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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and thank you for joining Atlassian's Earnings Conference Call for the First Quarter of Fiscal 2023. 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.

Welcome to Atlassian's first quarter of fiscal year 2023 earnings call. Thank you for joining us today. Joining me on the call today, we have Atlassian's Co-Founders and Co-CEOs, Scott Farquhar and Mike Cannon-Brookes; our Chief Revenue Officer, Cameron Deatsch; and Chief Financial Officer, Joe Binz.

Earlier today, we published the shareholder letter and press release with our financial results and commentary for our first quarter of fiscal year 2023. The shareholder letter is available on Atlassian's Work Life blog and the Investor Relations section of our website, where you will also find other earnings-related materials, including the earnings press release and supplemental investor datasheet. As always, our shareholder letter contains management's insight and commentary for the quarter. So during the call today, we'll have brief opening remarks and then focus our time on Q&A.

This call will include forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and assumptions. If any such risks or uncertainties materialize or if any of the assumptions prove incorrect, our results could differ materially from the results expressed or implied by the forward-looking statements we make. You should not rely upon forward-looking statements as predictions of future events.

Forward-looking statements represent our management's beliefs and assumptions only as of the date such statements are made, and we undertake no obligation to update or revise such statements should they change or seem to be current. Further information on these and other factors that could affect our financial results is included in filings we make with the Securities and Exchange Commission from time to time, including the section titled Risk Factors, in our most recently filed annual and quarterly reports.

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

Please keep in mind that we'd like to allow as many of you to participate in Q&A as possible. And to facilitate that, we'll take one question at a time. Please rejoin the queue if you have another question or a follow-up and we'll do our best to come back to you later in the session.

With that, I'll turn the call over to Scott for opening remarks.
Scott Farquhar  
Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp.

Thank you for joining us today. We are proud of our execution in Q1 against our long-term initiatives. We announced a new subscription offering in Atlassian Together, launched Atlas into general availability, and held Work Life, our first large-scale customer event focused on a single market.

As you've already read in our shareholder letter, Atlassian is not immune to the broader macroeconomic environment, but we remain steadfast in our conviction that we have the right leaders, products and strategies in place to capitalize on the incredible long-term opportunities in front of us. Turbulent markets provide an opportunity to shake up the leaderboards, and we're poised to play offense. We'll focus our investments to take share and strengthen our market position in this environment.

We'll, of course, balance our continued investments with the overall growth of our business and be responsive to the macroeconomic conditions. We continue to have line of sight to $10 billion in annual revenue and believe we will come out of this environment in a much stronger market position.

I'm incredibly thrilled to pass the CFO baton to Joe Binz, who I want to welcome to his inaugural Atlassian earnings call. He's only been here since early September but he's quickly gotten up to speed and will do far better than me in my short stint as interim CFO.

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

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from Keith Weiss from Morgan Stanley. Please go ahead.

Keith Weiss  
Analyst, Morgan Stanley & Co. LLC

Excellent. Thank you, guys, for taking the question. I guess kind of a top line and a bottom line question, you guys mentioned in the shareholder letter, and I appreciate the being upfront about kind of the macro impacts you're seeing. Free to paid conversion slowed down, and in some of the paid, it sounds like NRR slowed down a little bit. What have you guys been seeing in kind of top-of-funnel trends? Is that kind of filling as expected or did that slow down as well? And then, you are sustaining the operating margin guide for the full year even with the revenues coming down a little bit. Where are the areas you guys are looking to get the increased efficiencies as we think about FY 2023? Thank you.

Cameron Deatsch  
Chief Revenue Officer, Atlassian Corp.

So first off, this is Cameron. I'll speak to the top line position and I'll hand off to Joe to talk about expenses. So yeah, as we mentioned previous quarter, actually back in our August earnings, we spoke about how – while we were seeing plenty of people coming in and trying Jira, trying to our Free versions of our products and we continue to see that trend today, many more people coming in, signing up and using our products. We saw them starting to slow down, getting to that 11th user, entering their credit card information and becoming paid customers. So, that trend definitely came through throughout the quarter and we see it today, where we still have
plenty of people coming in. Year-over-year growth of our Free instances continues to grow, which is great, but just a little bit slower in the converting to an actual paying customer.

The new piece we saw in the previous quarter was that towards the end of the quarter, we actually saw user expansion in existing accounts. So, this is largely people going from 100 users in Confluence to 110 users, right, and that's largely due to companies slowing down hiring, trying to constrain their own internal IT budgets and using more licenses than they already have. Now we continue to see growth, just that user growth wasn't nearly as strong as what we've seen historically.

On the other side, on top line, so while the user growth slowed down, we do continue to see migrations tracking along as planned. Our editions, we're getting people from Standard to Premium and Enterprise versions of our products strong, and cross-sell. Jira Service Management, specifically, continues to be adopted well. So while we are affected by basically hiring rates and how quickly people are adding people to their organizations, the big projects like migrations or choosing their new IT service management tools, we've seen those slow down in those efforts to date.

