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Atlassian Corp. Plc (TEAM)

Q4 2022 Earnings Call

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Arjun Bhatia

Analyst, William Blair & Co. LLC

Quinton Gabrielli

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for joining Atlassian's Earnings Conference Call for the Fourth Quarter and Full Fiscal Year 2022. As a reminder, this conference call is being recorded and will be available for replay from the Investor Relations section of Atlassian's website following this call.

I will now hand the call over to Martin Lam, Atlassian's Head of Investor Relations.

Martin Lam

Head-Investor Relations, Atlassian Corp. Plc

Welcome to Atlassian's fourth quarter and full fiscal year 2022 earnings call. Thank you for joining us today. Joining me on the call today, we have Atlassian's Co-Founders and Co-CEOs, Scott Farquhar and Mike Cannon-Brookes; and our Chief Revenue Officer, Cameron Deatsch.

Earlier today, we published a shareholder letter and press release with our financial results and commentary for our fourth quarter and full fiscal year 2022. The shareholder letter is available on Atlassian's Work Life blog and the Investor Relations section of our website, where you'll also find other earning-related material, including the earnings press release and supplemental investor datasheet. As always, our shareholder letter contains management's insight and commentary for the quarter. So, during the call today, we'll have brief opening remarks and then focus our time on Q&A.

This call will include forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. Forward-looking statements represent our management's beliefs and assumptions only as of such date such statements were made and we assume no obligation to update or revise such statements should they change or cease to be current.

Further information on these and other factors that could affect the company's financial results is included in filings we make with the Securities and Exchange Commission from time to time, including the section titled Risk Factors in our most recent Form 20-F and quarterly Form 6-K. During today's call, we will also discuss non-IFRS financial measures. These non-IFRS financial measures are in addition to and are not a substitute for or superior to measures of financial performance prepared in accordance with IFRS. A reconciliation between IFRS and non-IFRS financial measures is available in our shareholder letter, earnings release, and investor data sheet on the IR website. Please keep in mind that we'd like to allow as many of you to participate in Q&A as possible. To facilitate that, we'll take one question at a time. Please rejoin the queue if you have a follow-up or another question and we'll do our best to come back to you later in the session.

With that, I'll turn the call over to Scott for opening remarks.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

Thank you for joining us today. As you've already read in our shareholder letter, we ended fiscal 2022 with strong Q4 results across all three of our markets: agile and DevOps, ITSM, and work management. Cloud revenue grew by 55% year-over-year in Q4 and ended the year with over 242,000 customers.

Atlassian is uniquely positioned, having great momentum and a differentiated business model. Now, while we can't predict what the future holds at a macro level, we're forging ahead with conviction and vigilance as we look to continue to fuel durable growth over the long-term and deepen our strategic advantages. We're incredibly proud of the way we continue to execute against our long-term goals, and we're excited to take this momentum into fiscal 2023.

I also want to take the time to mention that this quarter, I am operating as Interim CFO. This will be my first and last earnings call as Interim CFO as we welcome Joe Binz as our incoming CFO. We are so excited to bring Joe on and introduce him to you in the next earnings call next quarter.

With that, I'll pass the call to the operator for questions and answers.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from Fatima Boolani from Citi. Please go ahead.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Hey, everyone. Thanks for taking my questions. Just one around the cloud growth expectations for fiscal 2023 that you've reiterated, which is very encouraging, as well as the reiteration of the magnitude of – migration impact to that cloud growth. What I'm curious about is when you think about the fiscal 2024 dynamic, which is similar to fiscal 2023, how much of the migratory impact from the prior year, i.e. fiscal 2023, what type of purchasing or expansion behavior from those migrated customers are you expecting in the base in fiscal 2024?

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

A

Right, it's Scott here answering that question. Look, as we mentioned previously in our Investor Day a few months ago and reiterating now on this earnings call, we expect cloud growth to be approximately 50% year-on-year for FY 2023 and FY 2024, and so that remains the same. We've also said that high single-digit of that growth comes from migrations in any given year and so we expect again that to continue.

We haven't looked in terms of the FY 2024 dynamic of how that goes. What we do see, though, is our migrating customers expand at a similar rate to the customers we have in our existing instances. And we've also stated that previously, we have a net expansion rate of 130% in cloud and 140% for our larger customers in cloud. And so that's all I can give you on that at this stage.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

I appreciate it. Thank you, Scott.

Martin Lam

Head-Investor Relations, Atlassian Corp. Plc

This is Martin. Just to clarify. Jus to clarify, we're expecting 10 points of growth of the 50% growth in cloud sort of the next two years.

A

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Understood. Thank you. I'll jump back in queue.

