# HubSpot, Inc. NYSE:HUBS

*Earnings Call*

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# Call Participants

### EXECUTIVES

**Charles MacGlashing**
*Corporate Treasure & Senior Director of IR*

**Dharmesh Shah**
*Co-Founder, CTO & Director*

**Kathryn A. Bueker**
*CFO & Treasurer*

**Yamini Rangan**
*CEO, President & Director*

### ANALYSTS

**Adam Joseph Holets**
*BMO Capital Markets Equity Research*

**Bradley Hartwell Sills**
*BofA Securities, Research Division*

**Brian Christopher Peterson**
*Raymond James & Associates, Inc., Research Division*

**Elizabeth Mary Elliott Porter**
*Morgan Stanley, Research Division*

**Gabriela Borges**
*Goldman Sachs Group, Inc., Research Division*

**Jeffrey Parker Lane**
*Stifel, Nicolaus & Company, Incorporated, Research Division*

**Joseph Daniel Meares**
*Truist Securities, Inc., Research Division*

**Joshua Christopher Reilly**
*Needham & Company, LLC, Research Division*

**Kirk Materne**
*Evercore ISI Institutional Equities, Research Division*

**Mark Ronald Murphy**
*JPMorgan Chase & Co, Research Division*

**Michael Turits**
*KeyBanc Capital Markets Inc., Research Division*

**Michael H. Berg**
*Wells Fargo Securities, LLC, Research Division*

**Rishi Nitya Jaluria**
*RBC Capital Markets, Research Division*

**Ryan Scott Krieger**
*Wolfe Research, LLC*

**Samad Saleem Samana**
*Jefferies LLC, Research Division*

**Taylor Anne McGinnis**
*UBS Investment Bank, Research Division*

# Presentation

**Operator**

Hello, and welcome to the HubSpot Q2 2023 Earnings Call. My name is Alex and I'll be in the coordinating the call today. [Operator Instructions] I will now hand it over to your host, Chuck MacGlashing, Head of Investor Relations. Please go ahead.

**Charles MacGlashing**
*Corporate Treasure & Senior Director of IR*

Thanks, operator. Good afternoon, and welcome to HubSpot's Second Quarter 2023 Earnings Conference Call. Today, we'll be discussing the results announced in the press release that was issued after the market closed. With me on the call this afternoon is Yamini Rangan, our Chief Executive Officer; Dharmesh Shah, our Co-Founder and CTO; and Kate Bueker, our Chief Financial Officer.

Before we start, I'd like to draw your attention to the safe harbor statement included in today's press release. During this call, we'll make statements related to our business that may be considered forward-looking within the meaning of Section 27A of the Securities Exchange Act of 1933 as amended and Section 21E of the Securities Act of 1934 as amended. All statements other than statements of historical fact are forward-looking statements, including those regarding management's expectations of future financial and operational performance and operational expenditures, the impact of the restructuring, expected growth, FX movement and business outlook, including our financial guidance for the third fiscal quarter and full year 2023.

Forward-looking statements reflect our views only as of today and except as required by law, we undertake no obligation to update or revise these forward-looking statements. Please refer to the cautionary language in today's press release and our Form 10-Q, which will be filed with the SEC this afternoon for a discussion of the risks and uncertainties that could cause actual results to differ materially from expectations.

During the course of today's call, we'll refer to certain non-GAAP financial measures as defined by Regulation G. The GAAP financial measure most directly comparable to each non-GAAP financial measure used or discussed and a reconciliation of the differences between such measures can be found within our second quarter 2023 earnings press release in the Investor Relations section of our website.

Now it's my pleasure to turn over the call to HubSpot's Chief Executive Officer, Yamini Rangan. Yamini?

**Yamini Rangan**
*CEO, President & Director*

Thank you so much, Chuck, and welcome to everyone joining us on the call. Today, I want to highlight our continued momentum in Q2, reiterate our playbook for winning in this macro environment and close with updates on our generative AI road map as well as insights based on customer usage. Let's jump into our Q2 results.

Q2 was a solid quarter for HubSpot with revenue growing 26% year-over-year in constant currency. We delivered 700 basis points of margin expansion year-over-year, driving operating margin to 14%. We have talked about our strategy for balancing growth and profitability, and we are purposefully executing against this strategy. I'm really happy with the operating leverage we delivered while driving growth in the quarter.

Total customers grew by 23% to over 184,000 globally, fueled by over 7,600 net customer additions in the quarter. I'm very pleased with the strong results in Q2. The consistent performance demonstrated by our team and the momentum we have in becoming the platform of choice for scaling companies.

Q2 results were driven by 2 key themes: our ability to deliver product innovation for our customers and our ability to consistently execute our bimodal go-to-market strategy. As you have seen over the past 2 years, our bimodal strategy is working. Our starter tier continues to fuel volume on the low end of the market, driven by product and pricing optimization.

That said, the story in Q2 was about upmarket momentum with continued growth in multi hub as well as full suite adoption. We saw more new customers starting with multiple hubs, fueling larger deals. 1/3 of our Pro and Enterprise customers are now on 3 or more hubs, which is up by 4 points year-over-year. In addition, we continue to see Sales Hub pick up steam with larger customers. Our investment in upmarket functionality, like customization, extensibility and governance is paying off as we win bigger deals with Sales Hub.

