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Atlassian Corp. Plc (TEAM)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. Thank you for joining Atlassian's Earnings Conference Call for the Second Quarter of 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 second quarter of fiscal year 2022 earnings call. Thank you for joining us today. On the call today, we have Atlassian's Co-Founders and Co-CEOs, Scott Farquhar and Mike Cannon-Brookes; our Chief Financial Officer, James Beer; 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 second quarter of 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 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 brief opening remarks and then focus the rest of our time on Q&A.

This call will include forward-looking statements. Forward-looking statements include 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 the date such statements are 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 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. The reconciliation between IFRS and non-IFRS financial measures is available in our shareholder letter, earnings release and investor data sheet on our IR website.

During Q&A, please ask your full question upfront so that we can be fair and be able to accommodate next speaker. With that, I'll turn the call over to Scott for opening remarks.

Scott Farquhar

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

Thank you for joining us today. Happy New Year to everyone. Q2 was another strong quarter as we continue to see great momentum. It's extremely encouraging to see many of our past long term investments reflected in our Q2 results. The Atlassian Marketplace, which we started in 2012, recently surpassed \$2 billion in lifetime sales.

Cloud apps now make up nearly half of all marketplace apps, and the rate at which customers are adopting cloud apps is outpacing our own cloud products. It's exciting to see our ecosystem grow at such a rapid pace and for us to be able to expand the economy around Atlassian.

IT was an area we were committed to doubling down on three years ago. Recently, Jira Service Management was recognized as a leader in the Forrester Enterprise Service Management Wave with our strategy for ESM receiving the highest possible score. We also recently added Percept.ai to bring AI-powered virtual agent technology to expand JSM's frontline support capabilities.

Our continued investment and innovation in our cloud platform are driving great results. This quarter, we added more than 10,000 net new customers, nearly all landing in cloud, and quarterly cloud revenue grew 58% year-over-year.

As you've already read in our shareholder letter, we're looking forward and laser-focused on investing in the future. Hiring is our top priority. We deeply believe in the massive market opportunity in front of us, and investing in people is our path to seize these opportunities.

Lastly, we hope you can join us at Team '22 in April. We are cautiously optimistic to be back in person with our customers and partners, and we hope to see many of you there, but we're thrilled to also be able to host Viewing Parties around the globe and offer virtual options as well.

With that, I'll pass the call to the operator for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Alex Zukin from Wolfe Research. Sir, your line is open.

Alex Zukin

Analyst, Wolfe Research LLC

Q

Hey, guys. Congratulations on another just wonderful quarter. I guess maybe for me, how should we think about the results relative to your internal plan? And what were the two biggest areas that outperformed your expectations? And if you can, any bottlenecks to growth at the moment and how are those different than maybe this time a year ago?

Michael Cannon-Brookes

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

A

Well, thanks for the question. I'd start off by saying I was really pleased with the performance against our plans really right across the board. You see very strong performance in both the cloud and data center businesses. If I were to pick out one product, it would be JSM. I think that's just really hitting the mark with customers, a big opportunity for us going forward. That has, of course, given us the confidence to raise our full year subscription revenue guidance to around 50%. That's up from the mid-40s percent that we were talking about 90 days ago. And the other thing I would really highlight is I feel we are very much on track with our migrations timeline. So, pleased by that.

In terms of the last part of your question, I see demand continuing to be strong for both the cloud and data center businesses. I don't see bottlenecks there in the future. One of the other things I'm sure we'll talk more about this is the continual progress we have with increasing the capabilities of our cloud, quarter-by-quarter. And as we do that, obviously, more and more of our currently behind-the-firewall customers are able to move over to the cloud. It's clear that they want to go in that direction, and increasingly each quarter, we're making that possible. So we feel good about the opportunities in front of us.

Operator: Thank you. The next question comes from the line of Nikolay Beliov from Goldman Sachs. Sir, your line is open.

Nikolay Beliov

Analyst, Goldman Sachs & Co. LLC

Q

Hi. Thanks for taking my question. James, one for you. When will we start seeing the migration impact from server and data center to cloud in the numbers of loyalty discounts unwind over time? Are we talking maybe a year from now or two years from now? And as a follow-up to the Team in general, as you move to the cloud, your pricing clearly is changing. And you started the company probably 20-plus years ago with a business model all running around very low price compared to your competitors. And now, for example, Jira Premium is \$15 and Enterprise probably a little bit higher, approaching the pricing of competitors. So, I would think that's kind of a major shift in strategy here. And how is that reflecting in the business model and the type of the company going forward in light of that context? Thank you.

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

Well, Nikolay, let me start the answer there. In terms of the impact from migrations, what we're saying is that for fiscal 2022, so for the full year, we would expect migrations to be driving mid to high single-digit growth in our revenue year-over-year. So, you can contrast that, of course, to what I was just pointing out there in terms of our expectation of around 50% growth for subscription revenue in fiscal 2022.

And then, I would add that in the quarter just past Q2, it was a very similar sort of figure mid to high single-digit type contribution to the growth rate that we recorded in Q2, so that 64% subscription revenue growth of Q2 about mid- to high single digits coming from migrations. Just a couple of other things I would add. You referenced in your question there are loyalty discounts.

