Box, Inc.

Second Quarter Fiscal 2022

Conference Call Remarks

August 25, 2021

Introduction

Good afternoon and welcome to Box's Second Quarter Fiscal Year 2022 Earnings Conference Call. I am Cynthia Hiponia, Vice President Investor Relations. On the call today, we have Aaron Levie, our CEO and Dylan Smith, our 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 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, 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 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;
- the KKR-led investment in Box 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, August 25, 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.

Lastly, while we recognize there has been news around our upcoming Annual Meeting on September 9, the purpose of today's call is to discuss our financial results. We ask that during the Q&A portion of this call you keep questions focused on our performance.

With that, let me hand it over to Aaron.

Second Quarter Fiscal 2022 Overview

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

We achieved strong second quarter results across all metrics, marking our fifth consecutive quarter of achieving both revenue and non-GAAP EPS above our guidance. We delivered second quarter revenue growth of 12% year-over-year, a second consecutive quarter of accelerating revenue growth, billings growth of 13%, and RPO growth of 27%.

From our business performance and building momentum, it's clear that enterprises are increasingly making strategic, long-term decisions on how to support a remote workforce and digital processes, while still maintaining a high-level of security and compliance policies. As a result, more customers are turning to the Box Content Cloud to deliver secure content management and collaboration built for this new way of working. Our strong momentum is best illustrated by our customer deal metrics in the second quarter:

- Our Net Retention Rate was 106%, up from 103% in the prior quarter.
- We had 74 new deals over $100K, up 16% year-over-year.
- We had a 73% attach rate of Suites on deals over $100K in the quarter, up from 49% in the prior quarter and up from 31% in Q2 fiscal 21.

We view these strong customer metrics as evidence that we are executing on the right product strategy, one that is well aligned with the three major changes happening around the future of work in the enterprise:

1. First, hybrid work is going to be a necessity going forward;
2. Second, digital transformation is driving significant change across industries; and
3. Third, cybersecurity and privacy threats are increasing at a growing rate, as we've seen with recent ransomware attacks.

These trends have major implications for how companies work with their content. Content is at the heart of how leading life sciences firms discover, develop and deliver new drugs and treatments; how banks collaborate with and onboard new clients or close deals; and how consumer product organizations ideate on, manufacture, and scale new products. Whether it is a CAD design, sales presentation, marketing asset, research study, legal contract, or financial data: content is our customers' business.

Today, enterprises have to purchase and integrate a mix of solutions from disparate vendors to solve the content management lifecycle. This leads to broken processes for users, security risks due to gaps between tools, fragmented data, and increased costs for enterprise customers.

Our vision for the Box Content Cloud is to integrate and power the complete content lifecycle, from the moment content is created through the entire content workflow. By leveraging our product leadership in content management, our Content Cloud will continue to extend into key elements of this lifecycle including e-signature, content publishing, deeper content workflows, new collaboration experiences, analytics, data privacy, and advanced security.

Critical to our success is our ability to execute on our product roadmap, which expands our TAM and adds value to our core platform with new product innovation.

This is why we were pleased to deliver on our product roadmap with the launch of Box Sign to select customers in late July, capitalizing on the trend of more transactions moving from paper-based manual workflows to the cloud, while also addressing an incremental multi-billion dollar market. Box Sign was developed through the acquisition of SignRequest, a leading cloud-based electronic signature company, a good example of our disciplined approach to M&A. Our decision to acquire this particular technology versus developing internally was driven by time to market, with e-signature being the number one requested feature from customers last year. Initial response from customers has been very positive and we are rolling out Box Sign to all business and enterprise customers throughout this fall, with a significant roadmap of innovation ahead.

Also, over the quarter we made meaningful updates to our Governance functionality to help support customers' legal hold and document retention needs; as well as new features within Box Shield to help protect the flow of content with advanced machine learning based security features. Our security, compliance, data governance, and privacy capabilities remain one of the most critical reasons customers choose the Box Content Cloud, and our innovation here is only accelerating.

In addition to these and many other product updates in the quarter, we continue to integrate deeply across the SaaS landscape. A key part of our Content Cloud value proposition is interoperability and strong partnerships with leading technology companies. This is critical to our success at scale. Building on the great work we've done with so many amazing partners like Slack and Microsoft, in the second quarter we announced:

- A new integration with ServiceNow's Legal Service Delivery application to modernize legal operations, which benefits customers by bringing together ServiceNow's advanced workflow expertise to minimize manual processing while ensuring confidential legal content is secured on Box's Content Cloud;
- We also announced new and deepened integrations with Box for Cisco Webex to make it easier for customers to work securely and effectively in the cloud.

And we're just getting started. To address our $50 billion plus market opportunity, we are building the end-to-end platform for managing the lifecycle of content, and continue to be regarded by customers and analysts as the leading independent vendor for cloud content management.

Of course, evolving our product strategy to meet today's enterprise remote and hybrid workforce needs and strengthening our partnerships with leading technology companies are only part of our strategy to drive growth. We have also been methodically enhancing our land and expand Go-To-Market model to deliver our full platform to our customers.

