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EDITED TRANSCRIPT

TEAM - Atlassian Corporation PLC at Deutsche Bank Technology Conference

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PRESENTATION

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

Okay. I think we're going to get started. Hi, everyone. Thanks for coming to Day 2 of Deutsche Bank's Tech Conference. My name is Gray Powell. I cover infrastructure and security software here. Today, we're very excited to have James Beer, the CFO of Atlassian presenting with us.

So James, thank you very much for coming.

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

Well, thank you for having us here.

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

Cool. Yes. So I have a lot of questions so I'll probably start off with a few and then I'll open it up to you all as we go along. Hopefully, we can keep it interactive.

QUESTIONS AND ANSWERS

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

Maybe just to start off. So maybe you can talk about some of the efforts you're making on the cloud side. So TEAM has been talking about and seen a shift to their cloud products for some time now. It seems like you're putting more effort in that this year with some of the free offerings and some of the other initiatives that you have going on. Can you talk about the different things you're doing to drive adoption of your cloud-based products? And then just how that's going to impact your overall economics?

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

Yes. Sure. Good morning, everyone. As you say, we've been a [front] player on the cloud side of the business for a number of years now. But as we talk to our customers, we are seeing increasing levels of interest from our larger organizations, our larger customers as to their overall interest level in converting over to the cloud from our traditional server, data center-type offerings. And I think that makes a lot of sense from the customer's perspective for a variety of reasons. Obviously, you've seen this theme playing out across software generally. So we're very much going with our customers, if you will. I think that's the first point to make.

And in terms of how we're really focusing our efforts to, in essence, provide catalysts for that conversion over to the cloud, we talked on our last earnings call about a couple of initiatives around free offerings. So first of all, we noted that while we already today have free versions of multiple of our products: Bitbucket, Opsgenie and Trello, that we would be planning on rolling out quite shortly now additional free editions of certain of our other products. And so obviously, we feel as though that will significantly increase the inflow of new customers to our cloud offerings. And

that over time that will not only make sense for our customers but will also make good economic sense for us as well. And I'll come to that equation in just a moment. So that was the first key initiative.

The second is that we announced that we would also be offering a free trial version to our server customers so that they don't need to, in essence, double up on a license while they try our cloud offerings. Again, we're seeing more and more interest in the server customers looking to trial the cloud editions of our products. And obviously, this is a relatively significant project for a customer to look at how to convert from a behind-the-firewall offering to a cloud service. And so we wanted to take away a piece of friction, if you will, in helping them with that transition process by providing a free trial so that there's no budgetary challenge from the customer's perspective to try our cloud services. So we're pleased to have those 2 initiatives underway.

And in terms of the overall economics of the cloud for us, we certainly feel as though it makes, again, a lot of sense from the customer's perspective. They don't have to, obviously, operate the software themselves. There's hardware implications there that saves the customer money. Probably more importantly, there are people implications there in that the customer doesn't need the people to keep the software up to date, load new editions, load new versions, anything of that nature. So there's a good total cost of ownership argument for the customer.

And then for us, we've talked in recent calls and at the Analyst Day here several months back as to how in the aggregate our revenue increases as the years go by on the cloud side of our product set versus the case on the server side. And so there's a nice long-term benefit in that regard. But beyond that, I feel that there are also important opportunities for us because when we operate the software, we're operating the cloud versions of our software, obviously, we're able to see exactly how the customer is utilizing the software. And so we're able to put logical prompts into how the software is being used to encourage that customer to bring in more of their colleagues, add to the user count. This is why we made the comment on the last earnings call that we see the rate of user growth being higher on the cloud products than on the equivalent server products operated behind the firewall.

And then similarly, again, because we see exactly how the product is being used, we can add logical prompts that would offer the customer to use one of our other cloud products. And so we've got a way to accelerate the opportunities for cross-selling. So an example would be somebody -- we see somebody using a lot of free text on a Jira ticket. In that case, we could prompt someone to utilize the trial version of Confluence. That's the product that is most suitable for larger-scale free text and so forth. So there are a variety of additional vectors, if you will, that we see as being nice opportunities for us to continue to grow the cloud business in a very beneficial manner for our economics.

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

Okay. Nice. So I think you hit on maybe like some part of at least my next 5 questions.

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

Okay. All right. I'll try not to repeat the answer.

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

But I'll see what I can do. So one of the things you mentioned I think that's pretty interesting is just cloud versus server, you have better visibility on what the customer is doing on cloud. It's easier for you to upsell products. So are there any stats or anything you can kind of give us to kind of help make that case, just like the typical product attach rate for a cloud customer versus a server customer or anything like that to kind of just help us understand the (inaudible)?

