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Presentation

Operator

Good afternoon, and thank you for joining Atlassian's earnings conference call for the second quarter of fiscal year 2025. As a reminder, this conference call is being recorded and will be available for replay on 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 of Investor Relations

Welcome to Atlassian's Second Quarter of Fiscal Year 2025 Earnings Call. Thank you for joining us today. On the call with me today, we have Atlassian's CEO and Co-Founder; Mike Cannon-Brookes; and Chief Financial Officer, Joe Binz.

Earlier today, we published a shareholder letter and press release with our financial results and commentary for our second quarter of fiscal year 2025. The shareholder letter is available on Atlassian's Work Life blog and the Investor Relations section of our website, where you will also find other earnings-related materials, 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 a 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 assumptions. If any such risks or uncertainties materialize or if any of the assumptions prove incorrect, our results could differ materially from the results expressed or implied by the forward-looking statements we make. 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 the date such statements are made and we undertake 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 our business performance and 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 recently filed annual and quarterly reports.

During today's call, we will also discuss non-GAAP financial measures. These non-GAAP financial measures are in addition to and are not a substitute for or superior to measures of financial performance prepared in accordance with GAAP. A reconciliation between GAAP and non-GAAP financial measures is available in our shareholder letter, earnings release and investor data sheet on the Investor Relations section of our website.

We'd like to allow as many of you to participate in Q&A as possible. So out of respect for others on the call, we'll take one question at a time.

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

Michael Cannon-Brookes
Co-Founder, CEO & Director

Thank you all for joining us today. As you've already read in our shareholder letter, we executed well in Q2 as we scaled past $5 billion in annual run rate revenue, driven by subscription revenue, which grew 30% year-over-year.

Our investments in our key strategic priorities of serving enterprise customers, delivering rapid innovation in AI and breaking down knowledge silos with our system of work are driving momentum across the business and increasing customer commitment to the Atlassian platform. Companies like Cisco, DHL and Reddit are turning to Atlassian to help solve their toughest team collaboration challenges, bridging the

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gap between their technology and business teams. And our world-class cloud platform with AI threaded throughout is delivering. With more than 20 years of data and insights on how software, IT and business teams plan, track and deliver work, we're uniquely positioned to help teams across every organization on the planet work better together.

Today, more than 1 million monthly active users are utilizing our Atlassian intelligence features to unlock enterprise knowledge, supercharge workflows and accelerate their team collaboration. These features are clearly delivering value as we've seen a number of AI interactions increased more than 25x year-over-year. These powerful AI capabilities along with automation and analytics are also driving increasing adoption of Premium and Enterprise editions with sales to higher value SKUs up 40% year-over-year. With the breadth of our offering, the pace of innovation, and the recognition of our product leadership across all the markets we play in, the Atlassian platform is incredibly well-positioned to further connect technology and business teams across the Fortune 500,1000.

We had some incredible customer wins in Q2, including a record number of deals greater than $1 million in annual contract value signed during the quarter with some of the largest companies in the world committing to the Atlassian Cloud and embracing the Atlassian system of work. If you're interested in hearing more about the ongoing evolution of our go-to-market motion, check out the Loom that I just posted to our IR website.

The progress we're making across our business and the signals we're getting from our customers reinforces our conviction that we're making the right investments to help us scale to $10 billion in revenue and beyond. We're eager to get after it and build on this momentum, pushing ahead on our mission to unleash the potential of every team.
With that, I'll pass the call to the operator for Q&A.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from Keith Bachman from BMO Capital Markets.

Keith Frances Bachman
BMO Capital Markets Equity Research

Congratulations on the solid results. Mike and Joe and Martin, I wanted to ask you about the goals with really the larger enterprise accounts. Mike, in the shareholder letter, you reiterated the sort of 10% of your revenues are being driven by the large customers. And I really wanted to hear a little bit about how you increase that penetration. Now certainly, part of it is go-to-market. In your Loom you referenced that you now have hundreds of sales reps versus virtually none previously. Where does that go to you think over the next 12 to 18 months as you continue to try to penetrate the larger accounts?

And secondly, from a technology perspective, where do you think you have the most opportunities to harness the situation in terms of what product areas? I would think JSM would be the largest opportunity, but I wanted to hear a little bit more about it because I'm not sure that would beat Jira seats specifically on the software development side, but love to hear any color on those 2 areas.