To accelerate growth, over the past couple of years we've been actively implementing a number of strategic go-to-market initiatives, including optimizing pricing and packaging, improving sales segmentation and territory planning, driving efficient marketing programs and pipeline generation, increasing sales enablement and doubling down our focus on key verticals such as Life Sciences, Financial Services, and the Federal Government. The success of our go-to-market initiatives and the growing demand for our more advanced capabilities drove our strong Suites adoption in the second quarter.

This is why we've been working aggressively to sell the full Box platform through our Suites offerings to bring all that Box has to offer to our customers. 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.

Building on the success of Suites, in late July we also announced a new, simplified product edition for our enterprise customers called "Enterprise Plus", which includes Shield, Governance, Relay, Platform, Box Sign, the ability for large file uploads and enhanced support and consulting credits.

You can see the success of our GTM efforts most clearly when looking at our Q2 customer expansions. For instance:

- One of the largest banks in the world purchased a seven figure deal with multiple products, including KeySafe, Governance, Relay, Shield and Platform to support new use cases for Box, including claims processing and loan origination in a more secure, virtual environment. The bank has also standardized on Box for internal and external collaboration.
- An innovative bio pharmaceutical company did a six-figure expansion with Box to support its growing workforce following multiple acquisitions to help power its mission to transform the way that drugs are manufactured in the U.S. With Box, the company's workforce is able to improve collaboration, security, and GxP compliance, providing them with a scalable and secure foundation that allows them to work faster.

- Finally, a global leader in energy services that has been a Box customer since 2017 expanded its use of Box with a six figure ELA and purchase of Enterprise Plus. This will enable them to have a proactive approach to internal threat detection on content, be more prescriptive with security controls around content, and automate more than a dozen critical business workflows.

These deals showcase the simplicity and power of our business model: we are focused on expanding our customers through additional seat growth by going wider within organizations, as well as adding more value through additional feature enhancements and products that drive up customer value and retention.

Over the past year we have been executing on our strategy to re-accelerate growth, while also driving continued operating margin improvements, and our results in the second quarter demonstrate that our strategy is working. As a result, we have raised our guidance for the full fiscal year 2022 and we are reiterating our long-term targets of 12% to 16% revenue growth and 23% to 27% non-GAAP operating margins in FY24.

Our strong second quarter results and our confidence in our outlook for this fiscal year and beyond are the direct result of the leadership of the Board and the hard work and execution we've been driving as a company. I could not be prouder of the team at Box. And while we still have so much we want to accomplish, I am confident we have the right team and leadership to execute on our strategy and targets going forward; as well as a world-class board of directors that is focused on and committed to driving enhanced value for shareholders.

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

<u>Q2 Financial Results and Q3 and FY 2022 Guidance</u>

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

As Aaron mentioned, we are proud to have delivered strong top and bottom line results in Q2. We drove an acceleration across key metrics; revenue growth, net retention, and operating profit; clearly demonstrating strong business momentum as we build on our Content Cloud vision.

Revenue of $214 million was up 12% year-over-year, an acceleration from our Q1 revenue growth of 11% and above the high end of our guidance.

Our Content Cloud offerings are increasingly resonating with our customers, as shown by the strong Suites traction and net retention rate we achieved in Q2.

As our customers are increasingly adopting products with more advanced capabilities, 61% of our revenue is now attributable to customers who have purchased at least one additional product, up from 56% a year ago. In Q2 we closed 74 deals worth more than $100 thousand dollars, up 16% year over year. A record 73% of these 6 figure deals were sold as a Suite, up from 49% in Q1 and from 31% in the year ago period. Suites have enabled us to streamline our sales process and drive greater adoption of multi-product solutions, resulting in customers who are larger, stickier, and have a greater propensity to expand over time. We couldn’t be more encouraged by our traction here.

We ended Q2 with remaining performance obligations, or RPO, of $922 million, up 27% year-over-year, an acceleration from the prior quarter’s RPO growth rate of 20%, and exceeding our revenue growth by fifteen hundred basis points. Q2’s RPO growth is comprised of 16% deferred revenue growth and 37% backlog growth, demonstrating Box’s stickiness as we continue to sign longer term agreements to support our customers’ content strategies. We expect to recognize more than 60% of our RPO over the next 12 months.

Q2 billings of $213 million were up 13% year-over-year, and well ahead of our previous expectations to deliver a growth rate in the mid-single digit range. This billings result reflects the strong sales execution that we saw in Enterprise and SMB, with both teams generating double digit year-over-year sales productivity improvements.

Our net retention rate at the end of Q2 was 106%, up three hundred basis points from 103% in Q1. This result was driven by strength in customer expansion and a stable annualized full churn rate of 5%. Based on the strong momentum we're seeing in customer expansion and retention, we expect to deliver additional improvement in our net retention rate over the course of this fiscal year.