Joe, do you want to handle the expenses conversation?

Joe Binz
Chief Financial Officer, Atlassian Corp.

Yes, Thanks, Cameron, and thanks, Keith. So, there's really two focus areas. First and foremost, we're making reductions in our non-head count-driven discretionary spending. And then, secondarily, we'll be moderating the rate of planned head count growth in the second half of FY 2023.

I'd say in terms of areas, Keith, I think there's efficiencies to be found across the board, whether you're talking about gross margins or process efficiencies or even resource allocation, right, looking at where we have our resources allocated, make sure that we're constantly prioritizing investments and moving those resources at the highest ROI and most impactful things. And Scott mentioned this is all with an eye towards strengthening our position in the large high-growth markets we're targeting and enabling us to emerge in a stronger position out of the downturn as we were going in. So hopefully, that gives you a sense, but I would say it's very broad and based on those two primary principles.

Keith Weiss
Analyst, Morgan Stanley & Co. LLC

Got it. That's super helpful, guys. Thank you so much.

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

Michael Turrin
Analyst, Wells Fargo Securities LLC

Hey there. Thanks for taking the question. Appreciate it. And I'm sure it's going to be somewhat of a similar construct to the first one, but I'll ask a little bit differently. So, a couple of parts. The first one is just in clarifying some of Cameron's comments from the first question. It sounds like it's fair to assume that it's more -- it's less the cloud migration trajectory, like the pace of migrations that you're seeing changing here that's influencing the change in revenue target for cloud for the year than it is the expansion rate. So, first part is just is that a fair assumption that that 130% to 140% for large customers that we're seeing is what's causing the moderation impact?
And then, the second part for Joe is just I know you’re relatively new to the call, but your views just around potentially giving more margin, what would inform that discussion versus just continuing to stay the course with the investment cycle? I know the company tends to think long term? So just your thinking, given the macro is changing a bit, I think is useful here in the context of what you’re seeing. Thank you.

Cameron Deatsch  
Chief Revenue Officer, Atlassian Corp.

Happy to speak to the — just to be very, very clear, yes, we have seen no change in our migrations rates. Our migrations progress continues to be on track, as it's been the last few quarters. With the server end-of-life coming up to February 2024, as well as our loyalty discount program which will basically take another step down in June, we have a series of compelling events that we’ve been working with our customers over the last couple of years. We get better in those conversations every day. And the migrations efforts continue to be right along with plan. So, no impact due to migrations. It is largely purely focused on people adding users, that user expansion within their existing use of our products that we've seen slowed down a bit over the last quarter.

Joe Binz  
Chief Financial Officer, Atlassian Corp.

Great. Michael, this is Joe. Thanks for the question. On the NRR question or the expansion rate question. As you know, we don't provide updates on expansion rates on a quarterly basis. Directionally, it remains very healthy and above the 130% we discussed at the Investor Day. I think that's indicative of the fundamental health of our business, particularly around upgrades to Premium and Enterprise editions, customers adding new products and churn rates. And while we talked about the macro impact on paid seat growth within existing customers relative to expectations, the absolute growth rates there are still very good on an absolute basis. So, that's also a big driver behind those healthy expansion rates.

And I'll turn it over to Scott to talk a little bit about the margin tradeoff discussion.

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

Stepping back in terms of thinking about long term, like we've been through multiple downturns as a business. Like we've started in 2001, 2002 in sort of the dot com crash, we went through 2008, 2009, and I guess we're now in the third downturn for us. And what we've learned is that during those periods of time, like if you can invest wisely you can come out the other side with the leaderboard shaken up a little bit and you can come out higher on that leaderboard than you went going in. And so, that informs a lot of how we think about the investments through this period.

So, there's a couple areas. One is, we think that we can pick up staff where other companies are shedding staff. There's a lot of incredible people in the market who may only come on the market once a decade and may have an opportunity to pick those stuff up now. And so, we've been really thoughtful around kind of how many we hire and where we hire. But our experiences that we can come out really strong on the other side by selectively picking out staff that other people letting go.

We also, in terms of thinking about what the opportunities, and we said in our Investor Day, it kind of feels like a long time ago now, but it's only early this year, we said we have three really good opportunities that we were going to invest behind. That was migrating our customers to the cloud at the fastest rate we can, building new products to that point A program, and investing more in ITSM with our JSM platform there.
And so, again we think those are long-term investments that pay off short, medium and long term. We want to continue to invest in those areas. And so, we're going to continue to do that. And so, we're going to be thoughtful around that. We need to make sure that does fit within a certain cost envelope, and with the macroeconomic environments, we want to be conscious about what the cost envelope is. But again, our philosophy about investing for the long term, about having low-priced products that are very particularly attractive in this market, picking out staff, that hasn't changed through this cycle.