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

Yes. We haven't offered any particular stat along those lines. As I have mentioned, we have made the point that we've seen user count growing faster on the cloud side versus the server side. I would just observe, I feel as though the cross-selling opportunity is quite significant for Atlassian. I would say we're pretty early days. When you think about our product set now, we have several very successful products in our portfolio. And the orientation thus far has really been around more of the point product sale and I just see significant opportunity for us to broaden that out.

If I think about Trello, for example, we've spoken in the last year or 2 about how the prime goal post-acquisition of Trello was to drive user count. And we've done that very successfully. The last bit that we've issued, this is about a year ago now, was 35 million users. And that's been driving north very nicely ever since. We've now just started to turn our attention more so to monetization. And so you've seen us do some things within the Trello product that are helping us drive monetization. And we could talk about that more if you'd like. But what we've also said is we really haven't put a lot of effort thus far into taking that very large number of Trello customers and offering them other of our products. So I think that's an example of where we're really just getting started.

Another example I would offer is Opsgenie because I think part of what sets our situation apart from our primary competitors is that we have a multitude of products that are very much suited to working together to solve the core customer problem. So what Opsgenie is procured to solve, and that is an incident around a cloud service. The cloud service has gone down. We have the ability to have Jira Software, Jira Service Desk, Statuspage and Opsgenie all working in a very cohesive way to solve the customer's problem. So again, we're really just getting started down that track. I could go on, but I think those are a couple of good examples of the cross-selling opportunity.

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

Okay. Cool. So I guess a lot of different directions we could go. I want to hit on some pricing stuff in a minute. But first, I guess, so when I look at like just sort of the cloud -- the server to cloud shift, I mean cloud tends to be more expensive than just the maintenance and support piece on server for a given user tier. So you talked about some of the advantages. But I guess like why would a customer switch to your cloud offering if they were happy with sort of the number of users they had on the server side and just sort of with what they were doing there?

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

Yes. I think it fundamentally comes down to, they see us increasingly innovating on the cloud side of product set at a faster pace than we are doing so on the server side. So customers are increasingly seeing the attraction of what we offer in our cloud services. And then obviously, yes, they have to think about the total cost of ownership equation and feel as though they can absolutely get there. That's consistent with the conversations we're having increasingly with larger and larger organizations. I think that's really what it comes down to. When you think about where over the last couple of years that I've been with the company or so, a significant majority of our R&D expenditure has been oriented towards the cloud side of our product set. And customers are seeing that. When they come here to our user conference, as they did a few months back, it's quite clear, I think, to everyone that the focus of our product direction is on the cloud side. Yes, we're continuing to work on the server and the data center side, but there is a significantly greater portion of investment going on to the cloud products. And so they're seeing that value and increasingly getting more interested in converting over.

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

Okay. That's really helpful. And then maybe we can talk about pricing. So I guess I'm an analyst so that's like one of the most compelling aspects of the Atlassian story. I mean you guys have the best product in the space. You come in, depending upon the peer, 70%, 80% cheaper. You get customers early and then you're able to increase prices. So last week, you had some price increases that you announced. Can you talk about those price increases? And you increase prices every year. So how what you did last week compares to prior years and just sort of expectations around that?

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

Yes. The first thing that I always want to remind everyone of is that while, yes, we have raised prices in recent years, we will continue to look to be the high-value, low-price leader. I think that is a very important part of our overall strategy, of our overall attractiveness to customers. So nothing has changed in that regard.

Now on the last earnings call, coming to the price increases themselves, starting on the cloud side, we gave a little sort of a pre-signal, if you will, that the prices that we were going to increase on the cloud side of the business would in the aggregate be less of a driver of growth in terms of points of revenue growth, if you will, than was the case in the previous year. Now taking a step back, we've rolled out the remainder of our price increases. I would say, if you look across the entirety of Atlassian, the effect on our growth rate in fiscal '20 is roughly right around where it was in fiscal '19. Now there are some different puts and takes there. So on the cloud side, little bit less. We've rolled out data center price increases for the first time. And so that's a new element to the equation. And then the server side of the price increases, about the same effect as was the case last year, again, in terms of the impact on our revenue growth rate. So overall, it's really very close to about the same result as last year in terms of the impact on revenue growth rate.

Now peeling that back a little bit, I think it's important to note that on the cloud side of the house, as was the case last year in fiscal '19, again in fiscal '20, we're not raising prices on the smaller-tier user tier, the 100-and-below user tier. We want to continue to have every incentive for new customers to come into that cloud offering and for others who are considering moving over from the server to the cloud to have a very attractive entry-level price point there for the cloud services. So that's very important for us. Now remember that we've said a few times now that over 90% of our new customers are coming straight into the cloud already. And frankly, over time, I would expect that percentage to just keep inching up.