So, today, and until the end of June, somebody moving over to the cloud from either server or data center, they would receive a 40% discount. Now, once we get into July in a few months' time here, that discount will halve down to 20%. So that's important to remember.

The other thing I'd say is that when a customer migrates over to the cloud, of course, in the period that they make that migration, that's a very modest impact on our revenue. Obviously, the cloud business is recognized ratably in terms of the accounting. So those are the three points to keep in mind.

Scott Farquhar

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

A

I will add just on the back of James around sort of our price philosophy that we've talked about. And I just want to say there's no change to our pricing philosophy and hasn't really over the 20 years we've been running Atlassian. We've always priced for volume and we talked about reaching the Fortune 500,000 and reaching millions of people around the world. And that's what we've always priced for.

And so what you've seen sort of in terms of how that's manifested in our kind of list prices over the years is we've made it cheaper at the low end consistently by making it more free over time. And we've also captured more value at the higher end where we're providing more and more value for our largest customers.

And of course, as the cloud provides more value for customers, we take a lot of the management overhead away from customers by providing the hardware. And so our customers are happy for – to give us those responsibilities. And so I don't see there being any real change to our pricing philosophy. And I continue to see us do more free at the low end and more optimization at the high end as we deliver more value at the time.

Operator: Thank you. The next question comes from the line of Michael Turrin from Wells Fargo. Sir, your line is open.

Michael Turrin

Analyst, Wells Fargo Securities LLC

Q

Hey, there. Thanks and congrats from me as well on an impressive set of results here. Some of the commentary around ITSM and Jira Service Management stands out in the shareholder materials. You even have Cameron picking a favorite, which I'm sure isn't easy. Maybe you can speak to what's driving the momentum there? How that's impacting the model where that might be showing up? And maybe what makes Jira Service Management the right product at the right time as you referenced in the customer section? Thank you.

Scott Farquhar

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

A

Yeah. It's Scott here. I'll take that one. Look, Jira Service Management is, like, uniquely positioned to handle the convergence of developers and IT. And we're seeing in the market these days that IT is no longer an island over by themselves. It's no longer upgrading things that were handed on a CD over a weekend and taking people down. Developers and IT are working hand-in-hand to transform their organizations. And there's no other vendor out there that has that sort of unique position of bringing dev and IT together.

And the second aspect is [ph] they're the only companies (00:12:38) that allows us to – that can handle the Fortune 500, all the way to the Fortune 500,000 as we've talked about, Mike, and that comes from a deep focus on the end user experience, right, which is – which we delivered on across our product range for multi-decades at the moment and bringing that to [ph] IT (00:12:59) has seen a lot of value there.

And you've seen us say we're going to invest in ITSM three years ago when we've seen a consistent drumbeat of innovation. We've done some acquisitions to add functionality, but most of it's been in-house innovation and building up the feature set across our entire product range. And so we're super excited that that's being recognized by analysts out there, which is great, but more importantly, being recognized by our customers who are adopting it in droves.

And so, it wasn't a surprise. I mean, it was our plan three years ago to do this. And because we've got a great platform, we've been able to move relatively quickly in delivering all the value to our customers. And so, we expect ITSM to continue to grow into the future.

Operator: Thank you. The next question comes from the line of Keith Weiss with Morgan Stanley. Sir, your line is open.

Keith Weiss

Analyst, Morgan Stanley & Co. LLC

Q

Excellent. Thank you, guys, for taking the question, and congratulations on another really nice quarter. I wanted to ask about two – probably hitting that quarter full of – a lot of eye-popping numbers; two of the numbers that really stood out to me. One was data center seeing another acceleration in growth to 83%. Anything kind of one-time in nature we should be aware of in that number? I know there's a tough comp coming in Q3. So [indiscernible] (00:14:22) because we've seen that growth, but how should we think about what drove that acceleration?

And two, there was a comment about channel partner revenue growth accelerating. I think it was 130% growth year-on-year. Anything in particular changing in that program that caused that acceleration? And if you can give us some type of sense, as that become a more material channel, is that starting to move the needle a bit more for the broader Atlassian distribution strategy?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Thanks for the question. So this is Cameron here. And as far as the data center demand, the best way to look at that is it's just showing further commitment from our customer base into the Atlassian ecosystem, and also the highlights of the mission criticality of our applications. As we continue to say that that migration to cloud is a multiyear journey, different customers are on different stages of that journey, and that path to data center for many of them is a step towards the cloud.

All of them are well aware of that cloud, our investments in cloud, our strategy around cloud, and that cloud is in their future, but they're at all different levels of maturity of when they're able to move over. But the reality is, if you look to the last quarter, one-third of our cloud migrations came from data center customers. So we have proven that we can take the data center customer base to the cloud.

The second one's around our solution partners in our channel, which are just absolutely critical to our overall efficient go-to-market model that we have. Everything we do directly with my teams and marketing and sales and customer success gets amplified with our hundreds of solution partners out there in the market.

And obviously, as you see in the numbers, the solution partners have been increasingly critical to our cloud migration process. The reality is now we provide a variety of incredible self-serve migration tooling for customers to move to the cloud, but many of our customers want help from planning out the migration to managing the migration itself, and partnering with Atlassian. And that has allowed for us to continue to show great growth.