Michael Cannon-Brookes
Co-Founder, CEO & Director

Thanks, Keith. Look, it's a broad question to start with. But look, I would say, firstly, we had a great Q2 with -- in the Enterprise segment, just fantastic execution by the sales and success team across the board. So when you asked about which markets or which products, one of our advantages right now is a really broad-scale growth profile. Jira, yes, continues to expand seats really strongly in business teams as well as technology teams. Again, we combined Jira Work Management and Jira Software together after the customer demand to do so because of the desire to connect their business and technology teams together. So that gives us a great expansion platform across those larger enterprises. There are lots of seats and lots of employees that we don't yet touch in most of those larger customers. So that is a huge, obviously, growth vector for us going forward.

On the go-to-market motion, just generally in the Enterprise, I would say, look, we have a very highly effective flywheel, great financial profile as I'm sure you're aware, that lands both small customers and big customers in terms of the size of the company, small team landing, but both of those. Where we use our Enterprise overlay as we keep evolving and adapting our go-to-market motions to make those customers more and more successful is in how we take that increasing landing size and grow it into a larger impact for that customer. As you see, we have more than 500 customers spending $1 million. We had a record quarter of $1 million deals. That is showing across the board of products, across the set of markets we have just great momentum as customers continue to pull us in, right?

The CIOs and CEOs I speak to continue to want to form a deeper strategic relationship with Atlassian, not because of any single product we have, but because of our R&D speed, the innovation we're delivering. AI is just the latest example of that, but also the breadth of the platform, the amount of things they can see it improving from their goals all the way down to the day-to-day work that they do. And that's -- it's really positive for us. It's really giving us a good sense of momentum.

Operator

Your next question comes from Ryan MacWilliams from Barclays.

Ryan Patrick MacWilliams
Barclays Bank PLC, Research Division

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One for Mike. It was great to see Rovo at the Team Barcelona Conference. I'd love to hear about how Rovo adoption and progress has been so far and how you think features of Rovo like AutoDev can change the daily workflow process for developers.

Michael Cannon-Brookes
Co-Founder, CEO & Director

Thanks, Ryan. Look, Rovo, as all of the AI world, it's pretty early days. There's no doubt about that in what's a massive change in the technology industry, which is a very positive change. I would say, right now, we are very pleased with the feedback we're getting from customers about what we are trying to build. And the reception from customers, those who have proof of concepts running, those who've deployed and those who have purchased continues to be incredibly positive. Interest, evaluations, all at really high levels as customers are realizing the value and also playing with these technologies in their own businesses and seeing how they can adapt and work.

We -- obviously, at the broader level, as we've talked about with Atlassian Intelligence passing 1 million MAU, is a major milestone for us, right, across all of the Atlassian Intelligence features, which includes Rovo, a huge milestone in the breadth of the usage that we have, which is always our #1 thing that we try to do with Atlassian as a result of our R&D, 25x improvement in the number of features used over the last year. And it is driving monetization of those Premium and Enterprise editions as we talked about with growth over 40% in those editions.

In terms of Rovo and how it's trending in AutoDev, we continue to invest heavily, I would say, in the R&D around all things AI. We continue to believe in our strategic advantages that we have there. With Rovo specifically, that's around the quality of search, the depth and density of the Teamwork Graph to enable better answers for customers that are unique and differentiated and the amount of data that we connect to. We shipped a whole lot of new connectors this quarter, and there's even more coming in the quarter ahead to allow customers to really unlock all of the value and the knowledge that they have and enable them with agents to automate a series of different tasks, as you mentioned. That saves their users hours per week.

In terms of AutoDev and the development features, continues to be an area we work on. It's right on the cutting edge. We are delivering a great number of completed pieces of software to customers and to ourselves and an area that we will continue to invest in, but obviously feel incredibly bullish, building on the Atlassian Intelligence stack and then the Rovo Agent platform. So it's all a stack that continues to go there, but great progress made so far. A lot of work still to do to continue to go and chase that customer value. We're excited to get after it each quarter.

Operator

Your next question comes from Michael Turrin from Wells Fargo.

Michael James Turrin
Wells Fargo Securities, LLC, Research Division

Impressive fiscal Q2 results. Joe, I think given it's midyear, just an update to the risk-adjusted framing at the start of the year. Any commentary you can add on how things like expansion or tracking relative to what you are expecting? And how to think about things like transition risk with Brian now starting alongside? Just any commentary on the second half guide, assuming assumptions are still somewhat similar, but your update on the pulse of everything is certainly useful.

