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# EDITED TRANSCRIPT

TEAM - Q3 2019 Atlassian Corp PLC Earnings Call

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## OVERVIEW:

TEAM reported 3Q19 revenue of \$309m.



## CORPORATE PARTICIPANTS

**Ian Lee** *Atlassian Corporation Plc - Head of IR*

**James A. Beer** *Atlassian Corporation Plc - CFO*

**Jay Simons** *Atlassian Corporation Plc - President*

**Michael Cannon-Brookes** *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

**Scott Farquhar** *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

## CONFERENCE CALL PARTICIPANTS

**Bhavanmit Singh Suri** *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

**Gray Wilson Powell** *Deutsche Bank AG, Research Division - Research Analyst*

**Gregg Steven Moskowitz** *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

**Heather Anne Bellini** *Goldman Sachs Group Inc., Research Division - MD & Analyst*

**Ittai Kidron** *Oppenheimer & Co. Inc., Research Division - MD*

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**Nikolay Ivanov Beliov** *BofA Merrill Lynch, Research Division - VP*

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## PRESENTATION

### Operator

Good afternoon, ladies and gentlemen. Thank you for joining Atlassian's Earnings Conference Call for the Third Quarter of Fiscal 2019. 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 Ian Lee, Atlassian's Head of Investor Relations. Please go ahead.

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**Ian Lee** - *Atlassian Corporation Plc - Head of IR*

Good afternoon, and welcome to Atlassian's Third Quarter Fiscal 2019 Earnings Conference Call. 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 President, Jay Simons.

Earlier today, we issued a press release and a shareholder letter with our financial results and commentary for our third quarter of fiscal 2019. These items are also posted on the Investor Relations section of Atlassian's website at [investors.atlassian.com](http://investors.atlassian.com).

On our IR website, there's also an accompanying presentation and data sheet available.



We'll make some brief opening remarks and then spend the rest of the call on Q&A.

Statements made on this call include forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our 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. Further information on these and other factors that could affect the company's 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 recent Form 20-F and quarterly report on Form 6-K.

In addition, during today's call, we will discuss non-IFRS financial measures. These non-IFRS financial measures are in addition to and not a substitute for or superior to measures of financial performance prepared in accordance with IFRS. There are a number of limitations related to the use of these non-IFRS financial measures versus the nearest IFRS equivalents, and they may be different from non-IFRS and non-GAAP measures used by other companies. A reconciliation between IFRS and non-IFRS financial measures is available in our earnings release, our shareholder letter and in our updated investor data sheet on our IR website.

I will now turn the call over to Scott for his brief opening remarks before we move to Q&A.

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**Scott Farquhar** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

Good day, everyone. Thanks for joining today. We had another great quarter. In Q3, we achieved \$309 million in revenue, up 38% year-on-year and also generated more than \$127 million of free cash flow. Last week, we got to share many of our recent product innovations and announcements at one of our favorite events of the year, Atlassian Summit, our flagship user conference. This was our 12th summit and the first time we held it in Las Vegas. When Mike and I held our first summit 10 years ago, we could barely attract a few hundred people. So it's both humbling and awesome to see almost 5,000 people join this year.

We shared some of the biggest product announcements in our shareholder letter. There are too many to list, but just to name a few, we launched premium versions of Jira Software and Confluence in the cloud. We shared a number of new Cloud features such as the introduction of Encryption at Rest and the early access launch of support for 100 -- sorry, for 10,000 users. We welcomed AgileCraft, the newest member of the Atlassian family, and rebranded it as Jira Align. And we showcased Jira Software 8 Server and Data Center, and an even faster and more powerful version of Jira for our on-premises customers.

I'd particularly like to thank those of you who are able to attend our investors session at Summit. It was great to see so many of you there in person and view your enthusiasm for Atlassian. Both Mike and I and the team here appreciate your continued support. And we look forward to chatting again soon.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Gregg Moskowitz with Mizuho.

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**Gregg Steven Moskowitz** - Mizuho Securities USA LLC, Research Division - MD of Americas Research

Maybe just to start off, I know that you don't guide to it, but your deferred revenue did come in a fair amount lower than most people were expecting. So I guess I'm just curious how you would frame the impact of prior pull forward activity on billings growth and revenue growth this quarter.

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**James A. Beer** - Atlassian Corporation Plc - CFO

This quarter, you're quite right. When you look at the sequence of deferred revenue, we did see a different pan emerging. And this is very much driven by what we talked about last quarter. When in Q2, we saw relatively robust deferred revenue as various customers stepped in front of the price increases that we had announced in the middle part of September last year. And that drove an unusual level of activity in Q2.

