Suites customers now account for 58% of our revenue, up significantly from 48% in Q2 of last year. We're seeing increasing demand for Box AI and our more advanced capabilities, which has been a key driver of our strong Suites momentum.

We ended Q2 with remaining performance obligations, or RPO, of $1.3 billion, a 12% year-over-year increase, or 14% in constant currency. This represents a strong acceleration from last quarter's constant currency RPO growth of 8%, driven by the combination of bookings outperformance and longer average contract durations. Consistent with prior quarters, we expect to recognize roughly 60% of our RPO over the next 12 months.

Q2 billings of $256 million were up 10% year-over-year, and up 9% year-over-year in constant currency, above our expectations for low to mid-single digit growth. Roughly half of this outperformance was driven by strong bookings, particularly in Japan and our public sector business. Q2 billings also benefitted from roughly $3M in early renewals, as well a roughly $4M tailwind from FX versus our prior expectations.

Our net retention rate for Q2 was 102%, up from last quarter’s net retention rate of 101%, and driven by improving price per seat trends. Our annualized full churn rate continues to remain stable at 3%, demonstrating best-in-class product stickiness with our customers. We now anticipate exiting FY25 with a net retention rate of roughly 102%, an improvement from our prior expectations of at least 101%.

Q2 gross margin came in at a record 81.6%, up 470 basis points year-over-year and exceeding our expectation of roughly 80%. In Q2 we were able to sell data center assets that we're no longer using, generating a gross margin tailwind of approximately 60 basis points. We expect to realize a similar benefit in Q3 as we complete the sale of our remaining data center assets.

Q2 gross profit of $220M was up 10% year-over-year, exceeding our revenue growth rate by more than 600 basis points.

In Q2 we delivered operating income of $77M, up 19% year-over-year, once again demonstrating our commitment to generate leverage across the business. Q2's record operating margin of 28.4% was up 360 basis points year-over-year, despite absorbing an FX headwind of roughly 180 basis points. Our rigorous approach to expense management, coupled with gross margin expansion, continues to generate additional leverage in our operating model.

As a result, we also delivered a record EPS result of 44 cents in Q2, up 8 cents year-over-year and well above the high end of our guidance of 41 cents. This result includes a negative impact from FX of approximately 5 cents.

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

In Q2 we generated free cash flow of $33 million, up 59% from Q2 of last year. We generated cash flow from operations of $36 million, up 11% year-over-year.

Let’s now turn to our Capital Allocation Strategy.

We ended the quarter with $483 million in cash, cash equivalents, restricted cash, and short-term investments. In Q2 we repurchased approximately 3.9 million shares for approximately $102 million dollars. As of July 31, 2024, we had approximately $25 million of remaining buyback capacity under our current share repurchase plan. We remain committed to opportunistically returning capital to our shareholders through our ongoing stock repurchase program, and our Board recently authorized an additional $100 million stock repurchase plan.

With that, let me now turn to our Q3 and full year guidance.

As a reminder, approximately one third of our revenue is generated outside of the US, with roughly 60% of our international revenue coming from Japan. Since we last provided guidance, the US Dollar has weakened versus the Yen and the following guidance includes the expected impact of FX, assuming current exchange rates.

Additionally, we expect the non-cash, deferred tax expenses that we discussed previously to represent an impact of roughly 1 cent to GAAP and non-GAAP EPS in Q3, and 5 cents for the full year.

Finally, I would note that the seasonality of our second half expenses is expected to differ from the past few years for two reasons. First, in Q3 we expect to recognize the benefit from data center equipment sales that I mentioned earlier, resulting in lower Q3 cost of sales. Second, this year BoxWorks will be held in person in Q4, representing a little more than $2M in Q4 sales and marketing expenses.

For the third quarter of fiscal 2025:

We expect Q3 revenue to be in the range of $274 million to $276 million, representing 5% year over year growth. This includes an expected headwind from FX of approximately 130 basis points.

We anticipate our Q3 billings growth rate to be in the mid-single digit range. This includes an expected tailwind from FX of approximately 210 basis points, as well as an expected headwind of roughly $3M from the early renewals that were billed in Q2.

As we complete the sale of our remaining data center assets in Q3, we expect our Q3 gross margin to be roughly flat sequentially, representing a year-over-year improvement of more than 500 basis points. Beginning in Q4, data center asset sales will have been completed and will no longer impact our gross margin going forward.

We expect our Q3 non-GAAP operating margin to be approximately 28%, which includes an expected negative impact of approximately 110 basis points due to FX. This represents a 330 basis point improvement year-over-year, and a 440 basis point improvement in constant currency.

We expect our Q3 non-GAAP EPS to be in the range of 41 to 42 cents, a 16% year-over-year increase at the high end of this range. This includes an expected headwind of approximately 2 cents from FX, and 1 cent from non-cash deferred tax expenses. Weighted-average diluted shares are expected to be approximately 148 million.

For the full fiscal year ending January 31st, 2025:

We anticipate revenue to be in the range of $1.086 to $1.09 billion, representing approximately 5% year-over-year growth, and 7% growth in constant currency. This represents a $10.5 million increase at the midpoint versus our prior guidance, with roughly two thirds of this increase attributable to FX, and roughly one third attributable to strength in our underlying business. We now expect an FX headwind of roughly 170 basis points, versus our previous expectations of 250 basis points.

We now expect our FY25 billings growth rate to be in the mid single digit range, an improvement from our previous expectations of a low single digit growth rate. We now expect FX to have a negative impact of approximately 30 basis points on this year's billings growth, versus our previous expectations of approximately 150 basis points.

We are raising our FY25 gross margin expectations to roughly 81%, an increase of 100 basis points from roughly 80%. This represents a year-over-year improvement of 360 basis points.

We are also raising our FY25 non-GAAP operating margin expectations to approximately 27.5 percent, up from approximately 27 percent, and representing a 280 basis point improvement year-over-year. We now expect FX to have a negative impact on operating margin of roughly 130 basis points, versus our previous expectations of 160 basis points.

We are raising our EPS expectations for the full year, driven by outperformance in the leverage we've been able to generate across the business. We now expect FY25 non-GAAP EPS to be in the range of $1.64 to $1.66, representing a 14% increase at the high end of this range versus $1.46 in the prior year. This includes the 5 cent impact from deferred tax expenses that I noted previously, as well as an expected FX headwind of 12 cents, which is 3 cents lower than our previous expectations. Weighted-average diluted shares are now expected to be approximately 148 million, 2 million lower than our previous expectations.

As we enter the era of Intelligent Content Management, Box is powering the full lifecycle of content in a single platform, with native enterprise-grade security and AI capabilities. As Aaron mentioned, we are already seeing the success of this strategy with increasing adoption of Enterprise Plus and its enhanced Box AI capabilities, catalyzing an acceleration in our RPO growth and an improvement in our net retention rate. Additionally, our disciplined financial strategy allows us to continue making targeted investments to fuel product innovation and our go-to-market initiatives, while also expanding margins and returning capital to our shareholders.

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