Prepared Remarks
Stewart Butterfield, Chairman, Chief Executive Officer and Co-Founder

We had a quarter of record results, with revenue growing 58% year on year. We exceeded 100,000 paid customers in the quarter and now have 720 customers with more than $100,000 of annual recurring revenue, a figure which was up 75% since last year. I'll talk more about our exceptional growth in the enterprise segment in a moment.

Last quarter, of course, we also completed our listing process. I want to acknowledge the strength of execution by our accounting, legal, finance, business technology, and communications departments, along with hundreds of others across the company, and of course our partners and advisors.

The transition to being a public company is just one hallmark of what we see as the company entering a new phase. The next five years will be very different from the first five years. We came out of the gate with near-perfect product market fit for our very earliest customers, who tended to be smaller and more technical teams. But over the years, as we launched the Enterprise Grid product, scaled to teams of 100 thousand users, added key features for security, administrative control and compliance, we began to see real product market fit for the large enterprise use case.

Now, that fit is clear. This quarter saw win after win in the largest companies in the world. I want to start off by highlighting a few of those.

A Fortune 100 financial services firm, which has been a Slack customer for years, with continual expansion throughout the company, added thousands more active users and is now going wall to wall for their more than 50 thousand employees across functional roles including, marketing, HR, legal, finance and sales.

They saw our commitment to their needs and we partnered together to deliver several security features which were critical to their security team. At the same time, our success team was deep in the trenches, partnering on change management and training, and sharing best practices.

What we were able to achieve together in this case was deep engagement from end users, productivity wins across all parts of the company and a healthy foundation for increasing the sophistication of their usage and thereby driving more value from their investment in Slack, all in a system that met their regulatory and compliance requirements.

Of course, like most of our large enterprise customers, they run on Office365. They still chose Slack because only Slack was capable of meeting their needs.

Increasingly, in regulated industries, we are seeing significant traction because Slack blends security and compliance with scalability, an open platform and a great user experience. In
addition to exciting wins in healthcare following our ability to support HIPAA compliance, a large Midwestern insurance company also expanded to thousands of users this quarter. Slack is a key plank in their transformation efforts and plays an essential role, as it does elsewhere, as a lightweight fabric for systems integration. They leverage more than 500 integrations, including PagerDuty, Dynatrace, JIRA and an extensive set of internally-developed integrations to drive more return from their overall investment in software.

This is another Office365 customer, and they chose Slack because only Slack’s open platform integrates with the full range of internally and externally developed tools they use.

With more than 1,800 apps in our app directory, ranging from partners like Atlassian, Salesforce, SAP, and Zoom, to Slack-first services like Lattice, Guru and Troops, our open platform continues to play an important role in enterprise adoption. We also see customers creating their own apps, integrating Slack into their internal systems and workflows — in a typical week, more than 500,000 of these custom integrations are actively used. Slack’s value extends far beyond simple messaging and enterprises increasingly see that.

In one of the world’s largest media conglomerates, we expanded further this quarter to support over 45,000 active users across nearly every department and function in the company. An Office365 user, they’ve consolidated usage across a dozen or so business units using our Enterprise Grid product, which centralizes administration, provisioning and control over any number of federated workspaces. They chose us because only Slack can give them the flexibility and scalability to create a structure that mirrors the way their organization really works.

I want to emphasize the critical nature of true scalability for our enterprise customers. Only Slack’s Enterprise Grid product can support the scale and structure of the largest organizations in the world. We have customers with ten, twenty, forty, sixty thousand active users on Grid, all the way up to our biggest customers, which now tip well over 100,000 active users.

And it’s not just the US where we are seeing success in the enterprise segment. More and more, we see the same thing in all major markets. In Europe, one of the best-known global banks expanded usage and upgraded to Grid. And one of the world’s largest retailers of home goods made the transition from email to channels this past quarter, signing a multi-year, multi-million dollar deal.

In a survey of Slack-using employees during their initial pilot, 83% reported it made them more productive, and 95% said it led to less use of email. Of course, the only way that Slack increases productivity is if people use it. In this case, as in many others, the customer chose Slack, because their own employees told them that Slack makes them more productive.

Meanwhile, in Japan, where we are in the process of opening a second office in Osaka to complement our fast-growing Tokyo headquarters, the business continues to outperform. This
quarter we scored major wins in enterprise — new million dollar deals with one of the major telecom providers and one of the largest systems integrators.