And so of course, that activity was drawing from quarters such as Q3. And in fact, we think that we'll also draw some activity from quarters into the future as well. So it's very much driven by that moving forward of activity into Q2, driven by customers reacting to price increases that were about to come into play.

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**Gregg Steven Moskowitz** - Mizuho Securities USA LLC, Research Division - MD of Americas Research

Okay. Thank you, James. And then just to clarify, are you seeing or have you seen any underlying changes to demand for any of your products or across any of your geos?

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**James A. Beer** - Atlassian Corporation Plc - CFO

No, we've been pleased by the underlying strength. If you look at the subscription line for example, it reflects a nice ongoing strength year-over-year, particularly right across our Cloud products, and of course the data center business is accounted for within that line as well. And that continues to grow as well.

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**Gregg Steven Moskowitz** - Mizuho Securities USA LLC, Research Division - MD of Americas Research

Okay. And then just one last quick one if I may. Given that you closed the Opsgenie acquisition about 6 months ago and significantly lowered the price points almost immediately after, I'm just curious to get your thoughts on what you've seen around demand elasticity for that product so far.

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**Scott Farquhar** - Atlassian Corporation Plc - Co-Founder, Co-CEO & Director

Scott here. I'll talk about that. Well, [clearly], yes, as you mentioned, we've closed Opsgenie [back in the space] so really excited about a natural adjacency to the products that we have today. And we've had a history of pricing our products aggressively to make sure we capture market share out there, and we've done that from the very start with Jira and Confluence, and we've done that with other products since. You'll continue to see us do that. We think it's a very nascent market, and at this stage, we're after capturing market share versus maximizing any individual customer. We know that happens a lot later as you get a larger customer base.

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**Operator**

The next question comes from Nikolay Beliov with Bank of America.

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**Nikolay Ivanov Beliov** - BofA Merrill Lynch, Research Division - VP

James, just a follow-up on your comments about the draw forward from 3Q and forward quarters. I would imagine the draw forward from quarters off of 3Q will be significantly less than the impact in 3Q, correct?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Well, I would expect it to be a lower impact as each quarter goes by. Recall, when we were doing the call 90 days ago, we noted that the pull forward activity included some multiyear renewal activity. In fact, you saw that quite clearly in the sequential trend of long-term deferred revenue. So there will be a tail to this feature. But I would expect that as each quarter goes by, it naturally diminishes somewhat.

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**Nikolay Ivanov Beliov** - *BofA Merrill Lynch, Research Division - VP*

Got it. And you announced the pricing of the Premium edition. Jira Software is 2x higher than the current edition, more or less, same for Confluence. Can you describe the genesis of Premium? And what do you think the addressable audience is going to be for that as a proportion of the business?

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**Michael Cannon-Brookes** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

Nikolay, yes, sure, it's Mike here. I can talk to that. Look, as our Cloud offering continues to grow, as we said, we now passed 100,000 Cloud customers, you necessarily start getting more advanced customers with advanced use cases that need more specific functionality to tailor to the use case, and that's really the genesis of Premium. We've always tried to be very customer-led when introducing new offerings or editions, and Premium is no different. As we get advanced Jira Software and Confluence customers in that 100,000, that continue to push the envelope of what they require, that's where the Premium comes from. You're right about the pricing. Obviously, we've only just opened the early access program last week. So more to come about how that's going. Very early days.

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**Operator**

The next question comes from Ittai Kidron with Oppenheimer.

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**Ittai Kidron** - *Oppenheimer & Co. Inc., Research Division - MD*

A couple of questions from me. First, on the OpEx guidance. I guess the operating margin guidance for the next quarter, James, it implies a significant increase in OpEx. Now maybe you can kind of dig into that. What's behind that? I'm looking at the last couple of years. The implied increase here is more than double what it was in the 2 previous years. So any color you can give us on that?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes, sure. So again, last quarter, we talked about the fact that we were going to expect to see lower operating margins in the back half of the year versus those that we recorded in the front half. And that was very much driven by our focus on building up our recruiting engine and thereby driving more new employees joining the company. And in fact, that's very much what you've seen. You see that in the Q3 data that we've put out just now.