In general, for large customers, when I'm talking to them, the first thing I'd say is, hey, which partners are you working with, who can we partner with to build this plan out hand-in-hand going forward.

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

And let me just add on to the first part of Cameron's answer there. In terms of data center growth, a couple of things also to remember in terms of, Keith, you referred to something like a one-time nature. I think about the rev rec, remember, that a portion of the data center activity that we would contract with a customer is taken upfront. So that's quite different to our cloud revenue accounting, which is fully ratable.

And then the other thing I'd just point out, recall, we raised prices around this time last year on the data center. The full effect of that is now flowing through. And so, both of those things give a little extra fuel to the inherent demand that Cameron is referring to for data center.

Operator: Thank you. Your next question comes from the line of Fred Havemeyer with Macquarie. Sir, your line is open.

Frederick Havemeyer

Analyst, Macquarie Capital (USA), Inc.

Q

Hi. Thank you very much and congratulations on another really impressive quarter here. I wanted to ask, from your perspective, how does the hiring landscape for top tier talent, how is that evolving at this point? I mean, you mentioned throughout your investor letter that your hybrid work policies have been a strategic differentiator for your hiring practices.

In addition to just offering hybrid or remote work options, are you seeing anything out there to suggest that top talent is now weighing either compensation packages or stock comp packages any differently in this more volatile environment, potentially favoring companies like Atlassian?

Scott Farquhar

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

A

Thanks, Fred. It's Scott here. Look, we've been really happy with our TEAM Anywhere policy. That's to allow people to work wherever they want, if that's in an office, that's great, although that's been a little harder through the pandemic, and – or wherever we have the legal right to employ them. So we have seen a lot of our employees – our new employees are working remote from existing offices and we've seen existing employees move as well. So that's really great. We think that's going to be a long-term differentiator for Atlassian. And I think that's going to be difficult for companies that don't have similar policies to attract and retain the best talent.

In terms of compensation, we have seen some minor upticks in compensation. We were early to that, I guess, ahead of many of sort of peer companies who, I guess, have waited to see attrition tick up before they address the thing. And so we're really proud with how we've worked on that with our employees. And there's been talk of the Great Resignation across, particularly North America, but we haven't seen an uptick in a similar way that our peers have seen an uptick around that.

Now, on the back of all that, we are setting aggressive goals for hiring into the future. Like, we think and we see we have such great opportunities across all three of the markets that we have talked at length about. And the way of going about that is building out our largely R&D functions to build out the products that's needed to go after these large markets.

And so we're – you'll see an uptick in our investment over the coming quarters and years, and we think that's going to pay off really well for us.

Operator: Thank you. Your next question comes from the line of Steve Enders with KeyBanc. You may ask your question.

Steve Enders

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay, great. Thanks for taking the question here. I just want to ask about Sri exiting as CTO. I just want to get a bit of sense for what the kind of plans are to manage his responsibilities going forward and how the company is thinking about that at this point?

Michael Cannon-Brookes

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

A

Yeah. Steve, It's Mike. I can take that one. Look, Sri's obviously been an absolutely fantastic leader in technology over the last six years. He's taken us into the cloud and then continued to build a truly world-class cloud platform, so we couldn't be happier with where we sit. And also, his superpower has been building high-performance teams, building a great leadership team. So we're in an incredibly good situation in terms of engineering broadly.

Obviously, we'll be very sad to lose him as he moves on to another phase in his life, which is understandable, but we will – I have no doubt we'll be able to find more talent internally, externally. We're in an incredibly good position. We've, over the long-term, had a clear philosophy on culture and building a sustainable company, and a part of that is about leadership transition and continuing to move forward in all of our departments. And I feel incredibly confident about where we are in our technology and engineering functions.

Steve Enders

Analyst, KeyBanc Capital Markets, Inc.

Q

Yeah, perfect. Thanks for taking the question.

Operator: Your next question comes from the line of Keith Bachman with Bank of Montreal. Your line is open.

Keith Bachman

Analyst, BMO Capital Markets Corp.

Q

Many thanks. James, I wanted to put this one to you, if I could. You announced pricing changes that would be effective on Feb 15 for data center and server. And I wonder if you could characterize what you think the impact has been or will be prior to the 15th for those pricing changes, see some pull-in of demand and/or any characterization of post – for those two particular areas of data center and server? Thank you.

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

Yeah. Sure, Keith. At the end of the day, it is obviously the customer that makes the decision as to whether or not they're going to early renew, add to their investment with Atlassian ahead of these price changes. So, we really can't predict, given the volume of customers that potentially have this offer available to them.

So, when you look at the price changes themselves that we announced a few weeks back, they vary by product, by user tier, which is very normal for us. I would generally think of those as approximately mid-teens percent type growth in price across server and data center. And so, I would expect that to begin flowing into our P&L in the fourth quarter in a more meaningful way.

So there may well be some event-driven customer purchasing ahead of those price increases as we saw in Q3 of the last fiscal year. But, again, at the end of the day, the customer really decides. And so this is why we've been talking for some time now about a certain amount of variability in our financial model as our customers go on this journey from service cloud.

