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

Thank you everyone for joining today's call.

We had a great quarter: revenue was $169 million, up 60% year-over-year. We added more than 5,000 net new Paid Customers in the quarter, bringing the total above 105,000. And we continue to show leverage: non-GAAP operating margin improved 26 percentage points year-over-year.

Today, I want to hit on three points. First, our continued outstanding momentum in the enterprise segment, where we surpassed 50 Paid Customers with over $1 million in annual recurring revenue for the first time. Second, our accelerating pace of innovation on the product side, with some exciting new launches. Finally, I'll spend some time on what we're seeing with shared channels, which launched halfway through the quarter. For me personally, this is the most exciting thing to happen for collaboration since we first launched Slack.

So, starting with enterprise: we use "Paid Customers with over $100,000 in annual recurring revenue" as a proxy for our large enterprise customers, and this quarter we set a new record by adding 101 of those customers, for a total of 821 $100k customers. That's a 67% increase over Q3 of last year and included strong growth in the largest enterprises — another 11 of the Fortune 500, and in our international business, more than a third of the new $100k customers were outside the US.

We also saw great growth at the high end of this range, ending with more than 50 Paid Customers with over a million dollars in annual recurring revenue. Last year at this time, we had just over 30 and we're happy to see this number tracking to the growth in the broader base of $100k customers.

The overwhelming majority of these million-plus customers — nearly 70% — are also Office365 customers. In general, we continue to see tremendous adoption across customers of the Office suite. They choose Slack despite having a bundled alternative that is marketed as free. They choose Slack because it scales to the complexity and breadth of their enterprise, because it is open and integrated with all the software they use across their business, and because of the careful attention we pay to user experience which creates deeply loyal and committed fans.

These enterprise wins in Q3 included companies across nearly all segments — healthcare, retail, financial services, education, logistics, media and manufacturing. Innovative companies such as GlaxoSmithKline, Vodafone, IMAX, SiriusXM, and Dartmouth continued to choose Slack.

Moving on, we have been doubling down on the strength of our product. We've made improvements to the basics — application performance and reliability, new user onboarding, and compliance features important to customers in regulated industries — and we've extended our platform lead with the launch of Workflow Builder, which increases the number of people who can develop on Slack by allowing non-technical users to create and manage simple workflows.

Workflow Builder was launched in mid-October and by the end of the month, over 10,000 unique workflows were created and in active use on Slack.

Platform was also instrumental in helping close many of those million dollar-plus contracts we won this quarter, particularly among customers who use Office365, and so who have access to multiple overlapping legacy collaboration tools, effectively for free.

Let's have a look at those customers.

An Office365-using Fortune 100 retailer expanded to tens of thousands of users on Slack. They rely on integrations with many tools, like Zoom, Jira, ServiceNow and Concur.

Also among the Office365 customers moving to million-dollar plus contracts on Slack was a midwestern insurer, and another was one of the largest technology companies in Europe who is expanding to tens of thousands of users — nearly one-third of its global employee population. They use over 1,000 integrations, most of them custom-built.

We won a million-dollar plus contract with a highly-regulated trading firm based in the midwest, that will be using our encryption key management feature to remain compliant. This customer has over 100 bots and custom applications integrated with Slack, despite also being an Office365 customer.

In fact, we are seeing significant momentum across regulated industries. This quarter we landed and expanded at multiple Fortune 500 and Global 500 financial services and healthcare companies. We also closed our largest federal government deal to date - a million-dollar plus deal at a customer that is, you guessed it, also an Office365 customer.

Our platform strategy and the strength of our ecosystem continues to drive value for our customers by making the software they use more valuable because they use Slack. We ended the quarter with over 700,000 active developers. And in November, we crossed over 2,000 apps in the app directory. Slack is increasingly the developers' platform of choice.

In Q3, we launched over 160 new features, and have a strong roadmap for the next few quarters. We're excited to keep delivering innovative new features that become important drivers of business value for our customers. On the product side, we feel like we're still at the very beginning.

That brings us to the most important innovation in the category since Slack first launched: shared channels.

Shared channels allow two Slack-using companies to create a channel that is shared between them and extend messaging between users at the two organizations. All of this happens with administrative control, reporting and compliance functionality.