And we've been doing that because we very much like the opportunities that we see in front of us, particularly around the Cloud platform, around Cloud products. The IT area in particular, we've talked about quite a bit over the last few calls. And of course, the data center area is another important area of investment for us for the coming years. So that's very much playing through as we expected.

Now since we were doing this call 90 days ago, of course, we've also announced the acquisition of AgileCraft. And when we did that, we noted that there would be some operating margin impacts. Now we expect that to be about half a margin point in our Q4 results. Now remember of course that, that includes the effect of the deferred revenue haircut. So it's not reflecting the ongoing run rate of AgileCraft because of that deferred revenue haircut because the expenses don't get haircut there. It's just the revenue side of the equation, the deferred revenue that gets haircut. So it's really those things that are driving the operating margin story.

**Ittai Kidron** - *Oppenheimer & Co. Inc., Research Division - MD*

Very good. Very helpful. I'll just follow-up on this. In '16, your fiscal -- in your fourth fiscal quarter of '16 and '17, you had a similar impact where your margins dropped in the fourth quarter. But you've rebounded fairly quickly. Within 1 to 2 quarter, you're pretty much back to your historical levels. Should we think about the same pattern this time around? Or do you think this investment cycle will be a little bit more sustained this time around?

**James A. Beer** - *Atlassian Corporation Plc - CFO*

Well, I would just say, obviously, we will do our annual guide on the next of these calls. I'd just say that we continue to see a lot of margin leverage in the model over time. I talked last week when we were in Las Vegas about us continuing to plan for modest levels of margin increases over time.

**Operator**

The next question comes from Bhavan Suri with William Blair.

**Bhavanmit Singh Suri** - *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

I guess I just want to touch sort of strategically on the approach you have with Opsgenie and Align. As you think about them, they're higher priced, typically the strategy has been lowest-priced best products. When you think about the low-touch go-to-market motion, I guess as you think about the higher-priced products, do they need more hands-on selling? And so you think about sort of the investment in Enterprise Advocates, is that part of what's going on here? Or do you think these are products that you can get away with selling virally despite the higher price point? I'm just trying to understand how that go-to-market motion works for something that's competitively priced versus things like Jira, which is still sort of substantially lower-priced than competitors.

**Scott Farquhar** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

[It's] Scott. I'll take the first part in terms of the strategic guidance, and Jay can talk more about the go-to-market motion. Firstly, again Opsgenie we don't think is a high-priced product. We think it's -- compared to its peers, it's very competitively priced. If you look at sort of where we're priced, like Jira is becoming or is the standard really for work across all development teams, in software and increasingly across all enterprises. And when you have that, you then look at what other problems the customers have around this and how do you fulfill them. For Jira Align, that's the case that people are trying to grapple with digital transformation at large scale. I have 1,000 people, 10,000 people. Jira is my standard for work, but I need a way of making sure that, that work is tied up to the strategic objectives of the company, and so that's where Jira Align comes in. Opsgenie is you find developers and ops people, these days they're on call because they have to deliver Cloud products and always-on products. And so they're increasingly on call.

And so for each of these, we look at what is the market for them and what's the customer base. And in many cases, Jira Align will be targeted at the larger customer base. Every -- not every one of our hundred-and-something-thousand customers will want Jira Align. It's only the very large customers. And so you price according to kind of the market size there. We don't have a significant change to go to market there. I'll let Jay talk more specifically to that.

**Jay Simons** - *Atlassian Corporation Plc - President*

The only thing I would add is I think with Opsgenie, we land as efficiently as we do with all of the other products in the portfolio, and then the price point gives us kind of expansion leverage over time. The one thing that Scott didn't mention is the channel is a really important leverage point for its sales. And so we have 550 solution partners around the world. Typically not focused on landing necessarily, but where we have landed and



there's expansion opportunity either with something like Opsgenie or the rest of the portfolio or with something like AgileCraft, that's a natural expansion point from an established existing Jira Software customer at scale. The channel is basically our sales strategy largely.

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**Bhavanmit Singh Suri** - *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

Great, Jay. I guess a quick follow-up on channel. So if you think about it, you look at guys like [C ONE], Prism, some of your larger platinum partners and you think about what they were selling or bringing to the table with Jira, Jira Service Desk, et cetera and now sort of you think about the greater focus with IT, I guess how does that impact the channel partners? And sort of what's been the initial feedback from them? Are they excited about sort of Opsgenie and the various pieces there versus IT? Or is it a new sort of channel that you've got to sort of cultivate as you go into that given you're a few quarters into that focus in IT?