Michael Turrin  
*Analyst, Wells Fargo Securities LLC*

Appreciate all the detail there. Thank you.

Operator: Your next question comes from Fatima Boolani from Citigroup. Please go ahead.

Fatima Boolani  
*Analyst, Citigroup Global Markets, Inc.*

Good afternoon. Thank you for taking my question. Cameron, the question is for you. It's a little bit of a counterfactual. So, I know you're staying committed to the proportion of your cloud growth coming from migration. But conversely, why wouldn't you see a slowdown in migrations to the cloud, if the sensitivity that you've seen most to date is on the user expansion area?

So in other words, why wouldn't the existing customer just sweat out the capacity that they have versus going to sort of a per user named seat model, where potentially the TCO in the short term could be much higher? Just a couple of thoughts there on why that wouldn't actually impair the migration cadence to the cloud. Thank you.

Cameron Deatsch  
*Chief Revenue Officer, Atlassian Corp.*

So basically, let me just try and rephrase the why haven't we seen a slowdown in the cloud migration rates when it is a – an effort for customers to make a change versus just sitting on their renewals and waiting till the last minute. The primary reason for that is that over the last two years, ever since we announced the server end-of-life now almost exactly two years ago, we've had a very well-engineered set of programs that we have released between loyalty discounts, new migration tooling, more engagement with our enterprise customers, incentivizing our partners and incentivizing our customers to ensure that cloud is the proper destination for them. And many of them over the last two years have been in various stages. Some moved very, very quickly. Some are building plans today. Some are waiting, like you said, to the last minute. But across the board, we have seen that entire approach been largely on track.

So they haven't been seeing the, hey, should we migrate to cloud as a capacity to challenge. It's not like 100 users, the fact that they need more, add users, they can add more users on premises if they want versus adding more users on cloud. It's more of the, well, we've been looking to go to cloud and we've made the strategic decision to go to cloud, there's a whole lot more value that we unlock in cloud and more productivity for the users we have. So, let's go through and continue to finish this project so that our teams operate more efficiently and have the best tools available to them even if we were going to have less people hired in the future. So, it wasn't really tied to how many people are in the room. It's more tied to them choosing the best solution for them long term, and of course, reacting to the programs that we put into market to compel them to move to cloud.
Fatima Boolani  
*Analyst, Citigroup Global Markets, Inc.*

Thank you for that.

Cameron Deatsch  
*Chief Revenue Officer, Atlassian Corp.*

Welcome.

Operator: Your next question comes from Arjun Bhatia from William Blair. Please state your question.

Arjun Bhatia  
*Analyst, William Blair & Co. LLC*

Hello. Yes. Thank you for taking my questions. I’m curious just when you think about the macro impact that you’re seeing, is there any way to just break it down any further between the behavior that you’re seeing from larger customers that are maybe multi-product, that are more committed, that have a broader deployment versus smaller customers that are early – earlier in their journey?

And then, Joe, one for you, just when you’re thinking about the rest of the year and the guidance that you’ve provided, can you just help us understand what you’re incorporating from a macro perspective in the forward numbers? Thank you.

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

Hey, Arjun, I can take that one. Look, I want to re-stress our philosophy of open company and no [obscenity] (16:51), right? We've told you every single quarter we've been public. We're going to be open with you and clear with you about what's going on. We've tried to do that the best we can in the letter, right? The two areas that we're seeing impact, again, is the Free instances, the rate of converting to paid, and secondly is the rate of user expansion growth. The historical rate has been pretty consistent for us slowing down a bit. The reason for that is we think both anecdotally and best guess is customers optimizing their spend, right? If you are going to add that 11th user, you're more likely today to think outside of 10. The good part about that for us is, we see no sort of decrease in usage or change in churn rates. These aren't customers leaving Atlassian at all. These are customers who are dealing with their own turbulence and optimizing their spend and tuning the number of users they have, right?

We've also highlighted where we see as great opportunities in front of us and being quite clear about where we're playing offense, and some of them go to the areas that you said. Cameron just addressed migrations, which continues to be strong. If you think about it from a customer perspective, if you're looking at optimizing spend, cloud is an easier place to do that than on premise because you are — can pay monthly and you can pay per user, et cetera. So, that gives you a slight use of optimization. And secondly, it's much higher ROI in terms of running the software. We do all that for you. So that's why we see continued opportunities in migrations, which are tracking strongly.

Secondly, in enterprises, we certainly see that as significant opportunity on the back of 10 years of really great work we're continuing to optimize for the enterprise. That's a huge opportunity area for us. And lastly, as you've mentioned repeatedly in ITSM, we're seeing really strong growth. So, all those play into the enterprise that you
talked about. But hopefully, that gives you some background color about where we think we're well-positioned to gain market share in this environment and really excited about the future.

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.

And this is Cameron. I'll add a little on...

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

Go ahead – oh, sorry.

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.