Operator: Thank you. The next question comes from the line of Fatima Boolani with Citi. Your line is open.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Good afternoon and thank you for taking my questions and get to telephonically meet you. Jim, the question is for you with respect to the concurrent acceleration that we've seen in the cloud and data center business. I was hoping you could put into context how both those businesses can sort of enjoy this degree of concurrent acceleration, especially considering you had mentioned about a third of the cloud performance being attributable to data center migration. So I'm just curious as to, if you can walk through some of the dynamics there? And if you can also give us a frame of reference for how much of that cloud performance in the prior quarters, how much of that was driven by migrations from data center, just so we have a frame of context. Thank you.

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

Sure. Happy to take that one. Let's start with migrations. I mentioned a little earlier that what we would expect and in fact, what we saw in Q2 was about a mid- to high single-digit impact on our subscription revenue growth from migrations.

Now, important, though, to note that when we think about cloud migrations, then about a third of that activity is coming from data center. So, again, put in context, when you think about the growth rate of the businesses that we're recording, both cloud and data center, migrations are important, but relatively small part of the overall picture.

So, let's take a step back and really think about what are the key drivers for the cloud. And I'd really point to a handful of items beyond migrations. First of all, I think most importantly, we continue to do an excellent job of expanding our user counts at our current cloud customers. You saw also in the data, we brought 10,000 new customers to the company. They're all effectively going to cloud. We talked about the percentage. And once they're at the cloud, we're doing a very nice job of expanding user count.

The second thing I'd really also highlight, the growing impacts that we're making with our customers on our premium and enterprise editions. This really goes to our overall editions, strategy that starts with free, standard, then premium, then enterprise. And we've really got those four additions now pretty much right across our portfolio, broad portfolio of products. And I think that's a tremendously important driver. We're seeing customers really get incremental value as they step up that ladder, if you will, of additions.

And then, we've spoken now for several quarters about how pleased we've been at the relatively low churn levels and how we've really put effort into minimizing that type of activity. So, that's working nicely. And of course, you saw us roll out a mid-single-digit pricing increase a few months ago now. And so that relatively quickly layers into the P&L when you think that the majority of our customers are on a monthly subscription.

So, those are really the important drivers that are driving the cloud business. Yes, migrations are a part of the story, but certainly, I wanted to put that in context.

Operator: Thank you. The next question comes from the line of James Fish with Piper Sandler. Sir, your line is open.

Quinton Gabrielli

Analyst, Piper Sandler & Co.

Q

Hey, guys. This is Quinton on for Jim. Thanks for taking our questions. Customer additions this quarter were really strong again. Is this kind of 10,000 net adds the right level moving forward or do we move back to more fiscal 2020, fiscal 2021 levels?

And then just as a quick follow-up, what inning would you say that the education of channel partners is at with selling to cloud products? Are we at the bottom of the ninth inning with one or two legacy partners to go, or is there a significant education left within the channel? Thank you.

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

Cameron, do you want to start off with that one?

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Sure. Yeah. As far as the – I can speak to both the new customer numbers as well as the innings of the channel partners. As far as the new customers, like, I have to call out just how incredible this machine that we built in go-to-market that we can routinely get 10,000-plus net new customers in the business while maintaining our efficient go-to-market spend.

But in addition to that, I got to call it two years ago, we made that change to the free model. So in addition to 10,000 paying customers coming in with more than two users, we also have thousands of more teams and companies choosing us and using us in market for free. And that just shows like how much demand there is and why people are choosing us.

As far as the number itself, like, it fluctuates quarter-to-quarter for a variety of reasons, changes in the funnel, seasonality, you name it. So let's be focused on the individual quarter numbers and look at the longer term trend. We've added over 51,000 customers over the last 12 months, which when I started with this company like many years ago was we had a fraction of that of our overall customer base. So we've just been able to continue to evolve and make that efficient go-to-market model work.

As far as innings, being an Australian company, most of our Aussie friends don't understand what innings means. I'd hate to say which inning they're in. The reality is we continue to train, certify, partner with and engage our partners in these migrations. It's multiyear journey. Some of the partners are well ahead and leading on migrations. Many of the other partners are going through these trainings and bringing the people in. So plenty more to do there, but I'll tell you that they are critical to our migration story and our execution there. James?

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

No, I think you covered that. Thank you.

Operator: Thank you. The next question comes from the line of Arjun Bhatia with William Blair. Sir, your line is open.

Arjun Bhatia

Analyst, William Blair & Co. LLC

Q

Thank you and congrats on the quarter. Certainly, in the shareholder letter, it seemed like hiring was a key area of focus. And I think you stated that building new products [indiscernible] (00:31:47) would be a priority as you scale your developer talent. I'm curious if you can share any particular areas of focus that you have out in the market from a product perspective that maybe is not addressed by the product portfolio today.

Scott Farquhar

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

A

I can take that. Hey, Arjun. Mike can add on I'm sure as well. So, look, if you look at the three markets that we're operating in, like, we were lucky to operate in markets that are very, very large, and we have different levels of maturity in each of those markets. And underpinning our ability to go after these markets is the Atlassian platform that we spent over a decade building out. And so when I look at the investments we're making, like, you'd have to say they're in the areas of the three different markets we talked about.