Q

Operator: Your next question comes from Michael Turrin from Wells Fargo. Please go ahead, Michael.

Michael Turrin

Analyst, Wells Fargo Securities LLC

Hey, great. Thanks and congrats on a strong end of the fiscal year. Scott, I know we won't see it often, but nice suit photo, very CFO with the materials as well.

Q

There's a great stat besides just in the letter on 90% of fiscal year revenue coming from – you've generally always run a consistent long-term playbook. So, just wondering, is that number fairly consistent with prior periods? And then on the other side of that, if we do see some moderation of the newer cohorts, are you confident that there is a catch up for the newer cohorts you're landing can similarly contribute to the model as you work through it just given the experience and expertise you've gathered there? Thank you.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

Thank you for the compliments on how good I look in a suit. I appreciate that. And you're right, we won't hopefully see that too often in the future.

A

We said historically, yes, that 90% of our revenue in any given year comes from our existing customers. And we were chatting just before on this call that if you think about the results we're getting this year, they're seeds we planted years ago, and the seeds we're planting this year come to bloom in the years henceforth. And so, this is not a business where we are trying to have a very extensive enterprise sales force produce a particular number in a particular period. We think very carefully about the long-term return characteristics of all the investments that we make in any point in time.

And so that 90% number, we continue to see that, like, that's not likely to change in any particular time. But we really think about the long term, the investments that we're making now are paying off over a two to three-year period.

Michael Turrin

Analyst, Wells Fargo Securities LLC

Thank you.

Q

Operator: Your next question comes from Arjun Bhatia from William Blair. Go ahead, Arjun.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Terrific. Thank you, guys, for taking the question and congrats on a great quarter. I know you guys addressed the macro a little bit in the shareholder letter, but I'm curious, as it relates to migration specifically, would you expect the shape of migration to change at all just given the macro situation? Do customers pause a little bit? Do they reconsider or do they say, hey, the total cost of ownership is there and I'm going to go full steam ahead? What are you seeing and hearing from partners and customers on that front?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Yeah. This is Cameron and I'll take that one. So, as you know, this migration journey has been going on for a couple years now. We announced the server end-of-life over 18 months ago and gave customers more than three years heads-up to make a decision on migrating to the cloud. So none of this is a surprise.

Many are in the different stages of their planning, whether that's from a technical perspective or budgetary perspective, and we are increasingly getting good at those conversations about, honestly, the larger ROI savings that customers get when they move to the cloud, whether that's reducing administrative costs, their own hardware costs, and of course, unlocking a ton of new innovation in our cloud.

In addition to that, we have a Forrester Total Economic Impact report where we've actually done deep research into the overall cost savings that customers get when they actually move to the cloud. So, the short answer is, no, our migrations plans continue as planned and we are very, very happy with the results to-date and you saw a lot of that in our recent Q4 results.

Operator: Your next question comes from Jim Fish from Piper Sandler. Please state your question.

Quinton Gabrielli

Analyst, Piper Sandler & Co.

Q

Yeah. Hey, guys. This is Quinton on for Jim Fish. Thanks for taking our question. Sticking to the demand side for just a second, is there anything you can call out from a geographic perspective in terms of weakness or relative strength? Looking at the numbers here, it looks like really strong growth across all geos, but wondering if there is one specific place that you're maybe keeping your eye on more than others. Thank you.

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Thank you, Quinton. Cameron here again. I'd say we are being exceedingly vigilant across watching all stages of our funnel, whether that's migrations funnel, the editions upgrades, retention rates and, of course, our new customers coming in. And this really sped up with the Russia-Ukraine war back starting in February. We have been keeping a very special eye in the EMEA region.

The good news as of to date is we have yet to see any specific trend geographically or even in industry segments or in customer size that gives us pause or worry to date. So, something we continue to watch like a hawk, but there is no new news to share today.

Operator: Your next question comes from Gregg Moskowitz from Mizuho. Please go ahead.

Gregg Moskowitz

Analyst, Mizuho Securities USA LLC

Q

Okay. Thank you very much and congrats on a very good quarter as well. Has there been any change to the mix of products sold over the last few months? Anything different with regard to customer prioritization?

And then just a quick clarification, just to help everybody with their models, if I may. I believe consensus was projecting data center revenue growth somewhere in the low to mid-20s for fiscal 2023. And given the comment in the shareholder letter about moderating growth after Q1 being somewhat vague, I'm just wondering if you're able to tell us if you're comfortable at this time with where those consensus numbers stand. Thank you.

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

This is Cameron. I'll speak to the mix. I'll let our new Interim CFO handle the second part of that question.