...just give you a little more view of the – how we view SMB growth over our enterprise customer-based growth. Now, first and foremost, that the constraints in the growth rate of users we do largely see across all cohorts. Like I said, all size customers, industries and geographies, it seems to be broad across the customer base.

However, we do consider – continue to see strength in our enterprise business for a few reasons, primarily due to the fact that migrations, which are going as planned, have an outsized impact when it comes to our enterprise business compared to our small and medium-sized business simply due to pricing dynamics. The second is also in our enterprise business, that we continue to see customers continue to standardize on our applications choose the Enterprise edition of our products when they move to the migrations, which continues to grow their inputs.

On top of that, in just over the last month, we've announced a partnership with Accenture, which gives us massive scale with one of the large global system integrators in the industry to help our customers through their massive transitions, whether that's their agile transformation or their cloud transition. And just today, as Mike mentioned, that our growth in IT service management market, we were named a leader in the Gartner Magic Quadrant, which shows that even more enterprise credibility as we look to expand into IT operations and service management use cases in the enterprise.

Joe Binz
Chief Financial Officer, Atlassian Corp.

And then, Arjun, this is Joe. You asked about the assumptions underpinning the guidance. We're assuming two fundamental things in our guidance. First, the current macroeconomic environment persists throughout the year and does not get materially better or worse. And then, secondarily, the macro impact on the business and the trends we saw in Q1 around Free to paid conversion rates and paid seat expansion at existing customers also persists throughout the year and does not get materially better or worse. So in other words, the guidance assumes status quo on those two factors.

Like most, we continue to monitor things closely, both on the macro side and on the business side, and we're adjusting and responding to it. As you know, there's a lot of uncertainty right now, and we think this is an appropriate range, given what we have seen to date, both in Q1 performance and our Q2 quarter-to-date performance on the underlying trends we saw there.

Operator: Your next question comes from Alex Zukin from Wolfe Research. Please go ahead.
Alex Zukin
Analyst, Wolfe Research LLC

Yeah. Hey, guys. Thanks for taking the questions. I want to dive into that last – the last answer from both Cameron and maybe others. I guess if we think about the enterprise impact, like can you maybe dissect the cloud revenue growth for the year, the take down? Is it the – are the seat adds – the headwind from the seat adds, is that more in the mid-market, the SMB, the enterprise? Is there – would you say it's being compensated by incremental module additions at the enterprise? Help us unpack that and give us a sense for when you started to see these issues. It was in the last two weeks of the quarter. How that's trended in October?

And from the financial perspective, is the cloud growth kind of exiting this year? Where does that trend? Because if I remember correctly at the Analyst Day, we talked about that 50% wasn't just for this year cloud growth but for a couple of years. So I'm assuming it's coming off for this year, but I just want to clarify is that also off for the next couple of years? Apologize for the multiple questions.

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.

No problem at all. I'll address the first part and then hand off to Joe. So as you know, our cloud growth, easy to think, is that it's new customers coming in, those customers adding users to the products that they have purchased, in addition to upgrading editions to either the Premium or Enterprise version of their products. Also, migration is another big piece of our cloud growth. Roughly 10% of our growth is due to migrations, and of course, cross-sell, expanding out to our other products.

So to diagnose, specifically, what we saw in Q1, the specific areas we saw in Q1 was the net new customers starting to slow the rate. We still added over 6,000 net new customers, but we saw that somewhat slowing down as Free customers slowed their conversion to paid customers. And we saw that user growth, so someone who is an existing cloud customer flowing down the rate on which they added more users. We did not see any impact to either migrations or edition upgrades or in our major cross-sell motions. So, it's primarily just user additions tied to largely hiring, our customers adding more and more employees into their business, and then slowing that down, which slows down our user growth. Those other efforts are right on track as we originally planned. Joe?

Joe Binz
Chief Financial Officer, Atlassian Corp.

Thanks, Cam. And then, Alex, your question on how we're going to exit Q4, we expect to exit Q4 with cloud revenue growth rates in the 40% to 45% range.

Alex Zukin
Analyst, Wolfe Research LLC

Perfect. Thank you, guys.

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

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Okay. Thank you for taking the question. So, I think of Atlassian as an unusual software company in a good way. A couple of the reasons being that: one, your quarters are typically very linear; and two, you have tremendous
visibility into customer buying and usage patterns. And so, I'd have to believe that you had a very early warning of
the paid user growth slowdown that began midway through the quarter.

And with that said, what I'm wondering is, was there anything that you were able to do that has enabled you to
mitigate the slowdown as it unfolded? Investors are pretty surprised to see results like this from Atlassian. And so
the question here or the spirit of the question is, whether you have the ability to make adjustments and navigate
the difficult macros better than others. Thank you.

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.

Hey, Gregg. This is Cameron again. Sorry, Scott. Go ahead.