So over on the server side of the house, what we've done, I mean there's a lot of detail. You can see all of this on our website. You can kind of crawl through all the different matrices that we have up on the website for each product, each user tier and so forth. But again, just trying to peel it back to a slightly higher-level story, for new customers on the server side, remember, that's a very small part of our business now. And you see that very clearly in the new license line on our P&L. That there, we're looking to make sure that there's every incentive for a new customer to come over on the cloud side rather than the server side. And then for our current server customers, we've continued to raise our maintenance prices as we have in the last couple of years or so directionally.

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

Okay. That's helpful. And then kind of going back to that shift from servers to cloud. Is there any risk in cannibalizing a server revenue stream or negatively impacting growth over the short term as you push more customers to cloud? And I don't know, it seems like you guys are pretty good at math, so I would imagine you've kind of worked through it but...

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

There is some of that potential certainly. And Atlassian has always taken and will continue to take a long-term view, a long-term orientation towards doing the right thing for revenue growth over an extended period. And so yes, by offering a free cloud edition of a product, by offering a free trial version to a current server customer, yes, that would chip away potentially at what otherwise could be entry-level cloud purchases by those same people. But what we did on the last earnings call was try to put a quantification around that. We talked about those 2 items, the free editions that we'll roll out shortly, plus the free versions that we would offer to our server customers, plus essentially the whole revenue recognition mix shift as we move more and more towards subscription revenue and in particular, to the cloud revenue. We add those 3 items together, it would be about 1 point of headwind on revenue growth rate. So we're comfortable that, that is a reasonable balance when we consider the long-term opportunity versus that short-term headwind.

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

Got it. Okay. That makes sense. So then another interesting aspect of the story. So it seems like you've been very focused on extracting more value from larger customers. So what do you see as just the best opportunity to do this? I mean there's like a lot of stuff. But is it Cloud Premium? Is it the data center upgrade? Is it incremental products, whether it's AgileCraft, Opsgenie, Service Desk? I guess where do you see the best opportunity?

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

Yes. A few things, as you say there, so let me sort of take a step back. And if you think of our model very much as land and expand, the first thing that I would note is how we continue to be very pleased with the rate at which we're landing. We had a very strong customer additions number in Q4. So we're very pleased by not only the absolute figure that we announced, up in the mid-8,000s for Q4 of '19, but once again the breadth of the products to which those customers initially came. So we're very encouraged by that.

In terms of then the expansion vector, there are a number of ways to think about that. The first is obviously, we continue to look to build out a customer's user count on that product that they have first selected. And so I've talked a little bit about how we do that with in-product prompting and so forth. So that's an important vector for us. Then also there's the opportunity to continue to broaden out the relationship that we have with the customer through multiple products and so forth. And both of those, I mean I've already mentioned how early we feel we are in the cross-selling opportunity. So I think both of those are going to be important for our ability to continue to build our relationships with our customers. And because we have now a nice set of products, both homegrown and some acquired, we feel as though we've got a lot of scope to continue to land in multiple places and then continue to apply those expand vectors either in user count or through additional products.

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

Okay. Okay. So then can you maybe help us size up the opportunity with large customers and -- or at least kind of just like a ballpark what you're going after? And for example, at the Analyst Day, you mentioned that there's 7,500 server customers with over 500 users. You have almost twice as much subscription revenue as maintenance though. So if we think about the total customers in sort of this larger category where there's cloud and server, just how big of that could we think it be? Is that 7,500 stat meaningfully higher if we include the cloud customers?

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

Well, the first thing I would just say is that, that statistic you're mentioning was something we noted back at Analyst Day several months back and that was for Jira Software and Confluence only. And so the figure behind the firewall would be higher than that when you think about the overall product set. But in terms of your question around, well, how about the cloud side of the equation, if you will? Now remember within subscription revenue there are 2 business lines accounted for there, the data center behind the firewall business and the cloud. Now the first of those, the data center behind the firewall business, yes, that will tend to be our larger customers. And the cloud side, however, the average size there is relatively small. So you shouldn't think of this as just being a proportionate multiplier, if you will, to the way you framed the question there because think back to only this time last year, we were just changing the user limit. Previously, about a week ago, a year ago, it was 2,000 users as a hard technical limit. And we announced at our Barcelona Summit this time last year that, that was moving up to 5,000 users. Now we've made a lot of progress in the last 12 months. A few months back now, we talked about an early version of a 10,000-user-limit product offering on the cloud side. And then on the last earnings call, we also talked about working on enterprise-scale cloud edition. So that's a big part of our R&D orientation, to scale up our cloud services and the capabilities. Today, the customers using our cloud services tend to be on the smaller side.

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

Okay. Maybe we can jump into some of the product categories. So Opsgenie is one that I think a lot of people are interested in. Partner feedback there has been pretty positive. What do you see as the market opportunity for that product set?