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**Jay Simons** - *Atlassian Corporation Plc - President*

Yes, they're all super excited. Remember that IT has been a primary selling point for even something like Jira Software. In the Fortune 500,000, IT is sort of the port of call that the channel is engaging with to expand the usage of Jira Software across the business. They're super excited about things like Opsgenie and Jira Service Desk and AgileCraft, I mean -- or Jira Align. All the things that we're basically adding to the portfolio I think are really meaty for them, and where they're already placed to help customers expand the usage of Atlassian.

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**Operator**

The next question comes from Heather Bellini with Goldman Sachs.

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**Heather Anne Bellini** - *Goldman Sachs Group Inc., Research Division - MD & Analyst*

I was wondering if we could go back to the commentary about the pull forward from last quarter. So I mean I know you guys don't guide to deferreds. And obviously, we're all kind of trying to guess where you're going to come in at. But there was about \$10 million of upside last quarter, and you guys kind of mentioned if you normalized for that, that's what the true number was ex the pull forward. And I guess you were talking about on the long-term deferred side there. But like this quarter, short-term deferred was impacted by \$10 million versus what consensus is. I'm trying to get a sense for your comments, James, about how it's going to continue to get impacted. Because aren't you having contracts that are renewing in period now that are at the higher price point? So that should be offsetting the amount of the pull forward from what's over a quarter ago now? I'm just trying to think through that impact and the offsets from the higher prices.

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes. That's right, Heather. I mean, we are obviously now starting to see the impact of the higher prices rolling through on the server side and in the areas of the Cloud business where we raised prices. So yes, there is a variety of layers to this, if you will. And just going back to something I started off the call in Q2 commenting on, this is in part why we very much focus on revenue as our primary top line metric. We talked in Las Vegas about the very high recurring revenue percentage of our total revenue in the mid-80s percent. And then also the fact that predominantly our business is sold either in a 1-year manner or on the Cloud side now, over 75% on a monthly basis. So we very much look at revenue as the way to really assess our business over the long term in terms of customer-related activity. And yes, there will be some effect from deferred revenue added into the future. But that will subside as each quarter goes by.

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**Heather Anne Bellini** - *Goldman Sachs Group Inc., Research Division - MD & Analyst*

So is there any clarity you could help give us just so we can try and minimize kind of -- or I guess help us think about the sequential impact on deferred revenue for the June quarter, kind of parsing your comments that there's still going to be a slight headwind? I mean, I don't think any of

us want to try to set a high bar for you guys, but it's kind of hard without any more clarity than just some of the phrasings that you're using. And I'm also looking at the fact that you guys also have a relatively -- if you look, your billings comp next quarter, I think that's harder given we're all thinking about the billings growth rate.

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes, I would just -- yes, Heather, I will just go back. Obviously, we've guided revenue. And then on the deferred revenue side, I think if you look at both the sequential trend last year and then this year for both short-term and long-term deferred revenue, you can see the additional pull forward activity that happened in fiscal '19 versus in fiscal '18. And so I think while there are a variety of these overlapping type issues that drive the end result, I think that gives you some sense as to how things will play out.

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**Heather Anne Bellini** - *Goldman Sachs Group Inc., Research Division - MD & Analyst*

So just to be clear, if we look at them, last year in Q4, you had a 10% sequential growth rate on your short-term deferrals and 7% for long-term. You've been running below the seasonality that you posted last year. Are you saying we should assume that you continue to run below your seasonality in Q4? And does that normalize in fiscal '20? Should we think about it that way?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Well, I'd just try one last comment on this. I would describe the pull forward activity that occurred in this fiscal year as greater than that, that occurred in the previous fiscal year. And so again, you can get a pretty reasonable sense for that by looking at the sequential trend in deferred revenue. So I think I'll just leave it at that.

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**Operator**

The next question comes from Michael Turits with Raymond James.

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**Michael Turits** - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Infrastructure Software Analyst*

I think this comes back to Bhavan's question a bit. When you talked about the increased pace of hiring, how much of that is also an increased pace on the sale side? You talked about having 25 Enterprise Advocates at this point. You got 19 a little over 1.5 years ago, for whatever reason, whether because of more complex sales, more sales up towards IT and top management. Is that driving an acceleration in sales headcount growth as well?

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**Jay Simons** - *Atlassian Corporation Plc - President*

Michael, it's Jay. No, not materially. I mean it's nominal hiring in the Enterprise Advocate group. There's other hiring that we do in our field operations group to support the channel, which is where we're getting the sort of sales leverage.