In every case, our sales team had the advantage of a lot of very happy end users. Our history of strong bottoms-up adoption is a vital factor in our success. We only win if people choose Slack, and they only choose Slack if it provides real value to them. There is no other path. We can’t rely on bundling or superior distribution or sunk costs of entrenched products. In the long run, the measure of our success will be the value we create for customers.

Accordingly, we focus relentlessly on the quality of the product experience and finding new opportunities to better serve our customers. The good news is that the opportunities are endless. Our mission is to make people’s working lives simpler, more pleasant and more productive and in each of those dimensions we believe we can keep improving for decades to come.

That brings me to one of the other highlights in this quarter. In July, we released a rebuilt version of our desktop client that has dramatically improved performance. It starts faster, uses far less memory and is much less CPU-intensive. This new version was also engineered with a modular, extensible approach that provides a foundation for us to rapidly and regularly improve the user experience. Feedback has been phenomenal, and it’s just the beginning.

The user experience matters because Slack is where work happens. For our paid users, it’s 9 hours/day connected and 90 minutes of active usage every working day. It’s the first work app you check in the morning, and the last you check at night. Without that kind of engagement, that aggregated attention, you don’t actually get the benefit of the transformation from inboxes to channels — the transformation from an individual-first approach to communication to an organization-first approach. And we believe this transformation is inevitable.

That brings me to the last point I wanted to make before handing it over to Allen. Later this month Shared Channels will be out of beta and available to all Slack customers. This is the most important addition to Slack since we first launched.

Shared Channels allows customers to securely collaborate with external partners, suppliers, and their own customers in channels while still maintaining their internal controls and compliance policies. More than 20,000 paid customers have already adopted Shared Channels during our beta program, a number that far exceeded our expectations at the program’s launch. What is incredibly exciting is that, as the size of the cohort has increased, the intensity of usage has also increased. That means that the average number of Shared Channels in use by Shared Channels-using customers has increased as more customers joined the beta. And the same thing is true with the size and density of the largest network cluster, resulting in a lower number of average “hops” from any two randomly selected participants.

We are already seeing customers choose Slack because of Shared Channels. We had a big win in the quarter with a major American sports league beginning to use Shared Channels to
communicate with the franchises, a network made up of the league, the teams and their partners. We even saw a large media streaming service requiring its creative agency to adopt Slack so they could use Shared Channels to collaborate. In some cases, because Shared Channels were so important to them, larger customers postponed their upgrade to Enterprise Grid, until Shared Channels beta became available in Grid this June.

This is our first real network effect across customers. We orient the business to seek out increasing returns dynamics anywhere we can find them, and that's definitely something we've seen in the platform ecosystem and the network inside of individual companies — Slack gets more valuable as more people are on it. But now we expect to be able to increase the value for all of our existing customers as new customers start using Slack.

This was, obviously, an exciting quarter. Not just the listing, but the building momentum in enterprise, the major technical upgrades, and most of all, the progress on Shared Channels which we believe will unlock massive new opportunities for us in the years ahead.

With that, I'll hand it off to Allen.

**Prepared Remarks**

**Allen Shim, Chief Financial Officer**

Thank you Stewart, and thanks again to everyone for joining us.

I will go through our second fiscal quarter results in detail before moving on to guidance for the third quarter and full year fiscal 2020.

Turning to Q2, results reflect our ongoing progress in what we view as a generational shift from email to messaging and channels.

Total revenues in the second quarter were $145 million, growing 58% year-over-year.

Revenue growth was above the high end of guidance, despite an $8 million one-time revenue headwind from credits issued in the quarter related to service level disruption in the quarter. Our uptime was 99.9% (or three nines) in the quarter, but this was below our commitment of 99.99% (or four nines). Service level disruption of this magnitude is unusual for us. Compounding the financial impact of the downtime was an exceptionally generous credit payout multiplier in our contracts dating from when we were a very young company. We've adjusted those terms to be more in line with industry standards while still remaining very customer friendly. We do not expect a revenue impact of this magnitude again.

Our Q2 calculated billings were $174.8 million, growing 52% year-over-year. Trailing twelve month calculated billings were $625 million and grew 65% year-over-year.
Calculated billings were minimally impacted, in the second quarter, by the credits we issued - a headwind of just under $1 million. Calculated billings in the second half of fiscal year ‘20 will be more significantly impacted due to the way we account for credits.