Joseph Binz
CFO & Principal Financial Officer

Yes. Thanks for the question. It's a good one. So I'll start with the Q2 trends that we see, and then I'll put it in the context of the guide for the second half. As we mentioned, we've really benefited this quarter from a stable macro environment. And trends in the business were very consistent in Q2 to Q1. We saw continued signs of stabilization in our SMB customer segment and low-touch sales channel. Paid seat expansion rates in SMB were stable to Q1 and top of funnel health remains healthy. So both of those feel

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like they're in a very good place, having been stable for 2-plus quarters now. And then Mike has talked a lot about the enterprise trends. Overall, very healthy and consistent with Q1 and excellent results on annual multiyear deals, migrations and upsell to Premium and Enterprise editions of our SKUs.

In terms of the guidance philosophy for H2, we highlighted at the start of the year that we had taken a different approach to our guidance this year and that it was more conservative and risk-adjusted than in the past. And we reiterated that approach on the call in October. We continue to believe this is the prudent approach given the 2 factors we previously discussed. The first is the uncertainty in the macro environment and the second is execution risk related to the evolution and transformation of our enterprise go-to-market motion. Nothing has changed with respect to that approach in our updated guidance for Q3 and the rest of FY '25. And we believe the risks we've previously highlighted are still relevant to the operating environment we face in the second half of the year. So I hope that helps give you a sense of how we're thinking about the H2 guide relative to where we are in Q2.

Operator

Your next question comes from Keith Weiss from Morgan Stanley.

Keith Weiss
Morgan Stanley, Research Division

Congratulations on a really fantastic quarter. I want to go back to Rovo, but more broadly, agentic computing. And Mike, you're talking about this being a really exciting and important transformation for the industry on a go-forward basis, something that we definitely agree with. But we're also hearing about agents from a lot of companies, application companies and productivity companies. And it seems like we're getting bombarded with agents from every direction. I'd love to hear your perspective on how agents are going to proliferate into organizations, what the competitive dynamic, if you will, like who's going to be well-positioned for that? And what's the Atlassian right to win in this ever increasingly crowded field for agents?

Michael Cannon-Brookes
Co-Founder, CEO & Director

Sure, Keith, I can -- that's good to hear from you. There's no doubt we've been through these technology transformations before, right? And when we go through them, you run through the hype cycle up and down, and there are certain words that mean something and then mean nothing and then end up meaning something. I think agents is probably squarely in that camp. We -- by that, the word is used everywhere suddenly for all sorts of things that I would argue aren't agents, but you can't control how the world uses the word.

At Atlassian, we take a pretty pure approach to things, and we tend to be pretty clear. We've been very declarative on what we feel is and isn't an agent and how we feel that we are building those agents, right? To me, they have to have goals. They have to be aiming at outcomes. They generally have some sort of personality and character. They have sets of knowledge that they can do and sets of actions that they can take and some sort of control parameters in terms of commissioning and everything else, which ends up making them look extremely like a virtual teammate and represented in the software as such. Again, Atlassian agents are unique in that they can basically anywhere that a human being can be used in our software, an agent can do the same sorts of things. You can assign them issues, you can give them certain sets of knowledge, you can give them permission to certain actions and not other actions, et cetera. So that's pretty differentiated to other people who are building either some sort of a chatbot or fundamentally just something you're calling an agent.

What differentiates us? We've been pretty clear on this, but it's really well worth reiterating. Firstly, we do have a significant R&D investment and an advantage in our ability to deploy that R&D. Why is that important in an agentic or AI world? Firstly, it's moving very quickly. So our ability to build, deploy, get customer feedback and learn in a loop is really, really important in order to navigate these transitions. Anyone who tells you they know where this is going to be 3 years from now is a fool. What I can tell you is that we have to be able to learn really fast and move really fast and take the latest and greatest

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innovations and deploy them and get them to customers quickly. That is the best strategic path to gain that value over time. And we are obviously doing that and I think doing really well in the R&D team and how we do that.

Second, any agent is going to be qualified by the quality of models for sure. So what is underlying these agents is a series of different AI models. We have a very comprehensive multi-model strategy. So we believe that models will continue to get faster and cheaper and quicker to deploy and more capable. Therefore, our Atlassian Intelligence needs to be able to keep adapting modern models as fast as possible. Again, we're running more than 30 models from more than 7 different vendors today. We continue to evaluate new models. Obviously, we had a lot of movement in that space in the last week or 2.

Thirdly, it's all about the data you have, the data you have access to, the quality of that data, the ability to search across that data and the ability to connect it. That's where our investments in enterprise search, very big investment in the last few years and in the Teamwork Graph over a longer period of time. Our graph has made major strides even in the last quarter about the speed of access, the density of the graph, the number of connections we can support, et cetera. That all is the fundamental knowledge layer that gives those agents capability to actually deliver something to a user in whatever form of outcome. And we feel we're very uniquely positioned on the data side at the moment and continue to invest there.