As far as the overall mix, no, we have not seen any significant shifts in customer demand across our product lines. I do have to continue to call out the strong demand we continue to see with Jira Service Management as one of our strongest cross-sell motions, surpassing 40,000 Jira Service Management customers to date. And we just seem to have struck a vein there in the market with a very compelling offering that's very feature complete, very easy to use, as well as highly competitive from a pricing perspective.

But I don't want to take away from our other products, Jira Software, Confluence, Trello, you name it, continue to see strong demand across the board as we continue to see people embracing digital transformation and needing tools to help ride – take these large technical projects that they're running and our tools help manage those projects throughout as well as this cultural transformation we continue to see as all of us are figuring out this new way of working, whether it's remote, back in the office or hybrid. We continue to see demand for collaboration products continue to be strong.

Hand the second off to Scott there.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

A

Yeah, just your question around do you see shape of revenue, again, as reminder for those people new to the Atlassian story, we have and end-of-lifed our server offerings. And so they have to make a choice whether they move to our cloud directly or if they're – have a longer process or a longer timeframe, they might choose to move to data center as a stepping stone to moving to cloud. And so we've been really happy again with all our migrations and actually happy about a third of our migrations come – we said that in our Investor Day, about a third of our migrations come from the data center customers already. And so we're really – all directions head towards cloud.

Now, specifically in our shareholder letter, we highlighted in terms of the data center revenue, maintaining high growth through Q1 before moderating over the remaining three quarters. And we can't give any sort of more details on that but really that's just to give you a hint to the seasonality that we might see over the next four quarters in terms of how we think those migrations might end up happening.

Gregg Moskowitz

Analyst, Mizuho Securities USA LLC

Q

Okay. Thank you both.

Operator: Your next question comes from Brent Thill from Jefferies. Brent, please state your question.

Luv Sodha

Analyst, Jefferies LLC

Thank you. This is Luv Sodha on for Brent Thill. Wanted to ask a real quick question on margin this quarter. It looks like there was an increase in investment on R&D, and it sounds like you're planning to continue that into the next year. Could you maybe give us some color into where these investments are being directed to? Thank you.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

Yeah. Thanks for those questions. So starting at our Investor Day, we had a discussion with you and our shareholders about the incredible opportunities we are seeing across our business, and those opportunities are kind of in every corner of the business. And as a management team, we think long-term and we think about how do invest behind those opportunities. And there are a myriad of them, but a couple we've highlighted in the past are our customers migrating to the cloud and we're seeing incredible demand for that migration. And if we can improve the throughput of those customers migrating to the cloud, that's great for them and it's great for us.

We've also seen incredible demand for our ITSM products in that market. And again, the features we can add there and getting our customers onboarded to those products is great for us and for them. And I can go on, but as a result of all these opportunities, we made a decision to invest heavier behind these opportunities than we had before. And as we said in our Investor Day that we expect margins for FY 2023 to be in the mid-teens.

And so those areas of investments are, as you mentioned, are largely in R&D. We are sort of really seeing huge investment there because of the features and getting our cloud to the stage where it can accommodate 100% of our customers requires more features. You will also see some investments kind of in other areas of P&L because, for example, there's some hand-holding to get our customers across. That doesn't show up in R&D as well. It shows up in other areas in the P&L. So largely R&D, but you may see some other areas of the P&L impacted just to the way that we're helping our customers migrate.

Luv Sodha

Analyst, Jefferies LLC

Perfect. Thank you.

Operator: Your next question comes from Alex Zukin from Wolfe Research. Alex, please state your question.

Alex Zukin

Analyst, Wolfe Research LLC

Perfect. Thanks so much. Hey, congrats on a great quarter. I guess maybe just two from our side. When you think about the macro impact that you are seeing in the business, I think you called out a slightly slower conversion of Free customers to paid customers. I guess when you dissect what's happening in the pipeline, why do you think that's the only macro impact you're seeing versus migration delays or versus longer sales cycles and the larger customers or we're not seeing kind of some of the other impacts that other companies are seeing? I think what are you learning in real-time as you analyze the data in the demand environment? And then I've got a quick follow-up.

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Yeah. I can cover that first piece. This is Cameron again. So as you mentioned and you see this in our Q4 results, across the many funnels we operate, whether that's our migrations, our editions upgrades, our cross-sell of products, our overall retention continues to be exceedingly strong. And that's been great to see and that's been supporting our net expansion rate we've already discussed on this call here. And largely what you see is existing customers continue to have demand for what our products do to help their teams work more productively in the future.

As far as that slight thing that we've mentioned in the shareholder letter, just so you all realize that we land all of our net new customers in Free plans. And this is – relatively, we're about two years into this experience, but we continue to have many, many, many thousands of customers signing up in Free plans and they either need to add an 11th user, which then they get to pay gate the 11th user or simply they want more premium capabilities in our standard and premium editions. Those are the reasons people enter their credit card.