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**Michael Turits** - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Infrastructure Software Analyst*

Okay. And then just one quick one for James. You talked about that increase in duration last quarter logical as part of the pull forward dynamic. Is there any of that still going on that survived past the pull forward that was primarily last quarter, prior quarter?





**James A. Beer** - *Atlassian Corporation Plc - CFO*

The pull forward occurred in Q2 and not in Q3.

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**Michael Turits** - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Infrastructure Software Analyst*

Right. No, in other words, has the duration go back down again from your perspective, was there -- clearly associated with the pull forward. Was there anything remaining there?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes, no, we very much reverted to normal course activity now that, that pull forward activity of Q2 is behind.

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**Operator**

The next question comes from Derrick Wood with Cowen.

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**James Derrick Wood** - *Cowen and Company, LLC, Research Division - MD & Senior Software Analyst*

I had a question on geographic growth. It looks like sequential growth in EMEA and APAC was lower than in Americas, which Americas looked quite strong. But EMEA did -- they had a bigger quarter in December. Maybe there was more pull forward effects there. But could you speak to some of the dynamics going on internationally and why maybe that EMEA number has been more volatile and Americas has been smoother?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes, the EMEA growth rates, I think you can track very much along to this pull forward point that we've been discussing because it was there that we have -- about half of our channel partners, and those channel partners were very organized, anticipating the price increase announcements that came in September of 2018. And so they were an important part of how that whole pull forward dynamic played out. Therefore, the EMEA growth rate in Q2 is very strong, and you're seeing a smaller growth rate in Q3 because of that activity being pulled forward.

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**James Derrick Wood** - *Cowen and Company, LLC, Research Division - MD & Senior Software Analyst*

Okay. And in the shareholder letter, you talked about half of the attendees at Summit were from IT. And I'm just curious, would you say that's been driven by the Opsgenie acquisition? Or is it more increasing interest in core products like Jira Ops and Jira Service Desk? And I guess as a follow-up, when you do land in IT, do you see any difference in deal sizes versus landing in developer products?

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**Michael Cannon-Brookes** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

Yes, it's Mike. I can take that. Look, it's -- I wouldn't say it's driven by the Opsgenie acquisition although obviously that helps accelerate things. Landing in IT is something we've been doing for 10, 15 years depending on where the software team is. And as we continue to broaden out, Service Desk is probably what, 4 or 5 years old now. Confluence has landed very solidly in IT teams for well over a decade. So it's just continued momentum behind that. We are increasingly seen as a partner to IT at an uber brand level, at the Atlassian level, in the ways that we help IT in lots of different scenarios, whether that be managing their documentation needs in Confluence across to all the DSM needs that services can help them with. And obviously then including DevOps and their continued movements there with Opsgenie and other things. And obviously Jira Software and Jira Core being pretty key pieces of how IT can run all sorts of processes. So I'd say it's just a continued rise. There's no massive change in that focus with Opsgenie.

**James Derrick Wood** - Cowen and Company, LLC, Research Division - MD & Senior Software Analyst

Okay. And any comment on deal sizes, difference with landing with IT versus a software developer-led deal?

**Michael Cannon-Brookes** - Atlassian Corporation Plc - Co-Founder, Co-CEO & Director

No comment on deal sizes being materially different, no.

**Operator**

The next question comes from Keith Bachman with Bank of Montréal.

**Keith Frances Bachman** - BMO Capital Markets Equity Research - MD & Senior Research Analyst

I had one question and a clarification if I could. And the question relates to the Cloud Premium available for Jira Software and Confluence. Assuming that this -- that the premium notion gets spread into other categories, does this, you think, lessen the impact of price changes? And what I mean by that is really, a, Atlassian's benefited from price increases I think over the past years. In other words, it's been an inelastic pricing curve. And does it, b, perhaps lessen the impact of the pull forwards and whatnot that you experienced last quarter and the reverse of that? So I'm just trying to understand philosophically the notion of increasing the Premium SKUs, if you will. Do you think it creates less upside in aggregate to the revenue line item and/or impact to what we characterize as seasonality surrounding the price increases? And I have a quick follow-up.