There's the investments required to help our customers make those migrations across the cloud and continued investments in the platform that we're – that we've built out over those years and continue to build out. And the benefits you're seeing come through, obviously, in migration numbers, but there are also benefits in our ability to launch new products, as you've seen with Point A, that we can bring and launch new products to the market pretty quickly.

And so I wouldn't say there being huge changes in that, like, I think as the platform continues to mature, we'll be able to bring more functionality to the market quicker. The ability for us to – as I've mentioned earlier, ability across – to work across dev and IT is, I guess, it's a bit like a chips and guacamole, right. They go hand in hand. And so that's like a unique ability that we have to do that.

And of course, Work Management for all built on a great platform for work, really unifies work across the entire organization, again, something that we're uniquely positioned to do. So, Mike, do you want to add anything?

Michael Cannon-Brookes

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

A

Yeah. I mean, I just wanted to – the question started in hiring, I guess, and ended in markets. So I'm not sure which angle you were trying to go on. I think Scott's point about the platform is really key. Our platform, we believe, is one of our strengths in executing against the large opportunities that we believe we have in all of our markets and around the business and in the Atlassian economy.

Building that platform takes a world-class engineering team and a world-class engineering team at very large scale. So you see us making continued improvements in things like TEAM Anywhere and our culture and pressing our long-term thinking as a business, and also executing against those opportunities, right. I've been clear that we are going to invest and we believe in those opportunities.

At the core of that platform is a truly world-class engineering organization. So if it's about where are we hiring, look, we have a deep long-term belief that building a world-class technology company without engineering and R&D at the core is, to steal Scott's analogies a little, like making guacamole without putting avocados at the core. It just doesn't work. And you'll see that from some other companies, but we have a deep belief in engineering and R&D at the core of executing against the huge opportunities that we have in front of us. And so that's why I would try and tie those two together in your question.

Operator: Your next question comes from the line of Ittai Kidron with Oppenheimer. Please ask your question.

Ittai Kidron

Analyst, Oppenheimer & Co., Inc.

Q

Thanks, guys, and great numbers. I have a couple of questions. One on work management. You haven't talked much about that. Maybe you can give us a little bit more color on the progress there, maybe number of customers. You mentioned that on Service Management, maybe if you can mention that on Work Management.

And then second question, more of a general one regarding the customers that have transitioned to the cloud. Can you talk about the – how the expansion activity of customers that migrate to the cloud is different than expansion activity of customers who remain on-premise?

Michael Cannon-Brookes

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

A

Hi, Ittai. Look, I can take both of those. Firstly, on Work Management for all, the first thing I would say is the fact that we get this deep into the call when we talk about our huge opportunities in IT, we haven't mentioned agile DevOps and software teams or Work Management. I think that's an example of just the size and scale that Atlassian operates at now and the set of opportunities we have. We could spend an hour-plus talking about any of our [ph] segments (00:36:28).

I would say we continue to be incredibly bullish on the Work Management space. We're doing an incredibly good job with Trello and continuing to make that part of our platform, part of our set of offerings whilst having a standalone flavor to it. Jira Work Management continues to power along. It's very new out of our Point A program of innovation, but adding a different flavor on project management. And we're incredibly bullish on things like Team Central and other things coming out of Point A as well at the same time.

So, I feel very comfortable with where we stand. We believe there'll be lots of different ways of attacking the broad work management problem, and that's all before we even mentioned something like Confluence. So, I'm really excited about how that happens and how that continues to evolve. I will say we talk a lot about digital transformation, changing software teams and IT teams. A big part of that is also a cultural transformation and how the software and IT teams work with the rest of the business.

So, yes, we have three different markets. We believe in all of them very deeply. They are tied together at the core of how every company is changing as a software and technology base, but also changing culturally to be more dynamic and more agile. And that's why we're in those three markets.

In terms of cloud expansion, it's a pretty simple story, actually. The ease of adopting a second product in the cloud, our ability to understand what customers are using and, hence, recommend other alternatives for them, either you should get more people in your team on board or you should try this other product is we can just do it a lot faster and easier, right. It's a single click in the cloud, nothing to install, nothing to try. With free, you can quickly get 10 users started. So our ability to help customers expand is just much higher in the cloud, and you see that in greater and quicker expansion numbers of customers. We have to have the products to deliver that value, but our ability to help customers and guide them, less friction in the cloud is just higher.

Operator: Our next question comes from the line of Rob Oliver with Baird. Please ask your question.

Rob Oliver

Analyst, Robert W. Baird & Co., Inc.

Q

Great. Thank you. Good evening, guys. Thanks for taking my question. James, you alluded to this earlier in your remarks, and Scott and Mike, I'd love to hear your view, but you guys continue to knock down a lot of the global compliance standards that are out there, that really are – I assume, are inhibitors to [ph] many (00:39:08) large enterprises and governments really going wholesale into the cloud.

So I'd love to hear a little bit about some of what you've seen in terms of as you knock those down, how that backlog has been converting. And then maybe some of the other global standards out there that you're excited about that you guys hinted in the letter that there's more to come imminently. Appreciate it. Thank you very much.