And the one thing that's worth calling out that we've seen literally just in the last month is that the cohort of customers that came in, in the April, May, and June timeframe are converting to those paid plans at a slightly slower rate than what we've seen in previous quarters. Now, I'd love to say that's specific to a product or a geography or an industry. There's no specific customer segment there. It just seems that, in general, those cohort of customers that are signing up in the last quarter are using the products. They're activating, they're getting value, but they simply just haven't put those credit cards and hit those paid walls yet.

So that's one of those areas that we continue to be vigilant. We have multiple analytics teams, multiple growth teams, as well as our onboarding and R&D teams that are focused on ensuring that those customers remain active, and that gives us more chances to convert them to paid plans in the future. That does not take away from the continued growth we see in our existing customer base. That also drives more than 90% of our revenue in existing year.

Alex Zukin

Analyst, Wolfe Research LLC

Q

Perfect. And I guess maybe just going back to the data center part of your business, the extraordinary growth that you're seeing, I think accelerating growth in the quarter, how much of that growth is from data center customers expanding versus understanding what the existing customers are growing like within data center to get a sense of the growth that you're seeing in data center coming from server migration to data center? In addition – and I apologize for the multi-part question – just the range of migration activity from data center to cloud versus server to cloud in that 10 points of migration as a driver for the 50% cloud growth.

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Got you. I think I can address this. So, overall data center demand, I'll hit that first and then we can talk about the server to cloud or data center to cloud journey. So, as like we've already mentioned, this server end-of-life message, we gave customers more than three years heads-up. And what you see customers doing every quarter is increasingly optioning out of going to cloud, which obviously that's where we lead with, that's where we have been putting all of our incentives to get customers to go to the cloud so they get as most innovation as possible or they can choose data center. And many are seeing, either way, it's an increased investment and commitment to Atlassian long-term. And we see that those are two good decisions for customers.

However, when those customers jump to data center and we see this again and again, they're seeing that as just a stepping stone to that cloud journey, but it gives them more optionality down the time, and of course, data center is a fantastic product. So we've historically said it's roughly 30% of our cloud migrations come from data center customers, which proves that stepping stone statement and I don't specifically [indiscernible] (21:40) of how much that drives into the overall 10% growth that we've shown that drives our overall cost growth, but you can see roughly a third of our customers are coming from data center.

That's all I have to share. Scott, did you have anything to add on that? Okay.

Operator: Your next question comes from Adam Tindle from Raymond James. Adam, please state your question.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Okay. Thank you very much. I just wanted to touch on the investment period and operating margin trends. You talked about mid-teens in fiscal 2023 playing offense and I think you said lower in the second half of the year. I'm wondering if that's indicative of a multi-year period of investment here. You certainly earn the right to invest based on what we've seen so far. I just wanted to level set investor expectations since I think Street is modeling improvement in fiscal 2024. I'm not sure if that's consistent with how you're thinking about things. Thank you.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

Thank you, Adam. Just a reminder to everyone what we said back at our Investor Day, which is Atlassian has an incredible business model. And if you look historically over the [ph] arc of time (22:52) both before us being a public company and during the seven years we've been a public company, this business model does generate large amount of free cash flow and margin returns. And so that's sort of the fundamentals that we have in the business. And we look at the long-term opportunities like they're more abundant than we've ever seen before, and that's the reason to invest.

Now, in your specific investment period, what we've said is that FY 2023 is going to be an investment year and we guided to the mid-teens margins for FY 2023. We haven't given any guidance for FY 2024 and we'll be doing that at the end of FY 2023.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Thank you.

Operator: Your next question comes from Peter Weed from Bernstein. Peter, go ahead.

Peter Weed

Analyst, Sanford C. Bernstein & Co. LLC

Thank you. So, taking a look at kind of your overall migration plan, I think you had originally anticipated maintenance shrinking down a little bit more than maybe it's seen now. And you're talking about a year from now getting to \$75 million, which I think was maybe a little bit of a slower ramp than at least I had been anticipating. How are you seeing that roll off of your existing customer base? Has it been stickier and is it something where

you're happy to spend more time and effort encouraging customers to migrate? And how do you see that affecting the curiosity of the cloud migration itself?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Yeah. This is Cameron again. As we've mentioned, migration demand remains very strong. And that server customer base, they effectively have till February of 2024 to make a decision on where they want to option out, whether it's going to data center or whether it's going to cloud. Obviously, we continue to remove any blockers or any reasons why customers would not adopt our cloud and we give people plenty of incentives along the way to move to our cloud offerings.