Service Hub also gained traction upmarket in this quarter with 12 of our 25 largest deals, including a Service Hub attach. Companies are looking to improve handoffs across their marketing, sales and service teams, and they want a clear shared view of customer insights. By connecting Sales Hub and Service Hub, support can log tickets that the sales team can now see because there is 1 central contact record. That contact helps sales team close deals and is just 1 example of why a connected front office platform is so powerful. Take MarineMax, a national boat retailer, for example, before HubSpot, their legacy CRM was causing a disjointed customer experience. They couldn't effectively route leads from marketing to sales and because their CRM was difficult to use sales reps weren't adopting it.

Since switching to HubSpot and adopting Marketing Hub, Sales Hub, Service Hub and Ops Hub, MarineMax has increased annual revenue by 113% and reduced their average sales response time from days to minutes. They now have a shared visibility across the entire customer journey, leading to a better and faster customer experience. I love hearing that our connected value proposition is resonating and that our product innovation is driving clear value for customers.

Now, I want to shift gears to talk about the macro environment. Overall, customer buying trends remain steady. Budgets remain under scrutiny. Multiple stakeholders continue to be involved in decisions. And while buying trends have not improved, they have not gotten worse either. Customers are continuing to optimize their budgets, and we can see this optimization across seats, additions, contact tiers and portals. The bar to buy has risen, but companies are continuing to invest in digital transformation and prioritized platform level decisions. This is where HubSpot shines. We have a proven playbook for driving growth with our product innovation and focused execution.

On the product side, HubSpot continues to win by being extremely easy to use and extremely powerful under the hood. Our product innovation is in high gear, and I want to highlight just a few developments from the quarter. With Marketing Hub, we doubled down on omnichannel by moving Instagram reels into public beta as marketers increasingly focused on short-form social video. We also introduced event visualizer to give customers even more insight into their audience's activity and get deeper analytics on customer behavior. With Service Hub, we introduced content assistant into inbox so that service teams can leverage gen AI to respond to customers faster across various channels. We're also enabling teams to summarize customer conversations with gen AI and move that functionality into private beta in Q2.

Lastly, on our path to building a more customizable and extensible CRM, we released customized pipeline views, enabling our customers to edit their views based on currency and tags that are specific to their business. We also improved permissions and user management for custom objects. This has been a top request from our Enterprise customers. Our pace of product innovation is just cranking and I'm very pleased with the progress we are making in becoming the platform of choice for scaling companies.

On the go-to-market side, how we sell -- why we win. We've built a competitive moat with 3 go-to-market motions, product-driven, partner-driven and direct sales-driven. Our customers tell us that the way our sales and customer success teams serve them sets us apart. They see a notable difference in our team's ability to move quickly to demo the value of HubSpot, articulate clear platform consolidation benefits and line up the best partners to deliver services. Today, over 40% of all newcomer ARR and existing customer expansion is [ causal ] and influenced by our partners, just awesome stuff. While the macro environment remains challenging, what we sell and how we sell continue to be unique differentiators for HubSpot to drive durable, profitable growth.

Lastly, let's shift gears to talk about everyone's favorite topic, generative AI. Last quarter, we talked about gen AI, and it is a transformative shift for SMBs and what this means for marketing, sales and service. In short, we believe AI will not replace go-to-market teams, it will guide and assist them to drive better customer outcomes. Today, I want to provide an overview of how we're building an entire layer of AI assistance across our platform, how our customers are responding and what our unique differentiators are with AI.

We launched ChatSpot earlier this year, and it has quickly grown to 70,000 total users with 20,000 prompts ingested weekly. Our customers tell us that they like our weekly updates. They love how quickly we are innovating with new AI capabilities, and they're getting value from the breadth of actions ChatSpot is helping them take. Customers are using ChatSpot to prospect for good fit companies based on location, industry, recent news and more. They're creating entire campaigns with SEO research, blog title generation and image generation, all from within ChatSpot. The easy chat interface combined with the power of HubSpot's platform have our customers eager for what's next with ChatSpot.

We also launched content assistant earlier this year, and since moving it to public beta in June, adoption has grown by 10x, with 26% of our enterprise customers using it today. Customers are describing content assistant as a game changer because they can quickly generate social copy, blog content, prospecting e-mails, all based on insights without having to leave HubSpot. Content assistant embeds gen AI into our customers' natural workflow, helping them work faster and smarter, right where they are.

As I look at our AI road map, we are ambitiously building AI into the entire CRM platform so our customers can get even more value from our platform. We want to help scaling companies power their entire customer journey with AI, and we believe we can help them leverage AI better than other platforms for 3 reasons. First, data is the fuel for AI and HubSpot has unique data. While other platforms provide data on who your customers are, HubSpot has data on who your customers are, what they did across channels, what they bought. And when we bring together the power of large language models with deep contextual first-party data in HubSpot CRM, magic happens.

Second, HubSpot is where work gets done in the front office. We own the workflows that scaling businesses use every day. We're beginning to see this play out with content assistant usage that I just mentioned.