Michael Cannon-Brookes

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

A

Yeah. Hey, Rob. Look, for sure, it's part of our continued momentum, right. One of the – I hope you've all seen, over time, Atlassian has just continued momentum and improvement – incremental improvement every single quarter. It's something we've done for just shy of 20 years now and we'll continue to do.

The area you've asked about in terms of cloud standards and compliance and governance and the whole sort of acronym soup that comes with that in every different geography in the world, we do believe is that that will continue to be a challenge for every SaaS company going forward, as there are more companies, more geographies, more legal conditions. And so we have to build a world-class engineering organization and a platform underneath our cloud products that allows us to quickly adapt to that market as it changes, that areas of changes, and also continue to add the standards that our customers need and ask us to support.

We've done that over time, and you continue to see us improve in that every single quarter, whether it's data residency in Australia for financial companies or whether it's BaFin in Germany. We've continued to do that and we'll continue to do that. We've seen a lot of examples of every time we add support for a different geography or standard, we unlock a portion of our customer base to move to the cloud. It's not a singular unlock. It's a whole series of ingredients, but it just increases the overall momentum of customers to the cloud.

But for sure, we continue to work on performance and scale for the larger customers in the cloud. We continue to work on compliance and regulations and standards. And we also continue to work on extensibility, which is equally important. The reason I mentioned that last one is Forge, our sort of future extensibility standard and technical framework, builds things like these compliance and regulatory standards in at the core, which is incredibly difficult to do, but we believe in extensibility for our customers going forward. It's long been a hallmark of Atlassian, and I think in a high compliance environment, that's going to be incredibly important for us going forward in the cloud. And we're seeing that in the adoption of Forge via those enterprise customers in the cloud where it handles the regulatory standards for them.

Operator: Thank you. The next question comes from the line of DJ Hynes with Canaccord. Please ask your question.

David (DJ) Hynes

Analyst, Canaccord Genuity LLC

Q

Hey, guys. Congrats on the continued success here. I have a product question for Mike or Scott, I presume. So there are a handful of visual collaboration tools in the market that are seeing really strong growth. I know you guys

recently invested in Miro. What is it about visual collaboration that makes it hard for you to replicate? Like, why invest or partner in that space versus doing it on your own?

Michael Cannon-Brookes

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

A

Yeah. I can take that, DJ. Look, we've long believed in having a broad spectrum of opportunities in that. With Atlassian Ventures, we are trying to make sure that we are investing and partnering in high-quality enterprise SaaS companies that are partners of Atlassian. You've seen us do that in the past with Zoom and Slack and others, and more recently, with Miro and Snyk and across our markets as well as a whole host of smaller up-and-coming names.

Visual collaboration in general, look, it's a very busy category, I would say, because it's such a broad option. It used to be called whiteboards, but it's not really a whiteboard. It's a whole series of different things that you can do there. It's a bit like saying it's one way to do project management. If you're a five-person marketing team, you do project management utterly differently than if you're 5,000 engineers building a bridge. So project management is a very broad term. I would say the same thing for visual collaboration. It's a broad term. I think there'll be a lot of fantastic products in there. And obviously, we believe in the ones that we use and the ones that we've invested in. But in general, our customer philosophy is being partnered and integrated with all of the best-of-breed SaaS products that are out there and allowing our customers to make those choices and just making sure that all the data they have in any Atlassian product is easily connected and integrated with all the data they have in any other product.

Operator: Your next question comes from the line of Brent Thill with Jefferies. Please go ahead.

Brent Thill

Analyst, Jefferies LLC

Q

Thanks. On Trello, you've been pretty clear, over 50 million on the platform, yet I think monetization is still low. Can you walk through how you expect to potentially change that over the next year or maybe not? And for James, Americas, at least in our model, look like the best quarter in 13 quarters. I know that the comp was a little easier, but anything stand out there in Americas that perhaps you haven't seen in past quarters? Thanks.

Michael Cannon-Brookes

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

A

Brent, I can take the first part on Trello monetization. I'm sorry I don't have much new news for you, but I can repeat our stance here. I mean, Trello, we focus first on continuing to grow the [indiscernible] (00:44:55) the size of Trello, going after the Fortune 500,000. We think about very, very large scale. And there's 1 billion knowledge workers out there trying to do all sorts of different things that Trello is very, very useful for.

You've seen us continue to improve the product with views, smart cards to integrate third-party data, as we just talked about, and a whole series of continued product improvements. That said, we've gotten better at monetizing Trello almost every year that we've had it on the platform and continue to do so. But I will say that we put usage before monetization when it comes to Trello.

You see it getting closer to the Atlassian platform in various different ways in terms of Atlassian account and identity and all sorts of different things. So we're very patient in doing those things correctly and continue to make Trello a huge product that's beloved by its users and we put that first, but it's a pretty nice business for us and we continue to invest in it. James, [ph] I'll leave you with the second one. (00:45:54)

James A. Beer

Chief Financial Officer, Atlassian Corp. Plc

A

Yeah. Just to follow up on that. One of the things we've done around Trello's pricing has been to recently bring in a standard edition. And again, this is an example. We talked about price increases at different points on this call. So it's a good example of where there are many indications where we actually lower price, again, to stimulate the sort of demand that Mike is referring to that.