And lastly, it's about the interfaces. So the surface level is really important here, both from a design perspective, but also from the ability to have access to those customers. That's where our more than 1 million Atlassian Intelligence now. We're obviously continuing to grow that number as fast as we can with great features that let us learn in the interface layers, right? Ultimately, customers and users don't use an AI model. They use a piece of software. They use some high-level technology to interact with an agent. How that interaction works, everything below that is up to us to do in terms of the data, the models and the R&D. But we feel really confident in [indiscernible] and are going to continue investing behind that trend.

Operator

Your next question comes from Fatima Boolani from Citi.

Fatima Aslam Boolani
Citigroup Inc., Research Division

Mike, you extolled kind of the virtues of the Loom capabilities. It's been a home run. It's really -- getting really strong adoption in your base, and you really did share some remarkable statistics on engagement and adoption in the base. I was hoping you could spend a little bit of time quantifying the monetization and the uplift that you're potentially seeing to your cloud performance as Loom is being infused in some of your strongest and largest flagship products. And I don't believe Loom is included in your Premium editions, but I would love some clarification on how that's actually moving the needle for you on the cloud side.

Joseph Binz
CFO & Principal Financial Officer

Fatima, this is Joe, and I'll pass it over to Mike for color on this. We don't provide the specifics on Loom's revenue or growth rate on a quarterly basis. You're right that we are pleased with the growth we're seeing, and we're excited by the customer reaction to the recent AI innovations we've been introducing into the Loom product line.

In terms of performance in the quarter, Loom revenue in Q2 was in line to slightly better than our expectations. And you may recall, we did give some guidance on the size of the Loom business when we provided FY '25 guidance and that we said it would be about 1.5 points of impact to FY '25 cloud revenue growth for the year. And so you should be able to use that to back into a rough size of magnitude of that business.

Mike?

Michael Cannon-Brookes

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Co-Founder, CEO & Director

Sure, Fatima. We -- look, Loom is doing very well. There's no doubt about that, and we continue to invest in the opportunity that we see there. I would probably break that answer into 3 parts for me. Firstly, the observations at the acquisition and the reason that we, as a company, fell in love with Loom and use it so heavily and then brought it into the Atlassian family. The ability to communicate and collaborate through video in a rapid form, bringing a really human element to the workplace is certainly resonating with customers, right, in a more distributed work environment, in lots of different areas, that's a really powerful device. And it is a unique capability. It's very different to just "video" per se. It's very collaborative. It's very rapid to create and move.

Secondly, AI is playing out well in the video space, both on the creation side. You see that in Loom AI, we had more than 38 million videos last year using Loom AI features, which is a huge number, if you think about it in terms of the amount of communication and the density of information contained in a video. AI is helping us on the creation side, lots of editing tweaks, titling, these sorts of things, chaptering doing really well, but also on increasingly the actual modification of the video in terms of removal of stop words or allowing people to edit the video like they edit a text document. This is a really important innovation area for us that we continue to invest in, and I think are doing some really good work at a practical application of AI video in the workplace.

On the consumption side also, AI obviously helps you to consume large amounts of video in various ways, giving you summaries and chapters. We're seeing that with the Rewatch acquisition that's moving into meeting summaries and other areas. And generally, Loom's ability to be a search archive for lots of types of video in the Enterprise, AI and the Teamwork Graph and integration in Atlassian are really bringing that to the fore. So we feel really strongly about the Loom road map. It's not included at the moment in any of the Premium or Enterprise editions of, I think you mentioned Confluence or Jira. It's a stand-alone SKU in and of itself.

Operator

Your next question comes from DJ Hynes from Canaccord.

David E. Hynes
Canaccord Genuity Corp., Research Division

Congrats on a nice quarter. Joe, we obviously have your guidance for data center growth in Q3. But can you just unpack a bit of what underpins those assumptions? There are a number of moving parts here in Q3 with the pricing changes, the potential for early renewals to lock in pricing. I think you've made changes to partner commissions. Just help us kind of wrap our arms around that and what you're factoring into the growth rate for Q3.

Joseph Binz
CFO & Principal Financial Officer

Yes. Great question. Thanks for asking. Our Q3 data center guidance for revenue is approximately 7% year-over-year growth. That reflects growth driven by pricing, seat expansion and cross-sell, which we believe will remain healthy but somewhat impacted by macro uncertainty and execution in our high-touch sales channel that I mentioned earlier, as well as continued momentum in migrations to cloud as we continue to deliver significant improvements in the Enterprise-grade capabilities and the value to our cloud platform and as we continue to help our data center customers migrate.