Finally, gen AI needs human intervention to work responsibly and we've always had a human-centric approach to product innovation. We're committed to having strong customer feedback loop and implementing the feedback very quickly. We're well positioned to become the AI leader for scaling companies, and we're moving fast. We are prioritizing AI use cases in our road map and without giving too much away, AI is going to be a major theme at our INBOUND conference in September. I'm really excited for you to learn a lot more about our AI strategy and road map at our upcoming conference.

Reflecting on the quarter, I'm very pleased with how our teams are driving the pace of product innovation, focusing on iterating fast with AI while executing on our bimodal strategy. This focus and alignment is what will continue to set us apart to drive full and profitable growth.

With that, I'll turn the call over to Kate to take you through our Q2 financial results. Kate?

**Kathryn A. Bueker**
*CFO & Treasurer*

Thanks, Yamini. Let's turn to our second quarter 2023 financial results. Revenue grew 26% year-over-year in constant currency and 25% on an as-reported basis. Subscription revenue grew 26% year-over-year, while services and other revenue increased 23% on an as-reported basis. Domestic revenue grew 25% year-over-year, while international revenue growth was 29% in constant currency and 26% as reported. International revenue represented 47% of total revenue in Q2. We added over 7,600 net new customers in the quarter, bringing our total customer count to over 184,000, up 23% year-over-year. Average subscription revenue per customer grew 3% year-over-year in constant currency and 2% on an as-reported basis to $11,400. Our ASRPC growth was driven by continued multi-hub adoption by our

Professional and Enterprise customers, offset by the large volume of starter customers we added at the low end of our bimodal strategy over the last few quarters.

Gross retention remained healthy in the high 80s for the quarter. Net revenue retention was 103%, down 1 point sequentially, driven by continued spend optimization by our customers across seats, additions, contact tiers and portals. While we expect pressure on net revenue retention in the near term to persist, we continue to see strong gross retention and believe we can maintain net revenue retention above 100%. Calculated billings were $542 million in the quarter, growing 22% year-over-year in constant currency and 25% as reported. The remainder of my comments will refer to non-GAAP measures.

Operating margin was 14%, up 7 points compared to the year ago period. On a year-over-year basis, operating margin benefited from the restructuring actions we took at the end of January as well as a seasonal shift in hiring into Q3 and Q4. While these factors have helped drive a step change in operating margin, we continue to invest in critical areas such as product innovation, AI and internal systems and data to ensure we're building the foundation for continued margin expansion as we scale. Net income was $70 million or $1.34 per fully diluted share. Free cash flow was $60 million or 11% of revenue, and our cash and marketable securities totaled $1.7 billion at the end of June.

And with that, let's review our guidance for the third quarter and full year of 2023. As Yamini highlighted, we continue to operate in a difficult macro environment. Customer budgets remain tight, decisions by committee are the norm and customers continue to look for ways to optimize existing spend. Our guidance assumes that these weak macroeconomic conditions persist throughout the second half of 2023. For the third quarter, total as-reported revenue is expected to be in the range of $532 million to $534 million, up 20% year-over-year at the midpoint. We expect foreign exchange to be a 1- to 2-point tailwind to as-reported revenue growth in the quarter. Non-GAAP operating profit is to be between $67 million and $69 million. Non-GAAP diluted net income per share is expected to be between $1.22 and $1.24. This assumes 52.6 million fully diluted shares outstanding.

And for the full year of 2023, total as-reported revenue is now expected to be in the range of $2.116 billion to $2.122 billion, up 22% year-over-year at the midpoint. We now expect foreign exchange to be a 0.5 point tailwind to as-reported revenue growth. Non-GAAP operating profit is now expected to be between $293 million and $297 million. Non-GAAP diluted net income per share is now expected to be between $5.24 and $5.29. This assumes 52.3 million fully diluted shares outstanding.

As you adjust your models, keep in mind the following: We expect CapEx as a percentage of revenue to be roughly 5% and free cash flow to be about $260 million for the full year of 2023 with seasonally stronger free cash flow in Q4.

And with that, I will hand things back over to Yamini for her closing remarks.

**Yamini Rangan**
*CEO, President & Director*

Thank you so much, Kate. I want to close with our commitment to building a sustainable and equitable company. One of our goals as an organization is to build a company, future generations will be proud of and making progress on our environmental, social and governance efforts is a critical part of that journey. We released our annual sustainability report in Q2, and I want to highlight a few key developments.

On the environmental side, we submitted our targets for validation by the Science Based Targets initiative, joining over 5,000 companies committed to ambitious climate action. In our effort to build a more diverse and inclusive company, we reached 47% female representation company-wide, nearing gender parity. We launched a customer trust center for our customers so they can learn more about our security, privacy, compliance and governance practices.

I'm really proud of the progress we are making to build a diverse and sustainable company. I want to thank our customers, our partners and our shareholders for the continued support of HubSpot. And a big thank you to all our employees who are executing with focus and solving for our customers every day. I look forward to seeing many of you at our Analyst Day as part of our INBOUND 2023 event on September 6.

With that, operator, let's open up the call for questions.

# Question and Answer

**Operator**

[Operator Instructions] Our first question for today comes from Samad Samana from Jefferies.