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

It's Scott here. Just want to sort of – philosophically, Gregg, one of the things we look at, we're a long-term
company and there are – many of our peers drive their quarters really back from the sales team. They sort of say,
how many salespeople I got and how many reps do I have and that's how they run their business. If you look at
our business, it really is a much more long-term self-serve model where our customers come. And we're also,
from a price perspective, much more reasonably priced on a [ph] first day (25:38) basis than many of our
competitors out there.

And so, in terms of – it's good and bad. There aren't many things we can do within a quarter to affect the quarter's
results, which is why you see the linearity that you've seen over the years from Atlassian. And so, when I look
about the macro environment and what we're seeing, we've cut this every which way, by geo, by product, by
market segment. It really comes down to that customers are not adding seats and heads the way they used to
add them, because the hiring environment has changed outside of Atlassian.

And so, we see that and we trended there. Long term, we're really – we've got – we can sell more products to
customers. So, we have a great product pipeline in point A products. We've had great market opportunities in
ITSM. The migrations are still going strongly. And one of the reasons they're going strongly is that the ROI is just
so compelling to them. Though they pay us more money, the overall cost to them of TCO goes down because
they're going to have less people managing things in an environment where they had to manage their own
servers and data centers. And so, that's a great opportunity.

All those are great opportunities for us in. They're not short term, do something within a quarter. They really play
out over the long term. And again, when we look at sort of the opportunities for us now, they are to take market
share because we have great products that are cost competitive versus competitors out there. And what we're
seeing here is that we haven't seen any material change in churn like it's mostly on adding seats, and so then
also points to the stickiness of our products. And so, that's the way I think about that.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Very helpful perspective. Thanks, Scott.

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.
I can also add onto just the timing of things that we saw. As we mentioned in August, what we were seeing in the August timeframe was the net new customers, the free customers converting to paid was slowing down going into August. We normally, through our summer season, the July and August, tend to see user growth slowdown across our customer base, largely due to seasonality, vacations and holidays. It just tends to be a normal seasonal trend where July and August are slower, as people are not upgrading instances, adding more users.

What we noticed usually most years and when you come back in September, everyone come back to work, the holidays wear off and people start adding users and upgrading their instances again. And that's when we actually did not see that normal user growth uptick that we normally do in September.

The great thing is that, while the advantage that we do have is that we have plenty other growth drivers we can continue to leverage in our business, whether it's upgrading editions, continuing to escalate our migrations efforts or relying on expansion to other products, of which we've even released a few new ones over the last few quarters. So, plenty other levers that we tend to pull when we see user expansion slow down.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Great. Thank you, both.

Operator: Your next question comes from Brent Thill from Jefferies. Please go ahead.

Brent Thill
Analyst, Jefferies LLC

Headcount accelerated to the fastest growth in 11 quarters kind of into the face of this slowdown. Can you just talk to what you're going to do through the next six to nine months and how you're thinking about that investment pace? And then I had just a quick follow-up on the geography perspective, EMEA looked like it had the biggest hit. Can you comment on what you're seeing in EMEA versus the US? Thanks.

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

I'll go to head count and Cam can talk about the geo side of things. On the head count, you're right. Brent, it is our high watermark on head count growth. We do have, from a seasonality perspective, a lot of graduates coming out in the US who started this quarter. So, that gives this quarter's numbers a boost. And we are thinking about sort of what does our head count moderation look like going forward. We are still going to be growing our head count, but of course moderating that growth in light of the macroeconomic conditions and ensuring that people are going on the most productive of projects.

Cam?

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.

Yeah. From a geographic perspective, as I mentioned prior, the trends we tend to see across our customer base has been largely across all segments, industries and geographies. So when we look to Europe specifically or APAC, we have seen no quantitative change other than what we've already spoken about, the user expansion slowing down, but migrations, our edition upgrades, our cross-sell programs continue to be on track from a quantitative perspective.
Qualitatively, when we talk to customers, we do get plenty of discussions and concerns about the largely uncertainty we see going into the next year. Plenty have financial concerns related to the variety of macroeconomic efforts that are areas that we see impacting their businesses. That has not caused projects to slow or migrations to slow down at this point, but it’s definitely a constant conversation we are having with those customers.

Brent Thill
Analyst, Jefferies LLC

Thanks.

Operator: Your next question comes from Michael Turits from KeyBanc Capital Markets. Please go ahead.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.

Hey, guys. On the subject of the slowdown in both expansions of customers and conversions, your time to slower head count growth among customers themselves, can you say, perhaps, if there is -- you see anything particular in the development world, in other words, among the head count growth or not in your customers for software developers? And how that may or may not be tied to what we've heard about in terms of the spend in the cloud this quarter?