In terms of the Americas result, yes, it was a strong year-over-year growth rate for the Americas. I'd just point back to one of my earlier comments about, obviously, data center had very strong growth in the quarter. And we do have this portion of the customer commitment that is taken upfront in terms of rev rec in the quarter in which the customer signs with us.

And of course, the US, the Americas, but particularly the US is home to a good number of our largest customers. So there's a certain amount of timing effect there that made for a very strong Americas year-over-year growth rate.

Operator: Thank you. And the next question comes from the line of Gregg Moskowitz of Mizuho. Your line is open.

Gregg Moskowitz

Analyst, Mizuho Securities USA LLC

Q

Okay. Thank you. I remember when you launched Atlassian Marketplace, that was less than a decade ago, and here we are at \$2 billion in lifetime sales. That's incredible. My question here is, with cloud now comprising nearly half of the apps in the Marketplace and with take rates continuing to be discounted as an additional incentive, are we sort of at a pivoting point? In other words, are we at a phase where you're seeing app development and app usage really accelerate?

Scott Farquhar

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

A

Yes. Scott, here. Look, we're really proud of the Marketplace. I remember the plane ride where Mike wrote the original code that went into the Marketplace and got us off the ground. And for us to get from there to \$2 billion in lifetime sales is amazing. And more importantly, that's \$1.5 billion of money that's going back into the ecosystem, right. And we've got such a strong and powerful ecosystem around Atlassian. And we've long, for over a decade, had goals around the ecosystem outside of Atlassian to be way larger than Atlassian itself, both in terms of the number of people working on it and the revenue there. And so we're really proud about kind of the jobs and everything [ph] we've created (00:48:33) around Atlassian and how we benefit all of its benefits from that.

In terms of like the cloud and tipping point, obviously, Forge, our app development platform in cloud, takes care of a lot of things that developers used to have to do themselves, such as running their own servers and now we take care of that for you. So that has lowered the barrier to entry for new people to build functionality inside our applications. And as we've seen kind of in our server-based applications, a lot of the early adopters of these new technologies are people using internally inside their own companies to integrate with different processes, to automate things themselves, to build extra functionality that is unique to that particular company. And that often then leads to people starting their own business, using those things and making it more generic or those things flow through our existing Marketplace partners who are building out on the Forge capabilities.

So I think like longer term, you're seeing pressure on Marketplace take rates across kind of – particularly on the consumer side of things, there's been downward pressure on that, and we get to play that out over the long-term. I would say that – the take rate, there'll be more pressure on the take rates than they have been historically, but that's also going to lead to a much, much, much larger ecosystem built around Atlassian like. And we're experimenting and seeing beyond our traditional partners how we can partner with people like that we've made investments into Atlassian Ventures.

And overall, like the number we focus on is not really our take rate. Like, that's nice, but the number we focus on internally is our sort of GMV or – so effectively, how much money is running through the Marketplace like to our third parties. And that's a number we optimize for internally.

Operator: Thank you. And our last question comes from the line of Steve Koenig with the SMBC Nikko. Your line is open.

Steven Koenig

Analyst, SMBC Nikko Securities America, Inc.

Q

...squeezing me in. I appreciate it. Most of my questions have been asked, but – and actually, let me also congratulate you on the quarter also on the very low employee turnover metrics that we're seeing from LinkedIn, especially in sales. I just think it's remarkable. I guess what I'll ask about maybe a little bit in the weeds, but the price increase is happening on February 15. You talked a little bit about the impact it could have on the coming quarter. What kind of customer behavior could we expect in the subsequent four quarters with respect to like those customers that maybe have renewed early to take advantage of locking in the price? And then, would they be looking to convert to cloud within the next four quarters? Will there be a greater incentive to convert to cloud? Kind of how do we think about that?

And I guess the larger question here really is as we kind of puzzle over your trajectories here, we talked a bit about data center and the drivers there. We talked qualitatively about the drivers in cloud. But we're seeing cloud continue to accelerate here. And just kind of how do we think about that even if it's qualitative? So that's all and thanks again and congratulations.

Cameron Deatsch

Chief Revenue Officer, Atlassian Corp. Plc

A

Yeah. So thanks for the question. This is Cameron here. So two pieces on this. So every time we do some price changes, obviously, customers have the ability to make a choice.

And I was actually just on a call with an executive of a very large pharmaceutical company just this week, largely talk about his options going forward, which is, one, you can renew. That's fine. [indiscernible] (00:52:10) an option going forward. Renew your data center licenses as we continue to plan for cloud.

The second is we can start planning out a few small cloud projects, maybe for some teams, or we can go all-in on cloud and get it all done with. It all comes down to what's your prioritization and what your company's readiness. After a 30-minute conversation, he basically said, give me the all-in on cloud option. Like, this is fine. We have a cloud mandate. We need to prioritize the work. Let's just get it done now. The reality is that's how we – but we prefer that optionality for our customers. We're not forcing them down any path. It's what's going to work for them and their projects and the value that we can deliver.