And then lastly, recall that we had significant growth in the prior year Q3 related to server end of support and pricing changes, and that creates a very challenging growth comparable this year.

In terms of the pricing change, we haven't seen any significant or unexpected change in customer behavior from the recently announced data center price changes. Historically, there have always been fairly predictable changes in customer purchasing patterns whenever we implement those price changes. And so when we have those in the plans, we model out the expected impact and we incorporate that into our revenue guidance, which is what we've done this year for the February data center price increases.

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The increases this year are slightly higher than in the past, and we've tried to take a prudent and conservative approach of incorporating that into our guidance. And with respect to those price increases, we haven't seen anything unusual to date relative to historical experience or our expectations in terms of deal pull forward. So we feel like we've captured that in the guidance.

Operator

Your next question comes from Brent Thill from Jefferies.

Brent John Thill
Jefferies LLC, Research Division

Joe, good upside on margin relative to the Street. I guess for the guidance, you're not really flowing that magnitude of margin beat forward into the guide. And maybe if you can just discuss where those investments are going? Is there some onetime investments that you still need to clean up? Just give us a sense of what's happening in the back half of the fiscal year.

Joseph Binz
CFO & Principal Financial Officer

Yes. Thanks for the question, Brent. It's a good one. In terms of the rest of the year, we are expecting operating margins in H2 to be slightly lower than H1. This is driven primarily by 2 factors on the cost side, as you point out. The first is spending we expected to occur in Q2, but actually pushed to H2. So that's a timing issue. And then the second relates to something Mike talked about earlier on the call in that we are going to slightly increase sales and marketing and R&D investments in the Enterprise space in H2. And that's given the strong positive signal we're getting there on the progress and the momentum and the returns on our existing investments.

We believe we can accelerate progress in that area -- strategically important area of our business. So we're going to invest against that. And so when you add all that together for the full year, we expect our non-GAAP operating margin to be roughly flat year-over-year at 23.5% and that's despite the challenging prior year comps related to server end of support. So overall, I feel very good about the expected trajectory of operating margins through FY '25 and how that lays a good foundation heading into FY '26.

And then lastly, I would just say, I continue to expect we will deliver greater than 25% non-GAAP operating margins in FY '27, consistent with our guidance at Investor Day in May.

Michael Cannon-Brookes
Co-Founder, CEO & Director

I just wanted to add on one thing. We -- from a broader color perspective, we're incredibly excited about those go-to-market investments that Joe talked about. There'll be more in a little bit of time as we drive that part of the business further forward. And to reiterate that the long-term targets we gave at the Analyst Day last year, probably about 9 months ago, in terms of the general moderated increase in go-to-market investments as a proportion of total revenue and the moderated decrease in R&D, while those 2 still maintaining sort of historical levels, those long-term targets are still applicable in all the guidance that Joe talked about.

Operator

Your next question comes from Kash Rangan from Goldman Sachs.

Kasthuri Gopalan Rangan
Goldman Sachs Group, Inc., Research Division

There's been a lot of discussion of consumption models interlayed with subscription. I'm curious to get your thoughts, Mike. And also with respect to the price increase, are you going to be offering certain things that will justify the price increase because you've had one series of price increases that we went through a couple of years ago? And I'm curious how -- what has been the customer feedback. Is it because the trade-off is that, okay, we're going to get something more by way of features, maybe there's

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consumption overlay on top of the future product road map? How do we rationalize the price increase in return for the value that the customer is getting from Atlassian?

Michael Cannon-Brookes
Co-Founder, CEO & Director

Thanks, Kash. Let me take those in a reverse order. Firstly, on the price increases, look, we have a long history of continuing to optimize price across our portfolio and in line with the value that customers are getting. Whenever I talk to customers, I remind them of the heavy R&D investment we have, which ultimately results in product improvement, and we have a great history and track record of delivering continued product improvement. If our product gets 25%, 30% better every year as we continue to build out the feature set, customers do realize that, that is worth a moderately increasing price. And as always, philosophically, we keep the value delivered vastly ahead of any pricing as a philosophy. So that tends to resonate really well with customers and is very clear to them. They see our investments, they see the results of those investments, and they're generally happy with it broadly.