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

Michael, I appreciate the direction of the question. It's just we think head count growth slowing in our customers. Where is that on a -- I think you're asking which departments of our customers are seeing that head count slowing. Does that factor in the other cloud spends and so forth? I think it's too early for us to have any sort of opinion, strong opinion on that, like we sell across the entire customer base in our customers. So, it's sort of hard for us to be specific about that because our history is going more to developers. But the thing to take away from last year's result is we're really sticking our customers. We haven't seen people decide to slow the migrations. We haven't seen people try to reduce source or cancel contracts or anything like that. It really is just tied to head count growth, but I couldn't give you any more detail onto which departments that is.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.

Okay. Can I just ask one additional question, too. I mean, so you're seeing it across all segments. But another way of thinking about is not segments, per se, but customers with different sizes of spend. And I think you obviously have some people spending a lot of money with you with additional small companies or big ones. But there's also the ability to have a fairly small spend with Atlassian, and therefore, maybe in some sense, it's to fall underneath the radar in terms of big budgeting decisions. Do you see any difference there between where you're a big part of the company's budgets versus small?

Cameron Deatsch
Chief Revenue Officer, Atlassian Corp.

Yeah. This is Cameron to answer that. And not really. If you look across the base, it's actually on the small end you see this coming in our Free. It's like we have plenty of Free instances with 8 users, 9 users, 10 users, and then their willingness to put their credit card in and pay relatively minimal amount to get into our paid plans, we've seen that slow down. Even when we get to our largest customers, most of our conversations with our largest
customers are about expanding to new product use cases, whether that's Jira Service Management or Jira Align or having these migrations conversations.

If they're large on-premises customers, so they're project-based. And a big portion of our revenue discussions are tied to that, where we have less discussions with them on is them adding 500 users or 1,000 more users because they've rapidly expanded their development teams or what have you. So, the answer is no. We have not seen user expansion tied directly to a share of wallet or the current spend with Atlassian. It's definitely much more tied to how many people are hiring and how much people are expanding their overall technology footprint in their businesses.

Michael Turits  
*Analyst, KeyBanc Capital Markets, Inc.*

Okay. Thanks very much.

**Operator:** Your next question comes from Steven Koenig from SMBC Nikko. Please go ahead.

Steven Koenig  
*Analyst, SMBC Nikko Securities America, Inc.*

Hi, gentlemen. Thanks for taking my question. Given that like the higher velocity sales merchants is going to be most affected here, I'm wondering if you look at your existing cloud customers and look at the monthly people versus the annuals, are you seeing any kind of like earlier slippage in the monthly? And are we going to need to work through 12 months of the annual customers renewing with adding fewer seats? Like how do you think about maybe the net expansion rates for those two different types of customers? Thanks very much.

Cameron Deatsch  
*Chief Revenue Officer, Atlassian Corp.*

Yeah. One advantage of our business model is that we have plenty of customers on monthly plans. We have the option to go annual plans across the board, and we largely, like customers, make the choice. We have – but the good news is it's not like we have all annual plans come up at one time every year, as we have annual plans renewing every single month, just like we have monthly plans. So no, we see that user expansion challenge that we saw in – over the previous quarter continued to be like largely even across both our monthly and annual plans. We don't see any major delta between the two.

Difference with the monthly plan is that we will have much more, accurate tied to the customers paying for exactly the number of users they're using within the product. And it allows us the annual plans where we can continue to watch those customers. With cloud, we have incredible telemetry about the health and usage of the products and allows us to proactively engage those customers if we tend to see usage or activities starting to go into unhealthy territory. It's giving us even more abilities to run customer success programs, training programs and the like.

Steven Koenig  
*Analyst, SMBC Nikko Securities America, Inc.*

Got it. Thank you very much.

**Operator:** Your next question comes from Ari Terjanian from Cleveland Research. Please state your question.
Ari Terjanian  
*Analyst, Cleveland Research Co. LLC*

Thank you for taking the question. Just asking a little bit differently on the user expansion, appreciate all the color you've given thus far. Any way like you can estimate a breakout, like exposure to the tech vertical? I mean, it seems like kind of looking at the headlines, you have Amazon kind of slowing hiring, Shopify, Stripe laying off people. Just kind of curious, like obviously, those companies were hiring pretty aggressively during COVID. So, just kind of curious if you’ve accounted or have seen any like a benefit from those cohorts during COVID and if you’re kind of expecting, baking in for user growth from kind of the tech cohort in coming months here. Thank you.

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

Ari, I would understand your line of questioning and sort of what – are there tailwinds that are coming off from COVID or like that we should be thinking about. And we've looked at this and we think about almost every company these days is becoming a software company, whether you're a reseller or whether you are a car company or whether you are a transport company. Just every aspect of the economy is becoming a tech company. And that's why people turn to our products. And I don't think that sort of secular trend is changing anytime soon.

And I don't think – I think it's a large industry. It's a lot large than it was 20 years ago when we started. We sell to tech, to banking, to manufacturing, like all down every industry vertical we sell to. And so, I wouldn't say we're overly-exposed to technology workers. We do sell, again, products that help teams to be more effective and our history was to start with technical teams. Those technical teams are in every single company out there.