Turning to margins – gross margin came in at 74.5%, up 100 basis points from 73.5% a year ago. Q2 gross profit of $160 million was up 13% year-over-year, exceeding our revenue growth rate. We continue to benefit from both our ongoing shift to cloud data centers and the hardware and software efficiencies we're generating in the infrastructure we manage. Our gross margin expectations for the full year of FY22 continue to be approximately 74%.

Our ongoing efforts to improve profitability are paying off and we continue to unlock leverage in our operating model. Q2 operating income increased 47% year-over-year to $44M, which in turn drove a 500 basis point improvement in Q2 operating margin, to 20.6%.

We continue to deliver profitable growth and disciplined expense management. This year we've made significant progress in building out our engineering center of excellence in Poland, which will help us drive additional operating leverage and efficiencies over time as we transition certain engineering functions away from higher cost California locations.

This resulted in our delivering 21c of diluted non-GAAP EPS in Q2, above the high end of our guidance, and up from 18c a year ago.

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

In Q2 we delivered cash flow from operations of $45 million, up 39 percent from the year ago period. We also generated free cash flow of $30 million, a year-over-year improvement of 124 percent. Capital lease payments, which we include in our free cash flow calculation, were $13 million, down from $14 million in Q2 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 a result, we ended the quarter with $779 million in cash, cash equivalents, and restricted cash.

We completed our modified Dutch Auction tender offer at the end of June for an aggregate cost of approximately $238 million, and our Board subsequently authorized a $260M share repurchase program. As of August 24, 2021, we had repurchased 2.9 million shares of Class A common stock at a weighted average price of $23.89, for a total of $70 million. Combined with the modified Dutch Auction tender, we have repurchased a total of 12.2 million shares for a total of $308 million.

With that, I would like to turn to our guidance for Q3 and fiscal 2022.

As we announced a few weeks ago, based on our strong Q2 results and our continued business momentum, we raised our full year revenue, operating margin, and EPS guidance.

Note that our share count and EPS expectations factor in only the shares that we have already repurchased to date. While we expect to opportunistically purchase additional shares through the remainder of the year under our ongoing share repurchase program, the amount could vary significantly based on market conditions and other factors. Therefore, we’re taking a prudent approach and not assuming any future repurchases in our Q3 or FY22 outlook.

For the third quarter of fiscal 2022:

We anticipate revenue of $218 to $219 million, representing 12 percent year-over-year growth, and a third consecutive quarter of revenue growth acceleration at the high end of this range.

We expect our non-GAAP operating margin to be approximately 20 percent, representing a 200 basis point improvement year over year.

We expect our non-GAAP EPS to be in the range of 20 to 21 cents, and GAAP EPS to be in the range of negative 9 to 8 cents, on approximately 162 million and 154 million shares, respectively.

We expect our Q3 billings growth rate to be roughly inline with our revenue growth.

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

We have raised our full year revenue guidance and we expect FY22 revenue to be in the range of $856 million to $860 million, up 11% year over year. This is an increase from last quarter's guidance of $845 to $853 million, and represents an acceleration from last year's revenue growth.

We expect our non-GAAP operating margin to be approximately 19.5 percent, representing a 410 basis point improvement from last year's result of 15.4%, and a sizable increase over our previous guidance of 18 to 18.5 percent.

Due to our strong top and bottom line momentum, we now expect our FY22 non-GAAP EPS to be in the range of 79 to 81 cents, on approximately 166 million diluted shares. Our GAAP EPS is expected to be in the range of negative 34 to 32 cents, on approximately 158 million shares.

We continue to expect our billings growth rate to be above our revenue growth rate for the full year of FY22, and for RPO growth to outpace both revenue and billings growth for the full year of FY22.

We will provide further details into our Q4 expectations on our Q3 earnings call.

Finally, our FY22 revenue growth rate, combined with FY22 free cash flow margin, is now expected to be at least 32%, an increase over our previous guidance of at least 30%.

Box today is not the Box of 2019. Our strong Q2 performance is the result of the business transformation we began two years ago. This year we're delivering both revenue acceleration and increased operating leverage for our shareholders, proving that our Content Cloud platform is resonating with customers. We are well on our way to delivering against our previously stated target of 12 to 16 percent revenue growth and 23 to 27 percent operating margin in FY24, 2 years from now. In FY24, we’re also committed to delivering revenue growth plus free cash flow margin of 40%.

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

Closing Comments

Thanks Dylan.

Before we open it up to questions, we wanted to share that on October 6th, we will be hosting tens of thousands of attendees at BoxWorks, which will be an all digital event for the second year in a row. 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. Attendees will also be hearing from an outstanding slate of speakers including CEOs of Okta, Slack, and Zoom as well as IT leaders from enterprises like LionsGate, State Street, USAA, and World Fuel Services, among many others.

Q2 was a strong quarter, not only in terms of achieving quarterly revenue and non-GAAP operating results that were above our original guidance, but also in our metrics that showed the power of our Content Cloud platform. Net retention rate, billings, and RPO growth are all leading indicators that show the success of our strategy to not only retain customers, but expand our solutions within our existing customer base to drive revenue growth and operating margin improvement and ultimately, shareholder value.

Dylan and I would be happy to take your questions.