The second big one is even if they renew today, we have plenty of programs and practices in place that two months from now or four months from now or six months from now, if they want to move to cloud, we'll absolutely make them right from a licensing perspective. So by no means do we hold them to a 12-month cycles for these decisions. At any time, we're happy to start the migration efforts, get them cloud licenses and get their toe in the cloud.

So a lot of this comes down to largely the customer's appetite to take on the IT project that is in migration more than anything. For most of our customers, they are more than ready to go cloud, and almost all of them have cloud mandates and just comes down to timing of budgets, prioritization and IT projects.

Operator: Thank you. And the next question comes from the line of Pat Walravens with JMP Securities. Your line is open.

Joey Marincek

Analyst, JMP Securities LLC

Q

Thanks. It's Joey Marincek on for Pat. Appreciate the question. Can you just give us some more color on the Percept acquisition? And then sort of how are you thinking about M&A going forward? And then, separately, what are you looking for in your next [ph] EPO (00:53:57)? Thank you so much.

Michael Cannon-Brookes

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

A

Well, squeezing with three questions at the end there. Well done. Look, let me take Percept first. Fantastic team focused on AI and smart in – specifically in a service management and customer service manner. Again, AI and smart is relatively domain-specific to make a huge impact at the moment. And so I would see this as a part of our continual improvement in the ITSM space, both organic and inorganic, to make sure that we have the best set of ITSM tools around and also an investment in machine learning and smart as we keep putting at the core of our platform.

I always say that our customers shouldn't need to know that we care about AI and machine learning and smarts, but we bake it deeply into the platform. And this is about continuing to improve that in the area of service management and for IT teams and any service-driven enterprise out there. I can pass to Scott on M&A philosophy, if that's [indiscernible] (00:55:10).

Scott Farquhar

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

A

Yeah. Sounds great. Mike, look, we're lucky as a company. We have a track record of building new products. We've got a track record of partnering in our ecosystem, which we talked about on the call, and of course, a long track record of successful M&A, both really small tuck-ins and medium-sized companies like Trello, which we brought as an extension. And so I don't see that changing in the future, like we continue to execute really well on all three.

When we look at which things we want to acquire over time, the number one thing we look at is our cultural and mission alignment. So are they – do they have unleash the potential, right? That's going to be the most important thing is do they align with our mission. Then, does it fit culturally with Atlassian? And then everything else after that, kind of go-to-market and technology and other things are areas we evaluate, but like first two, the most important thing.

And so there's been no change to our M&A philosophy over a long decade on time horizon. We'll continue to look for assets that fit really well alongside Atlassian as well as kind of small tuck-in technology acquisitions that help us where it will be quicker to acquire something than build it ourselves.

Operator: And the next question comes from the line of Derrick Wood of Cowen. Sir, your line is open.

J. Derrick Wood
Analyst, Cowen & Co. LLC

Q

Great. Thanks. James, a question for you on operating margins. You guys are targeting, I think, 17% to 18% in Q3. That's down from 26% to 27% in the first half. Can you just talk about what's driving that margin step down, where you guys are looking to step up investments and kind of where you see hitting the low watermark and margins starting to rebound? Thanks.

James A. Beer
Chief Financial Officer, Atlassian Corp. Plc

A

Yeah. Sure, Derrick. We very much feel as – and we've been saying this for a while that there's such a significant opportunity in front of the company across the three markets that we really want to push to continue to build on the momentum that we're seeing, hiring, bringing excellent talent in wherever they are around the world. I think the TEAM Anywhere approach we have is really important in terms of differentiating our ability to attract the best talent, obviously, in a very competitive field. And it's with those additional folks that we'll be able to get after these very significant opportunities that lie right in front of us.

And so we're really enthusiastic about that. We're really positive about that opportunity. And more tactically, if you think about the fact that we are increasingly becoming a cloud company quarter-by-quarter, 53% of revenue is now cloud. That'll, of course, have an impact on gross margins. We've talked about that for a number of years, as we take on the work of hosting the services on behalf of our customers. And we're also going to be investing in additional support resources to help our customers meet that migration journey very much along the lines of what Cameron was just talking about with the large customer that he was talking with this week.

So those will drive some transitory impacts on the gross margin as we ramp up those support resources and do the migrations work. In terms of operating margin, that's where the significant bulk of the additional investment would be, and that in our business, as you know, really comes down to adding Atlassians. And so that's why it's really – and we described it in the letter is our top priority.

So that's what we'll be focused on opportunities across the three markets. The platform, I think, is a really important accelerant of our business. You've seen that showing up in our ability to quickly get new products developed. Point A, we've talked about those new products under that program will continue to be important.

So we'll continue to be very focused on the quality of our investing and the returns that we can generate for our shareholders. And I'd be confident that the health of the financial model for Atlassian will be strong.

Operator: Thank you. And that concludes our question-and-answer session. I will now turn the call back to Scott. Sir, please go ahead.

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

I just wanted to thank everyone for joining the call today. Thank you to our customers and to all the fantastic Atlassians out there, past, present and future. We appreciate your ongoing support, and we hope that you and your loved ones remain safe and healthy in these times.

Lastly, we hope to see some of you in person and for the rest of you in team virtually to Team 2022 coming up in April. Have a good rest of your day.

Operator: Thank you. This concludes our today's conference call. Thank you for participating. You may now disconnect.

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