And when I talk to our customers, those technical teams are also the types of people that most companies are doing their best to retain during the downturn. Like they're the ones that have taken a long time to build up a lot of IP and they're very hard to restart. And so, we think that [indiscernible] (38:48) industry but we do sell to technical teams across the board and we think those teams are sort of lost on the line to be reduced in terms of macro headwinds.

Ari Terjanian  
*Analyst, Cleveland Research Co. LLC*

Thank you.

**Operator:** Your next question comes from Mark Cash from Raymond James. Please go ahead.

Mark Cash  
*Analyst, Raymond James*

Yeah. Thanks for the question. This is Mark on for Adam. I wanted to ask about the royalty discounting you're doing to migrate customers to cloud. And understanding this is still ongoing, but how would you size the overall potential uplift to revenue and margins as these discounts are rolling off? And when would you really start to see that impact? Thank you.

Cameron Deatsch  
*Chief Revenue Officer, Atlassian Corp.*

Yes. So, this is Cameron here. So the loyalty discounts, and those who've been following us for a while, when we announced the server end-of-life, we basically had aggressive loyalty discounts that rolled down effectively every
July 1 over a three-year period, as we led to the server end-of-life. So effectively, the sooner that our customers would choose to move to cloud, they would get a bigger discount.

And then, over the three-year period, as the loyalty discounts roll down, they eventually get the lowest price, and that's still the truth for all of our customers. So, we still have a loyalty discount in place. It's the last tier of loyalty discounts going up till June 30. As of July of next year, all customers are effectively paying on new contracts, will be paying list. All existing customers, if they were on one-year, up to three-year contracts, at the end of their three-year, terms will be at list price as well.

Joe, did you want to add anything?

Joe Binz  
Chief Financial Officer, Atlassian Corp.

Yeah, Cam. I was just going to mention the question around when do we start to see those price changes and the impact of those in the model. And the answer to that is it's not immediate. So there's two reasons for that, Mark. First and foremost is the ratable recognition on subscription, which is 80% of our revenue. And secondly, the timing of renewals that happen throughout the year post those changes. So, you won't see an immediate impact when we go through those types of pricing changes. It will tend to run into the model over time.

Mark Cash  
Analyst, Raymond James

Great. Thank you.

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

Peter Weed  
Analyst, Sanford C. Bernstein & Co. LLC

Thank you. Earlier you touched on net revenue retention. And reference back to enterprise, you talked about 130%, 140% previously, and that you were still seeing NRR over 130%. Now I wanted to clarify, because obviously, your cloud revenue comes from more than large and mid-sized businesses, whether or not when you said 130%, you were still exceeding that. Was that just for kind of the medium and large sized businesses, or was that for that entire revenue base that you report on?

Joe Binz  
Chief Financial Officer, Atlassian Corp.

Yeah, Peter, thanks for the question. This is Joe. That was for the entire customer base that we report on.

Peter Weed  
Analyst, Sanford C. Bernstein & Co. LLC

Okay. And then, as you're taking a look at the smaller customers within there that you are trying to get into paid, certainly that transition is frustrating. But I think that you were alluding to it in the note here. But how are you seeing any competitive pressures there? I mean, certainly you hear things like GitLab being thrown around as an alternative that people could use if they have lower sophisticated organization. Is it genuinely that people are just not upgrading to paid or are you seeing situations where you are concerned with some of these customers that they need to be using other solutions to try to get done what Atlassian may be able to do better?
Cameron Deatsch  
*Chief Revenue Officer, Atlassian Corp.*

Yeah. This is Cam. This is Cameron. And yeah, first and foremost, across the board, whether it's the new customer acquisition or existing customers, we see no real change in our overall competitive position. We have incredibly strong products, incredibly happy customers, and we also have sort of mission-critical applications where we're highly integrated into their environments.

Specific to what you mentioned, the Free users converting into paid, we definitely haven't seen any competitive dynamic there because we still see them as Free users of our products. It's actually one of the advantages of our Free program and that people will be choosing us and using our Free versions of our products compared to going to an alternative vendor.

Across the board also, at a dollar level, if budgets are getting more constrained and customers are looking to save money across our entire product base, one of our core parts that make Atlassian product so attractive is that we are relatively priced less expensive than most alternatives. So no change in competitive dynamics, nor have we seen competitors being any direct impact to our Free to paid conversion rates.

Peter Weed  
*Analyst, Sanford C. Bernstein & Co. LLC*

Thank you.

Michael Cannon-Brookes  
*Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp.*

This is Mike. I just want to add in one thing to maybe add a little bit of a stronger message to what Cameron is saying. I think it's actually an opposite behavior, right? We've talked about playing offense in this environment on a few shareholder letters now. And again, this quarter, the same.

We actually see the upcoming period as a good chance for us to pick up market share in a lot of our markets. We actually think we're very strongly positioned in all three of our major markets. Our investment in R&D, our extremely affordable, high-value products for customers is a great chance for us to pick up market share in an environment where customers are optimizing that spend. So, that's an area we're very bullish in going after.