The good news across the board is we continue to see retention rates maintain high for the existing – the entire server customer base throughout this. So as we continue to see server renewals happen, we see people opting out to data center and cloud. The good part there is we continue to see that these customers continue remaining – they're loyal to Atlassian and largely figuring out what the best technical and business decision long-term is for their companies.

We have been focusing on cloud and as we've already mentioned, we are largely in line with our migration plans to date. So we'll continue to be vigilant there over the next year as we continue to incentivize our customers who choose cloud.

Peter Weed

Analyst, Sanford C. Bernstein & Co. LLC

Q

And I think you've been investing in some cloud migration personnel. Do you see that being kind of like fully built out or are you seeing that you're going to have to continue to expand that personnel to see the success of the group?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

This is Cameron again. Yes, so we have a dedicated cloud migration management and migration support engineers, as long as well as a dedicated migration tooling and a variety of people that can come and help these customers through the more technical migrations. We did make significant investment in the previous fiscal year across those teams and we believe they are fairly stable to date and can handle the volume that's coming in over the next coming quarters.

Peter Weed

Analyst, Sanford C. Bernstein & Co. LLC

Q

Thank you.

Operator: Your next question comes from David – Steven Koenig from SMBC Nikko. Steven, please go ahead.

Steven Koenig

Analyst, SMBC Nikko Securities America, Inc.

Q

Great. Hey. Thanks a lot for taking my question. So, let's see, I'm wondering regarding your hiring and your investing that you've been talking about, your comments on your plans to hire are certainly borne out by your – as we look at your job postings, they remain pretty solid, whereas a lot of other vendors are cutting their hiring plans.

I'm wondering how is your hiring progressing relative to plan in terms of your progress in finding the talent that you want? And then if I can just add a quick addendum, any textbook pricing adjustments of note since your February 15 price increase on server and data center? And that's all from me. Thanks very much and congrats on a great quarter.

Michael Cannon-Brookes

Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp. Plc

A

Hey, Steve. It's Mike here. I can take that [indiscernible] (27:14) getting a lot of product questions on today's call. So, let me jump in and take one of the talent ones. Look, we've been pretty clear, right, that we're playing offense. We continued to tell that quarter in, quarter out. We're using this period of time to deepen our strategic position and increase the advantages we have over the competition, right? There's less VCs out there with wheelbarrows of cash funding competition and so we think we have a really good opportunity going forward. We also have spent a lot of time retooling our hiring pipeline over the last two years and are really, really excited with where we stand at the moment.

So we've had, I believe, our two biggest quarters of hiring in the last two quarters and we continue to do so. Obviously, we don't just look at the volume of hires although that's sort of an absolute number marker. We continue to push quality of the talent available and we think that that will get easier in difficult circumstances. And also, obviously, making sure that the cultural fit and other things at Atlassian, which is incredibly important, and incredibly difficult and a huge challenge for us to do as we continue to scale. There's no doubt, as Scott mentioned, the majority of hiring is going to R&D to try to, again, deepen those strategic positions that we already have.

The last thing I would say is just a reminder that we made the same or similar sort of play in the 2008, 2009 period. We paused for a little while then and then we realized that we were in a very strong position as a company relative to the other companies out there. And so we hired well through that period and we saw the benefits of that for the three, four, and five years afterwards as we got a real updraft with the products coming out and the results of those products. So, we believe we have massive opportunities in front of us in all three of our markets and as such, we're hiring behind them.

Steven Koenig

Analyst, SMBC Nikko Securities America, Inc.

Q

That's great. Can you guys comment on is there any pricing actions of note paid in the last six months since that February price increase?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Yeah. So, this is Cameron. As you already mentioned, we did have price increases on our server and data center products. In February, all of our pricing changes were made public, and we – across the board and they're all available on our websites for all of our customers, as well as we gave our customers a relatively decent heads-up on these price changes, so they can plan their budgets accordingly. No other price changes to mention and our pricing strategy remains consistent.

Steven Koenig

Analyst, SMBC Nikko Securities America, Inc.

Q

Great. Great, well, thanks very much for the color.

Operator: Your next question comes from Keith Weiss from Morgan Stanley. Please go ahead, Keith.

Q

Thank you for taking the questions. This is [indiscernible] (30:10) for Keith. Somewhat annoying, we had another question on sort of the case for investment. As we sort of look at where the business stands today, you have a – it's a \$3-billion business, you have a 250,000 customers, I think 10-plus monthly active users. If you look at sort of where you're trying to take the business, getting to 1 million customers or 100 million monthly active users, expanding from developers and IT to line of business teams with the Work Management initiatives. As you expand into these newer markets and these longer tail of customers, are the unit economics from here going to be as attractive in terms – versus what the business you've built today to get to this 3 billion and 250,000 customers in terms – I was wondering if you could sort of frame out how you think expanding into these – into the longer tail of users and customers and product markets, what does that do to the sort of unit economics of the business?