On the consumption side, look, a very hot topic it seems suddenly. We have quite a good history in this area, I would say. Obviously, we have a lot of elements of consumption-based pricing already across the portfolio that are already in our results that you see today from Bitbucket Pipelines through Jira Service Management with both virtual agents and assets in the Rovo and Atlassian Intelligence spaces, automation, storage and now with Forge. So consumption-based pricing is something we are very familiar with. I think, over time, it probably will feather into be a broader piece of the overall mix. But again, we continue to learn and adapt as that grows, something we are quite familiar with over time in terms of pricing.

There are definitely areas of Enterprise SaaS broadly or our business, where within some sort of subscription offering, you get a certain amount of usage of a given facility, let's say. And then at some point, you pay for more of that facility, which is orthogonal to your usage of, say, users or whatever the core billing unit is. That's very familiar. Bitbucket Pipelines is a great example. You might have 50 developers on Bitbucket. How many builds you run and how much CPU time you use is kind of up to you. You can use millions of minutes or you can use tens of minutes. Because of the scalable nature of computing, customers tend to understand if they use more minutes, they'll pay us for those pipelines. And again, as long as we keep that value delivery ratio right, it's a good deal for everybody concerned.

So with AI, I don't think it's particularly different to the broader consumption-based philosophies we have, something that we continue to work on and deeper. And again, it's all about us learning and adapting with customers and making sure that they see the value they're getting before that price comes in or the bill comes in and they feel comfortable about what they're paying for.

Operator

Your next question comes from Rob Owens from Piper Sandler.

Robbie David Owens
Piper Sandler & Co., Research Division

Joe, I just wanted to drill down on the gross margin performance, and you did, I think, speak to in the letter, higher gross margins on the cloud side. So just how sustainable is that moving forward? Is that a moving target as some of these new subscription services get rolled out? And as you look at achieving that target operating margin, where should gross margins be in that time frame?

Joseph Binz
CFO & Principal Financial Officer

Yes. Thanks for the question, Rob. Gross margins were 85% this quarter. That was solidly better than our guided range of 84%, and that was driven by 2 things. One is the revenue outperformance and then lower-than-expected cloud COGS in the quarter. It was also up about 100 basis points year-over-year, and that's because higher cloud gross margins are partially offset by the revenue mix shift to cloud.

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In cloud specifically, we continue to benefit from price increases, upsell to Premium editions and engineering investments we're making to optimize cloud infrastructure and customer support costs. So focusing on and managing cloud COGS efficiently now is particularly important given the expected growth we expect in that part of the business.

I'd also say this highlights one of the many benefits of the engineering investment model that Mike talked about earlier that we have here at Atlassian in that we can invest in engineering talent that can be deployed to many things, including solving tough technical challenges that unlock these cost savings and efficiency improvements and serving our cloud customers in addition to product innovation. And I would just say there's been really great work by our engineering and support teams in this area, and there is more to come on this. So overall, we feel really good about the performance there and the overall performance on gross margins.

In terms of long-term operating margin guidance, at the Investor Day, we mentioned that we expected gross margins to be lower over the next 3 years, just given the mix shift in revenue to cloud. We're obviously going to continue to work really hard to reduce those cloud COGS and to optimize cloud gross margins. But that is still the way we think about the long term and that with the shift in revenue to cloud, which has structurally lower gross margins, that will offset -- more than offset the improvements that we think we can drive on the cloud gross margin side. So that guidance from the Investor Day last May still holds.

Operator

Your next question comes from Adam Tindle from Raymond James.

Adam Tyler Tindle
Raymond James & Associates, Inc., Research Division

I wanted to start on cloud growth, maybe with Joe. Paid seat expansion was above your expectation again this quarter. Just maybe level set and remind us where we are on seats. I know it's been kind of stable along the bottom sequentially, but not really growing. Has that metric returned to growth yet? And if not, maybe the timing or expectation on when that might return to growth?

And Mike, on this topic, it's relevant because investors are paying attention to the potential for AI and all this innovation to cannibalize seats. I think you understand kind of that fear or structural fear. Now that you're deploying AI yourself and seeing it in practice, I wonder if you might revisit that structural fear of AI eating seats.

Joseph Binz
CFO & Principal Financial Officer

Yes. Thanks for the question. On the paid seat expansion in the cloud specifically, we are seeing absolute growth in the expansion, but the rate has been stable quarter-to-quarter, Q2 versus Q1. That has been stable for several quarters. Within that overall paid seat expansion rate, we've discussed weakness in SMB. The good news that we see is that paid seat expansion rate in SMB has stabilized over the last 2 quarters. So from our perspective, we feel like we've stabilized there. We don't have a time line on when to expect that to turn around. A lot of that is driven by macroeconomics.