**Michael Cannon-Brookes** - Atlassian Corporation Plc - Co-Founder, Co-CEO & Director

Yes, thanks, Keith. Look, it's worth noting, we already have Bitbucket Premium and have had for I believe a year or more on the Bitbucket side of things. And obviously, Trello and Opsgenie both have edition-based pricing. So in a way, Jira Software and Confluence are just coming into line with other things we already have and obviously have learned from and understand how those editions' pricing works in the Cloud. Philosophically, it's no different than our long history of I guess price optimization. Again, I'd say philosophically, we always like to deliver usage before value. We like to make sure that customers use our product first and then purchase it second. And that's no different with the Premium editions and no different with the Cloud. We obviously know a lot more about the customer base in the Cloud. And so can be more precise with our pricing and pricing movements I suppose. And at the same time, you've seen us as we talked about at the Analyst Day last week, reducing a lot of prices at the same time, for example, Opsgenie and Jira Service Desk, where we believe the market size is still significantly larger than where we are, and we have a much larger opportunity than perhaps our competitors view the market size. So we just continue to be thoughtful about pricing.

**Keith Frances Bachman** - BMO Capital Markets Equity Research - MD & Senior Research Analyst

Okay. Fair enough. My quick follow-up is on Align. Obviously, last week, there seemed to be a lot of interest in Align from your customers and partners and even investors. I just wondered if you could give us any directional barometers about how we should think -- be thinking about the revenue impact. You've done that before with Trello. And I understand there's a lot of deferred write-off. But it's just hard to understand how we should think about the impact even if we just look at the next fiscal year. Is there any categorization or growth rates or dollar potential ranges of impact that you could give us to help us tune our models a bit?

**James A. Beer** - Atlassian Corporation Plc - CFO

Well, we've noted that for the current quarter, Q4, we'd expect about \$1 million to \$2 million of revenue from AgileCraft, and that's of course after the effects of the deferred revenue haircut. And that haircut effect stays in place for 3 to 4 quarters directionally. So obviously, we are excited about



the market there. We feel as though it has a lot of potential for us to continue to build out our impact, particularly larger organizations. But we're not offering a particular steer on the AgileCraft or Jira Align revenue for fiscal '20.

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**Operator**

The next question comes from John DiFucci with Jefferies.

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**John Stephen DiFucci** - *Jefferies LLC, Research Division - Equity Analyst*

I believe most of my questions have been asked. Just a quick follow-up to that, to Keith's. I guess, James, you said that AgileCraft was going to be dilutive to margins by 50 basis points this year. And I think you said that for fiscal '20, that it was also going to have a dilutive impact. I mean, would -- could you give us any help with that? Like, would it be more dilutive or less dilutive than the 50 basis points? I mean, it really depends on how much investment you're going to do over time, I realize that. But it's just...

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes. John, as you point out, we noted when we announced AgileCraft that we would see non-IFRS operating margin dilution in fiscal '20. Now obviously, again, that deferred revenue impact starts to trail away once you get into the back half of fiscal '20. So if you look and contrast that with the operating margin, non-IFRS operating margin impact that it has on Q4 of this year, I would certainly be expecting that headwind to subside as the quarters of fiscal '20 go by.

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**Operator**

The next question comes from Keith Weiss with Morgan Stanley.

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**Keith Weiss** - *Morgan Stanley, Research Division - Equity Analyst*

I think most of my questions have been asked. But I guess on the theme sort of acquisitions. On -- for Opsgenie, it's been sort of 6 months on board already. Any kind of indications you could give us on how it's been tracking versus your expectations? And I'm assuming you're not going to give us sort of a revenue number of what the contribution or the user number of the contribution is, but any sense you can give us on how that's started to sort of ramp up in terms of contribution into the results?

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**Scott Farquhar** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

Keith, Scott here. I'll take that one. Look, it's been 6 months, as you pointed out, we're pretty proud. We just -- at the summit, we launched the integration with user management. So that allows us to flow users from our products into -- from one product to the other seamlessly. We just announced that we've unified the UI so that it makes a lot easier for our users to move from one to the other and sort of maintain their mental context of where they are. So those things only happened last week. But we did -- as I've seen with the Atlassian brand, ahead of the opening the Atlassian brand, the pricing changes, and other things we've done inside Opsgenie has materially improved their run rate as a stand-alone company, and we're really happy with how that's playing out, and we expect it to further improve as we bring them into the products set.