Michael Cannon-Brookes

Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp. Plc

A

Sure. Mike. I can take that again. Look, I think obviously we feel bullish about our unit economics at the moment, and I don't see why that would change going forward. And we've always been very prudent in terms of capital in the business and continue to invest in very high ROI opportunities as we look forward.

You mentioned some of our numbers there. Obviously, there are millions and millions and millions of businesses in the world. There are around or approximately 1 billion knowledge workers. So, we have a huge amount of expansion possibility even just inside our existing customers. As Cameron mentioned earlier, we remain north of 130% in our NER numbers and north of 140% in the large customer segment, and we saw that again this quarter.

And so, from the point of view of expansion in those large customers, we have many, many millions of employees that we do not touch in those existing customers. And you see that in – specifically in our Work Management segment where Trello and Confluence and Atlas are continuing to get further and further into an organization and look more to the wall-to-wall access to wall-to-wall employees within those companies.

I think the other thing I would say is that we continued to, as Cameron mentioned earlier, be incredibly focused on not just the unit economics of our funnel, the product-related growth funnel, in terms of free and our evaluations and trials. And we're obviously incredibly well-instrumented there and we really understand the value of spending a dollar on marketing or sales and the conversion rate and expansion through our customer base. We've got 20 years of experience doing this. I believe we're absolutely best-in-class and continue to improve and evolve every single year.

We also are really, really good at the enterprise and premium expansion activities when it comes to bringing in more human power and more activity to expand customers across the product sets. And again, we've got a whole lot of new products coming out. But also the same focus on being very, very capital efficient when it comes to those sales motions. We don't just take it in the automated product-related growth funnel. We take it at the same time in all of our sales activities. We're very proud of how we do that and we have to keep raising the bar on that every year. I don't think long-term it should change the unit economics.

Q

I really appreciate the thoughts and congrats on the great data center and cloud subscription results this quarter. Thank you.

Operator: Your next question comes from Ari Terjanian from Cleveland Research. Ari, please go ahead.

Ari Terjanian

Analyst, Cleveland Research Co. LLC

Q

Hi, team. Thanks for taking the question and congrats on the great results. Just wanted to double-click on the Deutsche Bank cloud deal that was called out in the press release or the shareholder letter. Was just hoping if you could provide some more detail on that opportunity. Is that migration complete or is it just the signing? And what do you think caused them to pull the trigger? Because I know regulated industry is banking, Germany, Europe, these are areas that historically are more hesitant to move to cloud. So, I was just wondering if you could please provide some more color on that deal. And if you think it could be a beachhead and cause others in these geos and verticals to start moving? Thank you.

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Great. So, this is Cameron again. Yeah, I was deeply involved with Deutsche Bank for quite some time back. They've been a customer for many years. They have been a data center customer for many years. And we've been speaking about the cloud opportunity and journey with them for quite some time. But it shows – I think you nailed it right there. It's a German bank, highly regulated, massive scale, like you name it from a requirements perspective, they had it for our cloud. And it's a testament to the investments we've made over the last couple years in performance, in scale, in regulated things like bank fees, specific financial services, regulation requirements in Germany. That allowed us to open up that door and have that serious conversation about getting them to the cloud.

To answer your question, no, we have just started the cloud journey. We've largely – they've checked all the boxes to get them to adopt our cloud, and we've started our migration plannings to just begin moving their users and data. Then that'll be a multi-month or multi-quarter journey with the size of deployment and complexity that they have, as well as how mission-critical our applications are for the bank.

I mean, they literally are running on us every single day. Many of our customers are saying that our applications are more important than email for getting their work done inside the organization. So, it's something that we have to plan out very diligently with them. But they've been incredible partners throughout this exploration of cloud, and we are looking forward to having them 100% on the cloud in the upcoming quarters.

Ari Terjanian

Analyst, Cleveland Research Co. LLC

Q

Thank you.

Operator: [Operator Instructions] Your next question comes from Fred Havemeyer from Macquarie. Fred, please go ahead.

Frederick Havemeyer

Analyst, Macquarie Capital (USA), Inc.