**Samad Saleem Samana**
*Jefferies LLC, Research Division*

Yamini, I wanted to ask a question for you. You've talked a lot more about upmarket traction, and you've mentioned deals that are 3,000, 5,000-plus in MRR, which is much bigger than the overall average. So I was just maybe wondering if the momentum there has increased in recent months on the Enterprise side? And if it has, can you speak to the causal factors? How much of it is it the product enhancements that you just mentioned today versus conversations around AI and HubSpot having a single platform benefiting versus maybe stumbles by competitors. Just help us think about both the momentum of the traction and what's causing it, if it's changing.

**Yamini Rangan**
*CEO, President & Director*

Yes. Thank you, Samad, for that question. Definitely pleased with the continued momentum upmarket. And as you know, we look at our target market as the 1,000 to 2,000 employee segment with upmarket being the 200 to 2,000 employee segment. And look, we've had a lot of focus and investments going into the upmarket segments, so we're gaining traction for a variety of reasons, including all of the ones that you just mentioned. But maybe just to give a little bit of color, I'll start with what we're seeing with upmarket customers. And there are a couple of customer trends that we see up market.

First off, upmarket customers are consolidating on platforms. Over the last couple of years, they've bought a number of disparate systems, and this is the time that they're focused on eliminating costs, but also getting clear visibility across the entire customer journey. And so that's driving interest.

I think the second thing is focus this year for upmarket customers has been on sales productivity. Headcount is constrained in this environment, but customers still need to hit their growth targets. So they're leaning into equipping their sales reps with the right technology solution that needs to be successful, and we certainly see larger Sales Hub driven deals within our customer buying patterns.

Now having said that, upmarket has been a strategic priority across the company, both from a product and go-to-market side. Our product has gotten much better, and it's meeting the needs of upmarket customers. And this has been a constant drumbeat across the past few quarters. And ultimately, our product is easy to use but very, very powerful under the hood, and that's a differentiator. I think the perception has also improved upmarket. We're gaining momentum with execs in scaling companies. And we've always had like a great relationship with CMOs and the marketing organization, but now CEO, CFO, COOs, know and understand the value of HubSpot there as well.

And then finally, I think both the product -- both the partner teams as well as the direct teams are really able to clearly communicate the value of HubSpot as well as drive cost savings for our customers and how we sell is also why we win. So very pleased with the progress upmarket, and I think all of those factors really play into it.

**Operator**

Our next question comes from Elizabeth Porter of Morgan Stanley.

**Elizabeth Mary Elliott Porter**
*Morgan Stanley, Research Division*

I was hoping you could provide a little bit more color around the dynamics when you launch free products. Was there any sort of pent-up demand in the beginning that could be waning and impacting the new user sign up? Or how big of a funnel do you have to still work through on converting those free sign-ups to paid customers.

**Kathryn A. Bueker**
*CFO & Treasurer*

Thanks, Elizabeth. It's Kate. I will start and then others can join if they want. Look, I think you're asking about the free sign-ups because you saw a sequential drop in our net customer additions. I will confirm that, that is very much a dynamic happening with starter, we did see a quarter-over-quarter decline in starter. The free products that you highlight are one of a number of things that we use to drive demand at the low end of our bimodal strategy, we consistently look to move functionality down into our free and starter products. We consistently experiment with pricing and packaging. We're launching free tools on a regular basis. And so there is a normal ebb and flow to the free user base and ultimately, the net starter additions that you'll see from one quarter to the next.

**Operator**

Our next question comes from Mark Murphy of JPMorgan.

**Mark Ronald Murphy**
*JPMorgan Chase & Co, Research Division*

Congrats on the results. Yamini, at the last Analyst Day, I believe you and Kate had mentioned that Sales Hub had crossed through $450 million in ARR and it had done that with mid-50s growth at that time. And interestingly, I went back and looked at this, it was growing faster than Marketing Hub was when it was that size. And realizing that most companies never have that kind of a second act or third act, can you explain what is it that is propelling Sales Hub so rapidly? And whenever the economy does return to normalcy, do you think that, that can continue to carve out a stronger arc than what we saw historically with marketing cloud?

**Yamini Rangan**
*CEO, President & Director*

Mark, that's a great insightful question. I think like this goes back to the fact that we are in the middle of a fairly big transformation at HubSpot, one that we've been talking about for many years. We've been on this journey to go from app to suite to platform. And when we go from app to suite and Sales Hub becomes a legitimate front door, then it actually drives faster adoption within the installed base. So the second product and the third product and fourth product, they have the benefit of having the install base of the first product. And that's kind of what you're beginning to see.

I think that, again, maybe kind of dissecting the customer trends from what we see internally. From the customer side, every leader that I talk to, they're looking at ways to eliminate cost but drive better results. And over the last couple of years, they bought a ton of point solutions, and they're either struggling to integrate those solutions or the cost of these solutions are prohibitive. And we are now being seen as a powerful, cost-effective platform within this environment, and that helps with Sales Hub kind of momentum because if you are a Marketing Hub customer, then it makes a lot more sense to get Sales Hub or if you're looking at ways to drive cost savings than buying multiple hubs and kind of eliminating costs while getting better customer insights is working.