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**Keith Weiss** - *Morgan Stanley, Research Division - Equity Analyst*

Got it. And then maybe one follow-up for James. Understanding that M&A is a big part of sort of the operating margin pressure that you guys see in the forward quarter. But like you're saying, you have stepped up hiring a lot. Can you give us any kind of visibility or any kind of granularity into



what are some of the core areas of hiring? What are the core areas of investment you guys have heading into -- or debts taking place in Q3 and into Q4?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

Yes. The focus around our hiring is largely in the R&D side. I talked about our focused investments in the Cloud platform and our Cloud products in particular. And the office that is growing the fastest is the Bengaluru office. And so really that's -- the primary focus is the R&D area.

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**Operator**

The next question comes from Gray Powell with Deutsche Bank.

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**Gray Wilson Powell** - *Deutsche Bank AG, Research Division - Research Analyst*

Maybe on the product side. At the Analyst Day, you flagged 7,500 server customers that have over 500 users that could be candidates for the data center offering. I'm just curious, what's the normal catalyst for a customer to upgrade? And how fast do you think you could convert these customers?

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**Jay Simons** - *Atlassian Corporation Plc - President*

Gray, this is Jay. So the 7,500 were server customers that had at least 1 product with over 500 users of server. And so it didn't include the Cloud population. And what we clarified in that slide is that is a population that continues to grow by the way, that we can upgrade the data center and try to upgrade the data center. That's also the same population that will potentially move over to the Cloud and Cloud Premium that we announced at Summit. And so there's 2 kind of upgrade paths from just the standard server that they're using. The upgrade path to data center from server tends to be the message around data center. There's a bunch of features that are built to support large, mission-critical, scaled usage of the products. And so better performance, better reliability and architecture that allows the products to be deployed in a high-availability fault-tolerant way. And then additional capabilities for administrators to do upgrades without bringing the system down. And so if you're supporting 500 employees that use it every day -- every minute of every day, those kinds of capabilities are worth upgrading for. But naturally, if you upgrade to Cloud, you get a bunch of those things provided as part of the Cloud service.

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**Operator**

The next question comes from Rishi Jaluria with D.A. Davidson.

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**Rishi Nitya Jaluria** - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Most are going to be follow-ups on earlier questions. First, James, I wanted to clarify your earlier comments on the OpEx and operating margin side. It sounds like excluding AgileCraft, your margin guidance and OpEx guidance for the year would have been consistent with what you've guided on the previous earnings call. Is that a fair statement?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

That is correct.



**Rishi Nitya Jaluria** - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Okay. Thanks. That's helpful. And then on the EMEA side, I know we talked about the channel partners and some pulling forward of deals. Were there any other factors for why EMEA was flat or even slightly down sequentially? Were there any macro factors? Was there FX that drove that?

**James A. Beer** - *Atlassian Corporation Plc - CFO*

No, nothing material.

**Rishi Nitya Jaluria** - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Okay. And then now turning to the Cloud Premium SKU. Just wanted to kind of go into what the addressable portion of the customer base looks like. So if there's, round numbers, 100,000 Cloud customers, what proportion of those are addressable for a conversion from Cloud to Cloud Premium SKU?

**Michael Cannon-Brookes** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

Yes, mate, obviously we -- it's Mike here, sorry, Rishi. Look, we're obviously bullish about Cloud Premium and its prospects. We are not disclosing what we think the proportion would be at the moment. But also, it's a bit of a learning exercise for us. Obviously, we believe there's strong customer demand there for the offering among those advanced teams. It's worth noting that Premium is not necessarily about large customers as much as advanced users, advanced teams. So you can be a 50-user Cloud customer and need these capabilities. And you can be a 500-user Cloud customer and not use these capabilities because your usage of the product is not at that advanced level yet. So we have to learn those levels a little bit ourselves. But obviously, we've done a lot of research to release [this], a lot of customer testing, and we're bullish about the prospects for both.

**Rishi Nitya Jaluria** - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Got it. And then last one for me, and I'll jump out. But going back to AgileCraft and kind of the margin impact. I guess mainly, I understand there's accounting treatment with deferred revenue write-down. Should there be a similar impact on the cash flow margin front as we're seeing on the non-IFRS operating margin front? And I think more importantly, would that same kind of dynamic play out next year?

**James A. Beer** - *Atlassian Corporation Plc - CFO*

Well, you would obviously get a different dynamic around the cash flow margin as opposed to the accounting margin. The accounting margin is significantly impacted by this deferred revenue haircut that we've been talking about. Now it's early obviously in the growth of AgileCraft. And we have very robust margins at Atlassian. So the focus here I think is on the market opportunity, the scale of it. And I'll just note how in Q4 here we're guiding to an increased free cash flow amount. So we've moved that guide up by \$15 million at both the north and south end of the range.