Q

Hi. Thank you. I wanted to ask about your net retention rate because, throughout this year, you've been posting or discussing strong 130% – rather north of 130% cloud net retention rates. I saw in the shareholder letter today that you noted that larger customers were topping 140% cloud net – or rather net expansion rate. So, wanted to ask could you help to characterize what's driving that? Is that something that is a seat-based expansion, cross-sell or upsell, reach in to non-technical departments, expansion with new technical departments? Anything to just kind of characterize that and help us understand where this growth is coming from would be greatly appreciated.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

A

Fred, I appreciate you asking the question. Yeah, so the numbers you quoted are correct. And I think we've stated and announced from our Investor Day last year and reiterated some of it in our shareholder letter today. Now, if you think about Atlassian's business model, it has been historically and continues to be a land-and-expand motion where we land inside a part of an organization, maybe a small team, a couple different teams or even multiple teams across the organization and maybe aren't even coordinated with each other. And from there, they see the incredible value in our products. And they expand on a number of vectors. And those vectors are, like, say, the number of seats, maybe starting with one small team all the way up until large enterprise deployments, such like Deutsche Bank that we talked about with tens of thousands of seats. And so, there's a safe aspect where you land and expand there.

And we also see that customers expand on a product basis, right? They start with one product; they then see the value that they've got. They come back to Atlassian and discover what other products that we have that can do – solve their problems and how well that these products work together, particularly in cloud where they're deeply integrated. And so, that is – that's another one.

We have different additions now with premium and enterprise. And so, customers love the functionality. And they want to unlock additional functionality in the products. And so, they're willing to pay for our premium and enterprise versions as well. And I can go on, but I one want to touch upon is also our third-party application marketplace. We have one of the best marketplaces in enterprise software and customers can easily adopt incremental functionality, a whole new areas of functionality in our marketplace.

And so, with the expansion across all of those vectors in various ways and there's not typically one specific path that we see our customer take, but we're very comfortable and feel very great about that going forward, given how sticky our products are and how much additional functionality they can unlock across the organization once those start to become a new customer.

Frederick Havemeyer

Analyst, Macquarie Capital (USA), Inc.

Q

Thank you. If I can get another one here and take up more time, I wanted to also ask about scaling because, in the shareholder letter today, I think you also noted that 35,000 user cloud instances are now available to your entire customer base. And if I recall getting to that scale has been a journey and looking across the market, some of the other project management tools that are out there have some difficulties really achieving scale for large a number of concurrent users. So, I wanted to ask what has that journey been like? And generally, what does it take to build such a highly scalable, collaborative, live project management tool? And would you view that as a competitive moat?

Michael Cannon-Brookes

Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp. Plc

A

Sure, I can take that question. It's Mike here. Look, [indiscernible] (40:22) a testament to our R&D teams and specifically the infrastructure engineering teams there in terms of scaling our offerings in the cloud. There's a few things I would point to there, so a reminder for anyone listening, with a single instance of a Jira software in the case that you mentioned there, we started our cloud journey at about, I think, 1,000 or 2,000 seat range. We expanded to 5,000 then to 10,000. I think we've entered 25,000. And now, we've just GA-ed 35,000 and I believe we have 50,000 in early access programs. So, continuing to scale a single instance of Jira software.

At the same time, we've scaled lots of other parts of our back end infrastructure to allow further increase beyond that amount in a single Jira software instance. So, you see that in our enterprise division where you get unlimited instances so you can have lots of 35,000 user instances at the moment. And obviously from an identity and scaling perspective, you can go beyond there.

I would say it's really a testament to our continued investment in our customers and the continued – the world-leading amount of revenue that we spend on R&D because this stuff is hard. It's just one of those problems that's very, very difficult. You need a lot of hard work and discipline over a long period of time to continue to work out what parts of your infrastructure [ph] are on (41:52) scaling and continue to obviously be ambitious and push that ceiling upwards. We have many, many customers on premise and data centers who are well beyond the 35,000 limit. So, you won't see us stop there. We'll continue to push that limit higher and higher as we work with those large customers.

Lastly, I would say it's a testament to the platform that we built because most of that scaling doesn't actually happen in the Jira software world. It happens in the Atlassian cloud platform and our infrastructure ware is below that. Everything from the networking layer all the way through to databases, various shared services we have, et cetera, all have the scale to handle that, whether it's serving videos or whether it's mentioning users. Collaborative software is all about connecting with other people on your team. So, if you mentioned a user and it takes an awfully long time, it's a very poor customer experience. You get low customer satisfaction. So, it's not just about scaling the sheer numbers. It's making sure that all the user experiences happen at scale very, very fast and there's huge amounts of smarts and AI and machine learning, for example, to make sure that when you mention a user, we dig across your 35,000 employees and find the exact person that you're trying to find with a couple of keystrokes as fast as we can.

So, look, we spend a lot – awful lot of time and effort on that and we'll continue to do so, probably reflected in our NER and – great cloud numbers and more to come.