I think the other part of it is that one of our strategic priorities this year was to double down and focus on driving product leadership in Marketing, Sales and Service Hub, and that's exactly what our product teams are focused on innovating, and that's what you're seeing play out Sales Hub because it's now a really legitimate front door to HubSpot and we've talked about the steady drumbeat of product releases that are aimed at expanding our market opportunity within Sales Hub. And we're also driving our ability to serve more sophisticated use cases. And just this past quarter in Q2, we released sequences on mobile, driving more prospecting efficiency with reporting, better embedded pipeline metrics. All of these are just examples of functionality within our Sales Hub that drive upmarket momentum and things that our customers have been asking for.

So I'd go back to second, third hubs always have the benefit of the first one. And when customer needs meet with product innovation, meet with go-to-market execution, then we begin to see the consistency of the results that we are seeing now.

**Operator**

Our next question comes from Rishi Jaluria from RBC.

**Rishi Nitya Jaluria**
*RBC Capital Markets, Research Division*

Wonderful, Yamini and Kate. So as we think about your continued momentum upmarket and going head-to-head with some of the larger competitors, One of the pieces of feedback we hear from customers is that there are certain enterprise-grade features and functionality that they don't quite yet have available natively in HubSpot. How do you think about using generative AI to speed up the development around a lot of those enterprise-grade features and be even more competitive against some of the kind of more traditionally upmarket, but also maybe legacy competitors.

**Yamini Rangan**
*CEO, President & Director*

Yes. Great question. I'll start, and Dharmesh, feel free to just chime in there on the development side as well. Look, I think our focus is really that 20 to 200 and then 200 to 2,000 customer base. And you're absolutely right. I think the list of innovation and the list of things that we can continue to do to expand our share of that market is there, and that's exactly why this is our #1 priority within the company. We want to increase that product depth and leadership within that market. And so there's a long list of innovation that we are -- we know we're working on and our product and pace of innovation within product has been pretty high over the past few quarters exactly for that reason, so we can meet the needs of the customers.

I do think at the same time, they look at us as a way to get visibility across all of the products that are organically built while eliminating the cost, which is why you see us as a platform of choice for these enterprise companies.

Now gen AI certainly has the potential to accelerate productivity, not just in front office functions, but also for engineering and it's certainly something that we are looking at, but it's pretty early days in terms of driving that pace of innovation even further. Dharmesh, feel free to add there.

**Dharmesh Shah**
*Co-Founder, CTO & Director*

Yes. One thing I'll add is that generative AI, I think it opens up an entire like a generational opportunity. I've been in CRM software for 30 years now, since pre-cloud. So we saw once the advance -- the Internet came, this kind of entire new industry around cloud-based CRM. I think we're going to see something similar with generative AI. And HubSpot's approach has always been kind of democratize technology as it's kind of coming up and our focus on SMB. So I think opportunity this opens up for HubSpot is to say, "hey, we're tackling SMB, we want to do the same thing we did when we launched our CRM". We said we want every company to be able to benefit from having a really good CRM. Now that we see generative AI features coming down the road, our philosophy is we want every company to benefit from an AI-powered CRM.

So how do we take all these features that are now -- right now market leading, but how do we make them and disuse them and democratize them and make them available. So I think it creates an opportunity for us to capture more of mind share and market share within SMB, the market we're focused in, and it's a once-in-a-generation opportunity.

**Operator**

Our next question comes from Brian Peterson of Raymond James.

**Brian Christopher Peterson**
*Raymond James & Associates, Inc., Research Division*

So I wanted to maybe pivot off upmarket and focus on mid-market for a second. And I'd love to understand is the vendor consolidation trend that you're seeing. Is that narrative happening in the mid-market as well? Or is there maybe more of a spend rationalization there? I would love to maybe understand and get your perspective there.

**Yamini Rangan**
*CEO, President & Director*

Yes, Brian, I think it's happening in mid-market as well. There is absolutely no doubt that we see it. And for us, mid-market is that to 20 to 200 person company. That's what we call as mid-market. And if you look at what is driving vendor consolidation across all of the segments that we are in, it's the last couple of years of how customers have grown. SMBs were thrown into the digital environment post the pandemic and during the pandemic, they went in and bought a number of point solutions and -- or they went and got some enterprise-class solutions. And both of those have proven to be pretty costly in terms of maintaining the tech stack, but also pretty brittle in terms of getting customer insights.

And so -- if you look at a mid-market company, they are also in the same place of looking at eliminating costs while driving better customer insights and we see the same trend play out within mid-market. And again, we begin to see more multi-hub and even full suite Pro and Enterprise deals within the mid-market segment.

**Operator**

Our next question comes from Alex Zukin of Wolfe Research.

**Ryan Scott Krieger**
*Wolfe Research, LLC*

This is Ryan on for Alex. So just a quick one on retention. It seems like the deceleration in NRR is slowing. So if you look at NRR, on kind of a month-over-month basis, did it start to improve at all in the back half of the quarter, like in June? And then how should we be thinking about when that metric could trough kind of going forward?

**Kathryn A. Bueker**
*CFO & Treasurer*

Yes. Thanks, Ryan, for the question. Net revenue retention, you're right on the quarterly math. For the quarter, net revenue retention was 103%, which was down 1%. I don't think we're going to comment on monthly trends here, but I will make a couple of comments on net revenue retention. The first, I guess maybe I'll just start with the good news, which is our customer dollar retention, which we refer to as gross retention externally, remains steady in the high 80s which provides a really nice foundation for us around net revenue retention overall.