We talked about the approach to guidance. We continue to assume that macroeconomic uncertainty will have an impact in future quarters on that paid seat expansion rate, and that's baked into the guidance. But beyond that, we don't have a very specific view on when we expect that to turn around and start to expand again.

Michael Cannon-Brookes
Co-Founder, CEO & Director

And Adam, I can talk to the second one on cannibalization. Look, we take a pragmatic view on this, I would say. I understand the concerns that people have that float around. I don't think we're seeing any signs of that at the moment. We're going to continue to be watchful. The reason I believe we're not seeing those signs is Giffen's paradox has floated around a lot in the last week or 2, if you're all familiar with that

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from the energy space. But fundamentally, it does apply here, right? We don't have shortage of ideas of things that we want to bring into reality that software help us with. Technology is great at turning ideas into actual services or products. We are not constrained by a supply of ideas and human creativity. So anything that gains these efficiencies with all the short-term bumps that we can have, generally, we will refill with conservation of profits and other things in the longer term, right?

Most of the tasks that we're removing are generally not things that people want to do. They're not the creative part of the job. And so we're allowing people to have higher fundamental efficiency in doing that job. Whether that means lots of parts of the economy will suddenly be done with magically smaller numbers of people, I'm not sure I believe that. I think they'll come up with many more things to do, right? But it does make users far more productive, and that's generally a broadly good thing for us all.

We are seeing with customers increased productivity in the 1, 2, 3 hours a week per person broadly across a set of knowledge workers. This is fantastic. I don't know if those people are going home 3 hours early. I think they're probably picking off the next things on their task list to do. So as an example of sort of most people don't end the week in a knowledge work job with an empty list of tasks. This just helps them get through more stuff more quickly and helps those firms survive and thrive in what are competitive industries wherever they are. They're competing against someone else that's also trying to gain those efficiencies.

From a thoughtful point of view, again, as we mentioned, we do have consumption-based pricing, trying to make sure that, that's fair at lots of different areas of the business, certainly in the Atlassian Intelligence area. And we'll continue to learn and evolve. Whether that turns into task-based pricing or job-based pricing, we would be ready to adapt to that if that seems like an area that's going that way. We don't have a lot of customer signals that, that's what's desired yet. But from an Atlassian point of view, we maintain that flexibility to be able to capture that value as we get there.

The first thing for us to do is to build fantastic products that people really want and will consume in volume. And secondly, we have still a relatively small seat penetration within most of our largest Enterprise customers. So the upside there is very high for us, we feel, and that's what we continue to chase.

Operator

Your next question comes from Gregg Moskowitz from Mizuho.

Gregg Steven Moskowitz
Mizuho Securities USA LLC, Research Division

I'd like to follow up on Bachman's question from earlier because it is fascinating that you have 85% of the Fortune 500 and yet they only make up 10% of your revenue. Mike, can you touch on how challenging you think the path is or may be for Atlassian to get in front of C-level executives a lot more frequently? And how does Brian and the rest of the team plan to materially go after this?

Michael Cannon-Brookes
Co-Founder, CEO & Director

Greg, not challenging. I'm trying to work out how to answer this question. Is it hard for me to get in front of C-level executives or Brian or the Atlassian sales team or Atlassian broadly? No. I would say it's not hard for us to do that. I've met with tens, probably almost into hundreds now in the last 12 months of C-level executives across massive organizations all over the world. They're all Atlassian customers. They are all looking to increase their Atlassian spend. They have very high demands of Atlassian. That's great. We love customers that are demanding, right, that have high requirements and high needs, and it's up to us to deliver those.

They see our continued delivery of value, whether that's scale and performance and compliance and cloud, FedRAMP, all the facilities that Joe talked about in terms of Enterprise requirements is a long list, and it's going to continue to get longer as we get to lots more global regulation and different rules. We're all up for

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delivering that for customers and at the same time, delivering them fantastic products that actually make a big impact on their business.

Getting in front of them is not the problem, continue to be pulled in as they want to have us be a larger strategic partner. I love customers. I met with a large telco in Europe that explained to me, they wanted us to be one of their top 4 strategic vendors. The other 3 are dauntingly large technology companies that we are increasingly putting a list with, which is very humbling. And then they presented us with a list of things that we need to do to get there, and we're probably in their top 20 vendors, top 10 maybe today, and they wanted us to be in the top 4. I was like, give me the list, let's go. And we're working on a lot of things on that list already. We're delivering for that particular vendor.