In terms of geographic breakdown, 37% of our total revenue came from outside the U.S. which is up from 36% in Q2 of fiscal year 2019.

As of the end of Q2 we surpassed 100,000 paid customers, up 37% year-over-year.

We remain focused on expansion within existing customers and growing our large enterprise customer base, and ended the quarter with 720 paid customers greater than $100,000 in annual recurring revenue, which is up 75% year-over-year. This growth in larger customers is further testament to our strong adoption within enterprise customers.

We expect large customer growth to exceed total paid customer growth for the foreseeable future, as we invest more heavily in enterprise sales and customer success.

Our strong customer retention and ability to expand within existing customers have resulted in a consistently high net dollar retention rate, which was 136% at the end of our second quarter.

Moving forward I’ll be discussing non-GAAP financial measures.

Gross margin was 87% versus 88% a year ago.

Turning to Q2 operating expenses.

R&D expenses were $55 million or 38% of revenue. We continue to invest heavily into Slack’s user experience, scalability, our platform and new features such as Shared Channels and expect R&D expenses to grow roughly in-line with revenue growth in the second half.

Sales and marketing expenses were $67 million or 46% of revenue. Leverage in sales and marketing in the first half is largely due to a year-over-year decline in advertising and marketing program spend. We expect sales and marketing expense to accelerate in the second half and exceed 50% of revenue.

G&A expenses were $61 million or 42% of revenue. G&A expenses were elevated this quarter due to the expensing of direct listing related costs of $28 million. We expect G&A expenses as a percentage of revenue to decline moving forward.

Our Operating Loss in the quarter was $56 million, representing an Operating Margin of negative 38%.
Free Cash Flow was negative $8 million. Free Cash Flow includes $8 million of capital expenditures related to the buildout of office space.

There were some puts and takes to Free Cash Flow due to the direct listing. Free cash flow was negatively impacted by the $28 million of direct listing expenses as well as $19 million of direct listing related employer cash taxes related to RSU vesting. Free cash flow was positively impacted by $21 million of payroll taxes that were collected in Q2 but will be paid in Q3.

Stock-based compensation expenses and related employer payroll taxes were $307 million in the quarter, reflecting that the performance-based vesting condition for outstanding RSUs was satisfied upon the completion of our direct listing.

Now I'll turn to guidance.

For the third quarter we expect revenue in a range of $154 million to $156 million, representing growth of 47% at the midpoint.

We expect non-gaap operating loss in a range of $49 million to $47 million. We expect sales and marketing as a percentage of revenue to increase in Q3 and exceed 50% of revenue.

We expect non-gaap EPS in a range of negative $0.09 to negative $0.08. We are modeling Q3 basic shares outstanding of approximately 544 million.

For the full year, we are raising our revenue guidance to a range of $603 million to $610 million, representing growth of 51% at the midpoint.

We are also raising our full year calculated billings guidance to a range of $740 million to $760 million, or 45% growth at the midpoint. The credits we issued in Q2 related to service level disruption will provide a $5 million headwind to full year calculated billings. We expect Q3 calculated billings to be up slightly versus Q2.

We are raising our full year non-gaap operating loss guidance to a range of $180 million to $176 million. For the full year, we expect to record approximately $30 million of one-time expenses related to our direct listing.

We expect full year stock-based compensation expense and related employer payroll taxes of $470 million.

We are raising full year EPS in a range of negative $0.42 to negative $0.40. We are modeling full year weighted average basic shares outstanding of approximately 399 million.
We expect full year free cash flow in a range of negative $110 million to negative $100 million. In the third quarter we expect $21 million of cash outflows related to the previously mentioned employee tax withholding, so please keep this in mind as you model.

For the full year, total one-time cash expenses related to direct listing fees and cash taxes are expected to be about $48 million.

For fiscal year 20 capex, we now expect approximately $65 million of capital expenditures predominantly related to the build out of new office space to accommodate our growth.

In closing, we remain excited about continued traction in growing our customer base, building a network, and becoming a platform. We are also pleased with continued progress toward our growth phase goal of free cash flow positive, which remains a priority.

With that, I’ll open it up for questions.