**Operator**

The next question comes from Pat Walravens with JMP Securities.

**Patrick D. Walravens** - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

I guess I have 2 questions related to the acquisitions. The first one is when you acquire a company like AgileCraft or Opsgenie that had traditional salespeople, what do you do with them in the integration going forward? Do they remain in that role? Or do you transition them to something else?

**Jay Simons** - *Atlassian Corporation Plc - President*

Pat, it's Jay. So in both cases, they had relatively small sales teams. And in Opsgenie's case, the sales function worked very similar to the Enterprise Advocate function where we're landing with OpsGenie with the efficiency that's very, very similar to Atlassian. And then we have direct teams and our channel that can focus on expanding that customer up through Premium and more valuable versions to both the customer and to us of the product that they've chosen.

AgileCraft is a little different where they have a small sales team. They focus on larger accounts. And the way that we'll scale the sales coverage is again through the channel. And so most of the channel is already implanted in our largest customers because they've supported the expansion of Jira Software which is kind of the bedrock data source that feeds into Jira Align/AgileCraft once customers take that. And that's basically where we're going to get a lot of leverage in continuing to grow and expanding their business.

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**Patrick D. Walravens** - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

All right. That's great. And so I think the follow-up will be for you too. So as we were walking around and talking to the solutions consultants and people at the conference, there was a lot of excitement about Opsgenie in particular. But when you drill down on it, I would say that the knowledge base isn't there yet for a lot of those solutions consultants. How do you educate them?

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**Jay Simons** - *Atlassian Corporation Plc - President*

How do we educate the partners?

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**Patrick D. Walravens** - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

Yes, your partners about Opsgenie.

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**Jay Simons** - *Atlassian Corporation Plc - President*

Yes. So we have an enablement organization that basically focuses on equipping the channel with education on what the products do and material to help them sell. And we co-market with them through a development fund. That's sort of ongoing. We have a twice a year relatively large channel kickoffs, channel field events, both in Europe and the U.S. to kind of galvanize the channel around the biggest opportunities for us and for them.

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**Patrick D. Walravens** - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

And do you feel like you're there? Or does that take a while?

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**Jay Simons** - *Atlassian Corporation Plc - President*

I mean it's ongoing. It's ongoing. I mean we -- some of it is also a big activation point for a lot of the channel because most of our largest and most active channel partners are there in the expo hall. You probably talked to a bunch of them. And so we actually had Partner Day that preceded Summit, which is a big rallying point for all the things that we want them to focus on over the next 6 months.

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**Operator**

(Operator Instructions) The next question comes from Jonathan Kees with Summit Insights Group.

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**Jonathan Allan Kees** - *Summit Insights Group, L.L.C - MD & Senior Analyst*

I just wanted to ask about the segmentation for the products, specifically, the marketplace. It grew 36% in the quarter. And I guess that's part of a trend I've been noticing in my model here that it's been decelerating, and this is the first quarter in which it's actually growing not as fast as the company average. I'm kind of surprised because at Summit, there was a lot of apps there that were on display as well as a couple of quarters ago, you announced a lot of apps that were going to be made available for the data center. So just trying to understand there in terms of is this part of just an overall trend? Or is there just less promotion going on? Or what's going on with that?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

So we continue to be very pleased with the marketplace. It's an important part of our overall ecosystem. And remember that again in Q2, we talked about the fact that there was some pull forward activity around marketplace or other revenue because when we take our portion of an app vendor's sale, that drops immediately into the Other revenue line because we don't have any ongoing obligation to deliver. So you have that immediate revenue recognition. So that was another illustration of this pull forward topic that we've been talking about on this call.

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**Jonathan Allan Kees** - *Summit Insights Group, L.L.C - MD & Senior Analyst*

Okay. All right. So it's -- in terms of the growth rate, it sounds like you're still pleased with it. And just it'll be up and down especially around where there's pull-throughs for pricing increases?

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**James A. Beer** - *Atlassian Corporation Plc - CFO*

I think that's a reasonable way to think about it, yes.

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**Operator**

This concludes our question-and-answer session. I would like to turn the conference back over to Mike Cannon-Brookes for any closing remarks.

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**Michael Cannon-Brookes** - *Atlassian Corporation Plc - Co-Founder, Co-CEO & Director*

Thanks, everyone. Thanks very much for joining our call today. We truly appreciate your time and look forward to keeping you updated on our progress going forward. Have a great day.

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**Operator**

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.

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