The area where we continue to see challenge is the same one we've been talking about for a number of quarters, which is on that net upgrade rate. So kind of going back to the back half of 2022, there was more consumption-driven motions like seats and contacts for us continue to be pressured. We're seeing that both on the downgrade side, but we're also seeing lower volume of customers adding contacts and seats in addition.

And then finally, customers, you heard -- both Yamini and I talked about this in our prepared remarks, are really looking to optimize their spend across the board by sort of adjusting additions and consolidating their portals onto a single HubSpot -- instance, really looking for ways to maximize the ROI from our platform.

Now you ask a really hard question, which is like when is it going to turn? And I will admit it is like really difficult to predict. Obviously, it's dependent at least in decent amount on macro pressure. What I will say is that we feel good about our ability to retain the customer dollar retention at that high 80s level, and we feel good about our ability to retain net revenue retention above 100%.

**Operator**

Our next question comes from Brad Sills of Bank of America.

**Bradley Hartwell Sills**
*BofA Securities, Research Division*

I wanted to ask a question on AI, a lot of exciting use cases it sounds like already for -- in your customer base around ChatSpot AI and content assistant. How are you thinking about the monetization here? Are these -- is this baseline functionality that just continues to drive the moat? Do you think you might put some of this functionality into premium additions, maybe separate SKUs? Just any color on how you're thinking about the monetization opportunity for AI?

**Yamini Rangan**
*CEO, President & Director*

Yes. Thanks a lot for that question, Brad. This is Yamini, we're very clearly excited about generative AI. It is a pretty big transformative shift. And I think we look at it as being well positioned to serve the SMB market. And historically, if you've looked at HubSpot, we've done a really good job of taking powerful sophisticated technology and bringing it to bear within the SMB market. And this market is quite different from other kinds of segments because they typically don't have AI, ML experts and resources. And so we take our job pretty seriously to take a powerful technology and democratize there.

Now specifically on your question on monetization, we have a very clear first principle when it comes to monetization. And our principle is that we focus on delivering customer value first, and from there, monetization will follow. And we're going to apply that same first principle to AI. And when we think about this market, we're clearly in the early stages of iterating fast and adding value for customers. We're beginning to see that with both ChatSpot and content assistant in all of the use cases that we have in beta so far. Once we know what value we are adding to customers, then we'll likely follow a bimodal strategy to monetization. And what I mean by that is, on one hand, we'll likely democratize AI features and make it available in our freemium and starter tiers to drive adoption, you've seen that play out. We've taken really high-value features and added it to free and starter and that helps with adoption, but that also helps as an on-ramp to our other tiers.

And then the second part of what we'll likely do is drive higher value and ASP with more specialized features. And this can certainly come in the form of adding certain features to higher additions like Pro and Enterprise. It can also come from packaging AI features into more specialized add-ons. So we're certainly thinking about all of that. But the first priority for us is move fast, iterate fast and add a ton of value for our customers specifically within the SMB segment. We want to be the AI leaders within the SMB segment and for scaling companies.

**Operator**

Our next question comes from Gabriela Borges of Goldman Sachs.

**Gabriela Borges**
*Goldman Sachs Group, Inc., Research Division*

Kate, I'm looking for a little bit of color on the constant currency billings deceleration that you saw this quarter. And I realize that you just talked about how difficult it is to predict the macro. So I'm hoping you could share a little bit on some of the leading indicators that you and the team look at to try to get ahead of underwriting a turn in the macro and potentially to start ramping hiring again.

**Kathryn A. Bueker**
*CFO & Treasurer*

Yes. Thanks for the question. I'll try to give a little bit more color on the billings because I will admit it's a little bit of a head scratcher this quarter. As we -- what we try to ground ourselves on is constant currency revenue growth as sort of a baseline assumption that constant currency revenue and constant currency billings will grow together. And this quarter, what you saw is a little bit more of a gap. And you saw this really unusual thing where you had constant currency billings growth dipping below as reported billings growth and I would just note, like billings has 2 components to it. It has revenue and it has a change in deferred revenue. And while currency was a headwind to revenue, it was actually a tailwind to deferred revenue, which is why there was this 3-point tailwind to billings growth in the quarter.

And if you just look at that FX impact, that's half the gap between constant currency billings growth and constant currency revenue growth. Yes. Other than that, there's not -- the trends are largely the same as the ones that we've been talking about. We continue to see a little bit of a decline in duration as our mix shift away from Marketing and into Sales and Service, shifts away from new and into installed base. But we expect those 2 growth rates to come back together in Q3 as we have a -- call it a more normal FX comparison.

**Operator**

Our next question comes from Josh Reilly of Needham & Company.

**Joshua Christopher Reilly**
*Needham & Company, LLC, Research Division*

You look at the customer additions in the quarter, clearly, they're very strong at over 7,000 again. Can you just help us understand the price change on the starter bundle, how that impacts the trajectory of the net adds after a few months of the change being in the market? Is there an initial pop in demand and then it reverts or what's the cadence following these price changes? And was that a contributing factor to why the number was down sequentially?