After an extensive beta period, we launched shared channels into general availability in mid-September. Growth has been explosive. Despite the fact that it was released halfway through Q3, we ended the quarter with 26,000 shared channels-using Paid Customers. That's up 30% in that quarter alone.

We see salespeople closing deals on shared channels and customer success teams supporting their customers on shared channels. Shared channels are used by HR teams working with external recruiters, marketers working with creative agencies, and a broad variety of professional services firms serving their clients.

Shared channels are unique to Slack. No competitor has brought anything similar to market. Not surprisingly, this has started to have an impact in the field. As an example, shared channels were a key reason for a multi-thousand user win at a healthcare-focused federal agency that uses Office365. The agency will use shared channels to communicate with external vendors and partners.

All of this — the enterprise momentum, the pace of innovation, and the growth of the network of shared channels-using organizations — combine to drive the business forward.

Adoption of shared channels in larger customers has been especially rapid: 80% of our $100k customers now use shared channels to collaborate with partners, vendors, customers, and more. And we are starting to see novel new platform applications built specifically for use on shared channels.

The power and the dynamics of this network can be hard to understand merely from verbal descriptions. We recently released a blog post with some visualizations of the network where you can really get a sense of how extensively shared channels are being used and I'd encourage everyone to check it out.

Finally, before handing things over to Allen, I want to acknowledge the escalation in competitive narratives. Microsoft has announced that there are now 20 million people using Teams, around 10% of their Office365 user base.

When they first announced the shutdown of Skype for Business, we expected this. All the way back in 2015, Microsoft announced that Lync had 100 million active users. We have no reason to assume that any of those were lost when Lync was rebranded as Skype for Business. The product still drove end users' desktop VOIP phones and conference rooms.

Now that Skype for Business users are being force-migrated to Teams, it's reasonable to expect more of the same. Unless they hit a snag, we'd expect them to announce 50 million in the next six months and then 100 million within the next year.

Although Microsoft markets Teams as a Slack competitor — and there's no doubt this causes confusion in the marketplace — in practice, these are different tools used for different purposes and our customers achieve markedly different results. Just look at the weak engagement numbers that Microsoft themselves report about Teams and the much deeper level of engagement you see among Slack users. Slack represents a new category of software and regardless of which app opens when you click on a calendar reminder for a video call, if you need to work closely with colleagues in an environment that can integrate deeply with all the software you use, there is a clear choice — and our customers know it.

That's why we've continued to add Office365-using enterprise customers at the hundred thousand dollar plus level — and at the million-dollar plus level. Just as you can expect more Skype for Business users forced over to Teams, you can expect more of these customer wins from us as well.

WIth that, I'll hand it over 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 third fiscal quarter results in detail before moving on to guidance for the fourth quarter and full year fiscal 2020.

Total revenues in the third quarter were $169 million, growing 60% year-over-year.

Our Q3 calculated billings were $186 million, growing 47% year-over-year. Trailing twelve month calculated billings were $684 million and grew 59% year-over-year.

Our uptime was 99.999%, or five nines in the quarter. We continue to invest in maintaining industry leading uptime.

Remaining performance obligations were $279 million up 30% quarter-over-quarter. Because we have taken the practical expedient under ASC 606, our RPO disclosure is reflective of contracts greater than one year in length and excludes annual and monthly contracts, which are captured in deferred revenue. Accordingly, RPO growth is driven primarily by growth in multi-year enterprise license agreements. These multi-year deals tend to be larger and often reflect a decision by our customers to standardize on Slack.

In terms of geographic breakdown, 37% of our total revenue came from outside the U.S. which is up from 36% in Q3 last year. We continue to invest in international expansion, particularly within our direct sales organization. This year we opened offices in Munich, Paris, Sydney, and plan to open an office in Osaka in December.

As of the end of Q3 we surpassed 105,000 Paid Customers, up 30% year-over-year. As a reminder, in the second half of last year net new Paid Customer growth benefited from the Atlassian acquisition, which contributed approximately 1,800 customers in the second half of fiscal 2019.

We remain focused on expansion within existing customers and growing our large enterprise customer base, and ended the quarter with 821 Paid Customers with greater than $100,000 in annual recurring revenue, which is up 67% year-over-year. As Stewart mentioned, we also exceeded 50 customers with greater than $1 million in annual recurring revenue for the first time, with 53. This is up from 32 a year ago. Million dollar customers will be a milestone disclosure going forward.