Frederick Havemeyer  
*Analyst, Macquarie Capital (USA), Inc.*

Hi. Thank you. I wanted to ask, with respect to the slowdown that you're seeing in net new – sorry, Free to paid conversion as well as just user expansion, what we're seeing now in terms of layoffs, it's certainly ahead of what we saw at the COVID pandemic. But I wanted to ask, if you were to compare or consider what you're seeing now to, say, like the start of 2020 when layoffs intensified, businesses began to freeze hiring and just capital froze, how have you seen – or could you just generally compare and contrast what you're seeing now versus then?

Cameron Deatsch  
*Chief Revenue Officer, Atlassian Corp.*
So, this is Cameron. I will do my best looking back to that area. Obviously, going back to 2020, at the beginning of that year, we definitely saw this kind of right into COVID, we had two things that happened. If you remember, that is actually when we changed our business model from going trials-based to Free, which resulted in a huge uplift in signups and new Free activations of our products, but we also saw that in line with the impact of COVID, small businesses shutting down, and so on. And if you remember, our Q4 of fiscal year 2020, that was actually one of our slowest new customer growth quarters ever because of those two dynamics: our conversion to Free as well as smaller customers largely going out of business or not renewing.

Two years later, now we're at the kind of tail end of COVID and we are looking to seeing the trends, our net new customer number is still significantly higher than we had pre our Free launch. So even if you took out all the uncontrollable unknown pieces of the COVID dynamic over the last two years, our change of business model going to Free has significantly altered our ability to acquire and attract net new customers, and we see that today.

In addition to that, the fact is we still every single day continue to see more and more customers signing up, coming into our store, as I say, and clicking the Try button year-over-year, which is the same dynamic we saw back then. However, their ability to get to the 11th user, enter their credit card, all that is significantly dependent on other environments that we don't always have control of. The most important piece that we look to is are they using our products, are they getting value out of it and we can be patient for the revenue, and that is what we see is consistent between that kind of early COVID months and what we see now a few years later.

Frederick Havemeyer
Analyst, Macquarie Capital (USA), Inc.

Q

Thank you. And then, just I think one follow-up on that, and also, Cameron, that was, I think, a great job not just to try at explaining it. In terms of just Atlassian Together, the bundled solution that you've launched and announced this quarter, I know it's very early days, but it seems like that's more of an enterprise-focused offering. And is there an opportunity outside of just driving sales into enterprise potentially at this end or use the opportunity of the transition from some of these on-premise customers to either data center or cloud to onboard them into Together?

Michael Cannon-Brookes
Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp.

A

Fred, it's Mike here. I'm super glad you've managed to ferret out a product strategy question. Thank you for doing that. Yes is the answer. So a reminder, Atlassian Together is an enterprise-focused offering we announced at Work Life, a Confluence-targeting work management. Now, we have more than 150,000 customers in the work management arena, so a very strong market for us.

There's no doubt that we've continued, as you've seen in our platform, to make our products, as we say, work differently together. So, we believe every team works in their own way, and we want our products to work incredibly well together and we also want to work with all of the other products that that customers use, as the number of products per customer, I think has topped 89 or 90 in the latest [indiscernible] (49:13) survey and is going to continue to go up, we believe.

Atlassian Together is an offering targeted at our largest customers to allow them to purchase all of our work management applications together that work with each other and all the third-party applications generally used -- focused on customers who are increasing their spend significantly in terms of the number of users. So when you're rolling out Atlassian's work management applications from maybe 2,000 employees to 10,000 employees, it's an incredibly good way to do that because you don't have to manage individual applications and usage across your employee base.
It's very early days. Obviously, as you mentioned, if a customer is coming from server or data center, they only really have access to Confluence on the server data center realm. So Atlassian Together includes Atlassian Access, Trello, Jira Work Management, Confluence and Atlas, which is our new offering. So, those five products come in the Atlassian Together package. If you're coming from on-premise and moving to the cloud, you only have Confluence.

So, we do hope it is a compelling offering for customers who are migrating in that space. Far too early to see any actual results of that yet. Again, it was only announced a month ago. Initial customer feedback, I will say, is very positive. People understand the offering, especially for those larger customers that are moving significantly up in terms of their employee access to our work management applications and the ability for them all to collaborate with each other, but we will have more updates for you as that rolls out.

Frederick Havemeyer  
Analyst, Macquarie Capital (USA), Inc.

Thank you.

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

Michael Cannon-Brookes  
Co-Founder, Co-Chief Executive Officer & Director, Atlassian Corp.

Just wanted to say thank you all for the detailed questions and for reading our shareholder letter and for attending today. Thank you to all the Atlassian employees for another kickass quarter. And I hope you have a great weekend wherever you are in the world and we’ll talk to you next quarter.

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