**Kathryn A. Bueker**
*CFO & Treasurer*

Yes, I'll start. Net adds were down a bit from Q1 to Q2, but they were very much aligned with the expectations that we had internally and the expectations that we shared on the call last quarter. The other thing to note is they were much more balanced across addition, what we've seen over the last couple of quarters. In both Q4 and Q1, we were actually pretty surprised by the stronger performance in starter that was really the driver of the overall new customer addition. So yes, starter did decline a little bit, but it is in line with our expectations, and we frankly would expect that it would sort of stay in and around these levels over the next couple of quarters.

**Operator**

Our next question comes from Terry Tillman of Truist.

**Joseph Daniel Meares**
*Truist Securities, Inc., Research Division*

This is Joe Meares on for Terry. Just curious, on the 3Q '23 and 4Q '23 implied revenue guide, it's looking like about 18% growth year-over-year ex FX. And acknowledging we're in a tough macro, I'm just curious, is that decline from the first half, is that more macro driven? Or is that something that you're seeing as far as your individual NRR being affected?

**Kathryn A. Bueker**
*CFO & Treasurer*

Maybe I'll just kind of take a step back and talk about how we approach guidance. We approach guidance in a very consistent way. I just finished my fifth year at HubSpot. And we have approached guidance in the same way every quarter during that period of time. And the way that we approach it is this, we try to create a set of numbers that we feel good about our ability to deliver across a variety of scenarios. And we took exactly the same approach this quarter. Both Yamini and I shared in our prepared remarks that the external environment remains challenged, and that is what is the foundational baseline assumption for our guidance. That said, we want to put forward guidance that we can deliver even if things get a little bit worse from here.

**Operator**

Our next question is from Michael Turrin of Wells Fargo.

**Michael H. Berg**
*Wells Fargo Securities, LLC, Research Division*

Michael Berg on for Michael Turrin here. I wanted to ask on pricing and packaging. You've added -- like you've mentioned a number of times you've added quite a few features across all hubs, but notably Sales Hub. And as you incorporate generative AI, which we just had a pricing discussion, maybe you could help us understand how you might think about either increasing prices or taking more of the value you deliver to your customers.

**Yamini Rangan**
*CEO, President & Director*

Yes, Michael, I appreciate that question. Thank you. Our pricing philosophy has not changed. And if you step back and think about what our pricing as well as packaging philosophy has been, we add value first and then we think about pricing changes next. And when we had this discussion on AI monetization, I mentioned exactly the same thing, which is add value first and then kind of look at pricing.

And you're absolutely right that we've added tremendous value in terms of Sales Hub. When we look at pricing, packaging changes, for example, last year, we increased Marketing Hub Enterprise pricing, but that was after consistently adding value, 4 years of adding value into that tier. And when we do that, we feel very, very comfortable on the impact it has in terms of our customers. And so we follow exactly that same pricing philosophy, whether it comes to AI or it comes to Sales Hub.

Ultimately, we think that we're in the early stages of a fairly big transformation, the transformation of us going from app to suite to platform is early, the transformation of us going to upmarket is early. There's now the big shift that's happening with AI is early. And across all of that, our focus is add value and gain market share and adoption and then monetize.

**Operator**

Our next question comes from Michael Turits of Key Corp (sic) [ KeyBanc Capital ].

**Michael Turits**
*KeyBanc Capital Markets Inc., Research Division*

Interesting discussion around NRR. So I guess same kind of question around MSRPC, A, when you think that could start to re-inflect up. And an associated question, were you seeing and also -- quarter you commented on MSRPC being stronger in the upper tiers as opposed to being dragged down by starters. So what was that breakout like? So acceleration or not going forward and between tiers this quarter?

**Kathryn A. Bueker**
*CFO & Treasurer*

Yes. The ASRPC is obviously the other side of the coin to net customer additions. I think there's a little bit of a difference across the 2 metrics in the sense that ASRPC is a little bit more of a lagging metric as it reflects -- because revenue is the numerator, it reflects the activity that we've seen over the last 4 quarters. So anything that you're going to see in terms of movement in quarter is going to be a little bit more muted. What you did see with ASRPC is it expanded up in the low single digits, which is like what we expected and what we shared with you last quarter. And the drivers are the same ones that we talked about last quarter. The continued progress with multi-hub adoption in Professional and Enterprise was the big driver of the expansion. But again, there was an offset based on the significant net adds that we have seen over the last 4 quarters at that starter tier.

Now as far as the ASRPC outlook, we think it's going to sort of hang in and around these like low single digits for the next couple of quarters. But you are right, if we stripped out starter, we would see an ASRPC that is expanding at a higher rate.

**Operator**

Our next question comes from Parker Lane of Stifel.

**Jeffrey Parker Lane**
*Stifel, Nicolaus & Company, Incorporated, Research Division*

Yamini, HubSpot has always been a very horizontal platform. And as you're making this upmarket shift, do you see any appetite in the enterprise category, in particular, for more industry-specific features and tools. And as you think about the future penetration of this opportunity, is it necessary to have those type of tools? Or do you feel like there's enough work being done in the partner community and integrations that can support a healthy use case there.

**Yamini Rangan**
*CEO, President & Director*

Yes. Great question, Parker. I think it's more of the latter. If you think about the big transformations that we're on, we're going from this app to suite to platform. We're kind of going from the smaller end of SMB to upmarket customers. And both of those are still fairly early innings. And if we look at our market share penetration across both of these, it's single digits. And we think that with the level of product innovation that's happening as well as the focused execution. We have the opportunity to kind of take it to strong double digits in terms of market share. So there's a lot of opportunity that is left, that is still very much horizontal, our list of innovation and a list of things that we can bring to add value to our customers remains really robust and long. So we're going to focus on all of those opportunities.