Operator: Your next question comes from Kash Rangan from Goldman Sachs. Kash, please go ahead.

Kash Rangan

Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thank you very much. I wanted to say congratulations on not only the quarter but hiring Joe Binz, a terrific, terrific executive. On that thought, how comfortable are you with a new CFO of Joe's caliber coming in, that you have reset the margins and that you – we can be very comfortable that you have factored in all possible investments that the company needs to make to achieve this cloud transition?

Because I would imagine that a new CFO coming in probably wants to ensure that the Street's level set with respect to margin guide because Joe has a background with Microsoft [ph] and Intel (43:57) cloud transition. So,

I'm just wondering, how did you all get comfortable with the level of investments that have already been spoken for and guided into the model? That's it from me. Thank you very much and congratulations.

Scott Farquhar

Co-Founder, Co-Chief Executive Officer, Interim Chief Financial Officer & Director, Atlassian Corp. Plc

A

Thank you. This is Scott here. I'll answer that. Mike and I have been around for 20 years running Atlassian. We just celebrated our 20th anniversary in the last few months. We've been public for seven years. And whilst each individual CFO coming into Atlassian brings a whole bunch of their experience and their opinions around how it should work, the philosophy about how we run the business and how we set guidance and how we interact with you, our shareholders, in an open and transparent way, that is really set for Mike and I at the top.

And so we're really excited for Joe to get here with his deep experience with Microsoft to – that had their own cloud transition. But I don't expect there to be any material changes to the way we guide, to the way we invest and the way we interact with you, our shareholders, as a result of that. And I'm super excited to have Joe on board because, obviously, he's going to be a great addition to the team. I'm super excited about his ability to help us allocate capital across the amazing opportunities that we have in front of us. And that's really, really exciting given he's done that extremely well at his previous divisions.

Operator: Your next question comes from Michael Turits from KeyBanc Capital Market. Michael, please go ahead.

Q

Hi. This is [ph] Billy (45:37) on for Michael. Thanks for taking the question. Can you just give us an update on the regulatory work you've been doing around the public sector, FedRAMP and maybe different industry verticals, and how much opportunity you think is out there once you unlock these avenues?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

This is Cameron. I can speak briefly to that. So, as we mentioned before, over the last couple years, actually many years with our cloud platform, we continue to invest in not just scale, as Mike just mentioned, but all of the regulatory data and compliance requirements that our very, very diverse customer base has. And in addition to that, we've been able to knock off these cloud requirements and you see this every single quarter. And every single quarter as we announced these new capabilities, a new cohort of customers gets unlocked to start their cloud transition.

In addition to that, we do publish all of our future-looking roadmap in this area up on our public cloud roadmap. And that gives just increasing confidence for our customers so that they can plan ahead as well as engage with our teams on when they should actually start their migration journey. And that's been a critical part of our overall conversation going forward.

So, we've done – in the last just 12 months, HIPAA, [ph] band fee (46:50), we have all of our SOC 2 compliance and we continue to have additional requirements across the board. And we are continuing to our work on FedRAMP. Our federal customer base is significant and we do have customers across the federal customer base all on server and data center today. Great part there is overwhelming majority of those agencies actually have cloud-first mandates, like all of them are simply looking for the ability to go to cloud. And we continue to invest in

our cloud platform to hit up those specific requirements. But it doesn't stop with that ramp. There's still many other specific industry-related regulatory efforts that we will continue to invest in.

In addition to that, I do want to call out our Forge platform, which was our new capability to allow marketplace apps to be run within the Atlassian cloud infrastructure. This has opened up even more opportunity for our customers to build and deploy apps, as well as our marketplace partners to build apps and have them basically secured within the cloud platform, giving our customers even more confidence if they're in highly regulated industries.

Operator: Thank you. And that concludes our question-and-answer session. I will now turn the call over to Mike for closing remarks.

Michael Cannon-Brookes

Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp. Plc

Thanks, everyone. Just thank you for joining the call. Two small things before we sign off here. Firstly, congratulations to Scott on his Interim CFO role. I think he did a fine job today. We're super excited to have Joe join to take the wheel. Barring any emergencies, we look forward to him joining us on our October call.

Secondly, as you saw in our shareholder letter, building on the success of Team '22 earlier last quarter, we'll be holding unique events now tailored to each of our markets. So, we'll kick things off in September, on the 29th of September in San Francisco, in the Chase Center, with a Work Management-specific event that we're calling Work Life. So, please come check it out and see how teams can work differently together.

With that, thank you, everyone, for joining our call today. As always, we really appreciate all of your continued support, thoughtful questions. And last but definitely not least, thank you to all the Atlassians on a fantastic year. We will talk to you on next quarter.

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