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

Paid Customers with greater than $100,000 in ARR represented 47% of revenue in the third quarter, up from 39% in the year ago quarter.

Our strong customer retention and ability to expand within existing customers have resulted in a consistently high net dollar retention rate, which was 134% at the end of our third quarter.

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

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

R&D expenses were $54 million or 32% of revenue. We continue to invest 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 fourth quarter.

Sales and marketing expenses were $78 million or 46% of revenue. While we continued to see leverage in sales and marketing in the third quarter, this is due in part to the timing of marketing campaign spend. We expect higher marketing expenditures to bring sales and marketing as a percent of revenue over 50% in the fourth quarter.

G&A expenses were $36 million or 21% of revenue. We continue to expect G&A expenses as a percentage of revenue to decline moving forward.

Our Operating Loss in the quarter was $18 million, representing an Operating Margin of negative 11%.

Free cash flow was negative $19 million. Free cash flow includes $10 million of capital expenditures related to the buildout of office space. Free cash flow was negatively impacted by $21 million of payroll taxes related to the direct listing that were collected in Q2 but paid in Q3. Excluding those payroll taxes, we were free cash flow positive in the quarter.

Stock-based compensation and related employer payroll taxes were $76 million in the quarter. It is important to note that due to the performance-based vesting condition of our RSUs, stock-based compensation recognition is accelerated in the first year after going public. We expect stock-based compensation as a percentage of revenue to trend down meaningfully over the next year.

Now I'll turn to guidance.

For the fourth quarter we expect revenue in a range of $172 million to $174 million representing growth of 42% at the midpoint.

We expect non-GAAP operating loss in a range of $36 million to $34 million. We expect sales and marketing as a percentage of revenue to increase in Q4 and exceed 50% of revenue.

We expect non-GAAP EPS in a range of negative $0.07 to negative $0.06. We are modeling Q4 basic shares outstanding of approximately 550 million.

For the full year, we are raising our revenue guidance to a range of $621 million to $623 million, representing growth of 55% at the midpoint.

We are raising the low end of our full year calculated billings guidance and now expect a range of $745 million to $760 million, or 46% growth at the midpoint. There are two dynamics to keep in mind for the fourth quarter calculated billings. The first is that as our enterprise business has grown, the fourth quarter has become increasingly large-deal driven. The fourth quarter also is our most back-end weighted quarter of the year. Our pipeline coverage is higher quarter-over-quarter and year-over-year, but the range of outcomes is a bit wider due to the size of deals in the pipeline and when we are projecting them to close. Due to these factors, we are maintaining, but not raising, the high end of our calculated billings guidance.

We continue to expect that the credits we issued in Q2 related to service level disruptions will provide a $5 million headwind to full year calculated billings. Q3 calculated billings were negatively impacted by an estimated $1.5 million from the credits we issued last quarter. As customers with these credits are billed and credits are applied to their bills, the outstanding balance of credits from the second quarter service level disruptions are reduced.

We are raising our full year non-GAAP operating loss guidance to a range of negative $144 million to negative $142 million, which includes 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 $0.32 to negative $0.31. 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 $85 million to negative $80 million.

For the full year, total one-time cash expenses related to direct listing fees and cash taxes are expected to be about $51 million. We do not expect any direct listing related expenses in the fourth quarter.

For fiscal year 20 capex, we now expect approximately $60 million of capital expenditures predominantly related to the build out of new office space to accommodate our growth.

We continue to make steady progress toward becoming Free Cash Flow positive. We'll provide an update on timing related to our growth phase targets on the fourth quarter earnings call.

With that, I'll turn it back to Stewart.

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

Thanks Allen. Before we get to Q&A, I'd like to welcome two new members to our board of directors. Sheila Jordan is the CIO of NortonLifeLock and previously held senior positions at Cisco and Walt Disney World. Sheila has fantastic perspective on digital transformation and she brings the voice of our customers right into the boardroom.

The second new director is Mike McNamara. He was CEO of Flex for 12 years and grew the business to over $25 billion in annual revenue. Mike brings an operator's perspective to the board that I value immensely.

Last, today we also announced that Chamath Palihapitiya will be stepping down from our board. Chamath was a very early investor in Slack and if you know him, you know he is one of a kind. Thank you Chamath for your time, wisdom and invaluable contribution to the growth of Slack.