And I think AI also gives us a tremendous opportunity to drive more market share gains as well as adoption within our markets. And as you said, like partners are certainly leaning into certain verticals, and they're more than welcome to continue to like do that, but we feel that the opportunity is still early stages with a tremendous runway ahead of us for our strategy now.

**Operator**

Our next question comes from Keith Bachman of BMO.

**Adam Joseph Holets**
*BMO Capital Markets Equity Research*

This is Adam on for Keith. I wanted to touch on the commission changes and any incremental feedback you might have on reactions there? And then second part would be -- does that have any effect on the decrease in starter tier adds?

**Yamini Rangan**
*CEO, President & Director*

So let me start with the first part, which is the partner commission changes. We're really pleased with the response from the partner channel. And I've talked to many of our elite partners before the change, after the change, and we are consistently getting feedback from our partner channels and we spent a lot of time communicating to our partner channel on why we are changing this. And if you step back and think about we want to drive consistent value-added engagement with customers and we want our partners to be able to drive multi-hub adoption within our customer base. And so the commission changes were very much aligned to where we are going as a company.

And in fact, we have seen partners increase engagement with our customers as a result of the change, which is a really nice bonus. And I think it's a win for our customers, partners and in terms of HubSpot. And maybe, Kate, if you want to add on the starter, I don't think the partner commission change had any impact on the starter net adds, but you can certainly comment.

**Kathryn A. Bueker**
*CFO & Treasurer*

Yes. I would agree. The partners tend to be focused more upmarket in our customer base. And so the impact that they would have -- they did not have any impact on the quarter-over-quarter change in net customer adds.

**Operator**

Our next question comes from Kirk Materne of Evercore.

**Kirk Materne**
*Evercore ISI Institutional Equities, Research Division*

Yamini, I was wondering if you could just talk a little bit about just the [indiscernible] to the upmarket. Is that something out of all geographies, meaning is the U.S. a little bit ahead of EMEA in terms of what you're doing in multi-hub sales and just any, I guess, commentary on the macro from a geographic perspective, if there's any real difference you're seeing in the U.S. versus, say, outside the U.S.

**Yamini Rangan**
*CEO, President & Director*

Kirk, I didn't get the first maybe 10, 15 seconds of the question, I got the geo differences. Can you repeat the first part, please?

**Kirk Materne**
*Evercore ISI Institutional Equities, Research Division*

Sorry. If you're seeing any dynamics -- market dynamics [indiscernible] across [ all the ] geographies...

**Yamini Rangan**
*CEO, President & Director*

Okay. I think I got the geo differences. So I'll say no notable differences across our major markets. And what I talked about as customer buying patterns. On one hand, they're -- it didn't get better, it didn't get worse, very similar trends in terms of looking at budget, having multiple stakeholders involved in decision-making and driving projects. So I think that has remained consistent. So no notable differences.

And maybe the other part of the question was really, are there any differences as you think about upmarket and multiple Sales Hub adoption or multi-hub adoption? And again, no notable differences. So I think the broader themes coming back to what we are seeing across the pipeline, a lot more sales initiatives this year where our customers are focused on driving sales rep productivity, a lot more multi-hub adoption as people want to make sure that they are getting visibility across their entire customer pipeline and a lot more platform consolidation as they look to eliminate costs as well as get just much better return for their investments. And across all regions, we're seeing the trend of becoming a platform of choice for the scaling companies. So high bar for action across all regions, but we continue to be very focused on executing to meet that high bar.

**Operator**

Our final question for today comes from Taylor McGinnis of UBS.

**Taylor Anne McGinnis**
*UBS Investment Bank, Research Division*

Maybe on margin. So it looks like the 4Q guide implies mid-teens and previously the outlook called for high teens. I know you had some good outperformance in the quarter and it looks like the 3Q outlook is a little bit higher. So is it just the shifting of expenses between quarters, maybe some prudence in the forecast? Or is your view on 4Q OpEx growth changed or the level of investment, I guess, is there anything new that you would flag?

**Kathryn A. Bueker**

*CFO & Treasurer*

Yes. Thanks for the question. We are very pleased with the progress we're making this year on expanding our margins. You saw us record 7% increase in margins year-over-year in Q2. And if you just sort of take a step back and think about what's driving that. We took a bunch of actions through the back half of last year to really pull back on hiring pretty significantly. And then we did a restructuring in January, and that is really showing up in the year-over-year leverage.

If you think about where we're guiding for the full year, we are -- our operating profit margin guidance is 14%, which is a bit more than 4 points year-over-year increase over 2022. What I would tell you is we've been very prudent in the hiring that we've made in the first half of the year. We came out of the risk at the end of January, and we wanted to be very strategic about where we were adding heads. And as a result, we have -- we will see more of our hiring take place in Q3 and Q4 of this year versus our original plan. And that is what you're seeing in the seasonal margin in our guide.

**Operator**

Thank you. We have no further questions for today so that concludes today's conference call. Thank you all for joining. You may now disconnect your lines.