What they saw was the power of the Atlassian platform. It's a very insightful CIO that saw the breadth of what we're doing across, what we call, the system of work. So connecting their technical and business teams together, that's one of their biggest problems. Strategy and planning, AI, the depth and breadth of the Teamwork Graph being a truly unique data or asset for them that they don't have a big problem of connecting all their data together.

So we love those most complex and demanding businesses. We don't have problems getting in touch with them or getting to talk to them. We are continuing to improve the way that we tell the Atlassian story to explain to them how we can help and continuing to help them get that value faster, right? One of the things we pride ourselves on is on speed of deployment, speed of getting access to that. Again, in Enterprise search, it's no different. You can get our Enterprise search engine stood up very, very quickly. You can connect to lots of Enterprise data very, very fast and get results. And if we keep that philosophy in mind and deliver on all their requirements in terms of compliance, regulation, scale, performance, et cetera, I think we stand in a really good stead. I think Brian and the sales and success team just continue to deepen our capabilities in those areas. So we feel very bullish about that part of the business.

Operator

Your next question comes from Jason Celino from KeyBanc Capital Markets.

Jason Vincent Celino
KeyBanc Capital Markets Inc., Research Division

In the shareholder letter, it looks like data center saw some strong large deal activity. I don't know if this is referring to renewals or net new lands, but I know it's going to be a multiyear journey on migrations. But for this cohort of customers that are renewing these multiyear data center contracts today, what is holding them back from the cloud at the moment?

Michael Cannon-Brookes
Co-Founder, CEO & Director

Jason, I can take the first part of that, and Joe might want to follow on from a financial perspective. Look, I think the first thing I would say is I don't run into any data center customers nowadays who are -- if they're moving to cloud. They're all [when]. They're all making plans to move. They are not questioning our abilities, and that's credit to the engineering team broadly over the last few years, delivering on a lot of those compliance and regulation and needs of those businesses that we talked about. That, for a lot of these very large and complicated enterprises, though, they might have 10, 30, 50, even 100 data center instances around their enterprise. They are often smartly looking to do some cleanup on the way through about the workflows they're using or the data. Some of those instances are 20 years old plus and have a lot of legacy content in them that they may not need, et cetera. So that's a process.

Fundamentally, it can take some of those businesses some time to move. Certainly, often a lot of time, multiple years to move holistically, maybe all of those 50 or 100 instances, right? That doesn't mean they're not moving into hybrid states. We increasingly see the hybrid ELA offering as a powerful thing for those customers to learn about cloud, test cloud, use cloud and maybe they're more forward-thinking parts of the business or they're more fast-moving parts of the business. A lot of people moving their AI initiatives, for example, to the cloud is something I've talked to a number of customers about and some of the slower-moving, more legacy parts of their business may move later on.

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So we want to make sure that we give the customers that flexibility to be customer-led in how they manage that migration journey for themselves. It's very unique for a lot of those bigger customers. At the same time, making clear to them about where we are headed as a business, demonstrating the value of cloud. And again, we continue to have large customers. We had the financial institution that we talked about last quarter in the shareholder letter that has signed a very large cloud deal on the basis of Atlassian Intelligence and Analytics, 2 fundamental capabilities that they saw as powerful in the cloud and was moving their migration, right?

So sales and success team doing a fantastic job across the customer base, especially in the largest area to explain to customers what the value is and help them on those movements. So an area we feel pretty bullish on.

Joe, do you want to follow on the finance part?

Joseph Binz
CFO & Principal Financial Officer

Yes, Mike. Jason, the only point I'd make is to reinforce Mike's point that the vast majority of these deals in data center were hybrid ELAs, which give the customer rights to the cloud. And we continue to see really strong interest in these hybrid deals given the value and the flexibility they provide, specifically to our largest customers. And Mike talked about all the benefits that brings and our ability to migrate them in a way that makes the most sense for them.

And these deals were a significant driver of the billings outperformance in the quarter that you see, even though they were less of a driver of revenue performance just given the revenue recognition on these deals. So hopefully, that color helps as well on the big deals in the data center space.

Operator

That's all the questions we have time for today. I will now turn the call back over to Mike for closing remarks.

Michael Cannon-Brookes
Co-Founder, CEO & Director

Thank you, everyone, for attending today, and thanks to all of the Atlassian team for a fantastic quarter and huge progress across R&D and customer delivery, across marketing, across sales and success, and all of the G&A functions that support us all. So another quarter in the books. Thank you, everyone, for attending, and we look forward to talking to you all in 3 months and also seeing you in Anaheim. Hopefully, a lot of you at Team '25 in Anaheim in April.
Thank you very much. Have a kickass weekend.

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