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

Yes. We're very pleased with how the Opsgenie acquisition has gone. Thus far we're very encouraged by the market opportunity. We've noted that since we've acquired it, we've more than doubled the rate and pace of user growth versus the pre-acquisition situation. And I noted earlier how we've got a variety of products now that work well together with Opsgenie. So we really bring, I would argue, increasingly a differentiated suite of solutions to solving what is an increasingly challenging issue for customers. There are so many of these cloud services now being utilized right across the world by all sorts of companies and they do go down. And when they go down, that is a major problem for the IT department. And so it's very much all hands to the pump to solve it. And we feel that Opsgenie, being utilized with tools like Jira Software, Jira Service Desk and Statuspage, really gives us an important way to add a lot of value to our IT customers who we're looking to continue to build out the ways in which we serve that important customer grouping. The quality of the Opsgenie product technically has been excellent. We've really been pleased by that. It originally, when we purchased it, was focused on the alerting, the rostering of organizing the solution to an outage. We're increasingly now building it out to be the overall management platform for sorting out an outage. So we're very pleased by what we've bought technically. The quality of the team based -- a lot of the engineers based over in Turkey, that has been working out really well. So yes, we're pleased with how that's going and think that it will continue to be an important opportunity for growth for us.

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

Got it. Okay. So would you say that Service Desk and Statuspage are kind of the most common things that you'd sell alongside Opsgenie?

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

Yes. But Jira Software as well often is used as a key component of solving the overall problem.

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

Okay. And then I mean, might be hard to get like an exact number, but maybe just something in the ballpark. I mean if I'm like a customer that spends something like $20,000 per year on Jira Software, I'm excited about Opsgenie, I go all-in. What would sort of be the typical upsell?

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

Well, first of all, with Opsgenie, much like when we buy other products, we lower prices. And we rolled out a free tier. We lowered prices by around 1/3, quite a significant reduction. And so it will obviously depend on how the customer is utilizing Opsgenie. Are they utilizing the free tier at a more basic level? We have 3 paid tiers that are directionally on a per user per month basis of $9 through to $29. Now if you think of Jira Software, those numbers are way lower than that on a per user per month basis. Obviously, again, it depends on where you are in the user tiering and so forth, but mid-single digit, low single digit type dollars per user per month. Now what you've got to remember though is that at a customer you'd typically see significantly fewer users of the Opsgenie tool itself than you would Jira Software. So it all comes down to what is the mix as to how many users are signing up to utilize Opsgenie at the customer relative to the case for Jira Software. But at the end of the day, it's a nice upsell, as I say, from $9 to $29 per user per month. And that's very much commensurate with the value that we're delivering. Again, we reduced prices by 30%. And yet for us, I think, yes, it's an attractive upsell.

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

Understood. I let my part go a little bit long. So I'll open it up to the audience if there's any questions. One in the back there.

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Unidentified Analyst

Your free cash flow guidance as a percent of revenue, I think ticked down slightly. You had very prolific free cash flow generation in general since you've gone public. Help us understand over the next couple of years how we should think of free cash flow as a percent of revenue.

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

Yes. So the view that we've continued to articulate is that we would look to build both operating margins and free cash flow margins over time. Now in fiscal '19 we had a particularly strong free cash flow result. We added 2.9 points of margin year-over-year. So I think it's important to note how strong a margin build that was in '19 versus fiscal '18. And then as you think about what's playing out in fiscal '20, a few things to consider. So first of all, going in the positive direction, CapEx, I would expect to be in the $30 million range versus the $40 million range last year. And that's driven by the fact that some of our larger facility-related projects have come to a conclusion. And so I see less of that activity in the current fiscal year. But going in the other direction in terms of headwinds, the cash taxes, I would expect to be a pretty material swing year-over-year of the order of $30 million. And then the other thing I would just really point you to is, because of the price increases that we rolled out in fiscal '19, we saw certain pull-forward activity. I think we've talked about that quite a bit over the last year or so. And when that pull-forward activity occurs, customers pay us the cash commensurate with what they're pulling forward. And so that particularly benefited fiscal '19. And yes, in fiscal '20, we've talked quite a bit this morning about how we're raising prices once again, but it's very hard for us to predict exactly how customers will behave in terms of their pull-forward activity. So we haven't got any specific unusual benefit, if you will, from cash flow embedded within that guidance. So we'll see how the next few months play out in terms of what pull-forward activity is generated by those price increases that I've been talking about.

Unidentified Analyst

Understood. And that pull forward, if it happens, will likely happen in Q1 because of October 1?

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

Yes. So it's worth talking a little bit about that. So certainly, the timing of the announcement of price increases is quite an important factor. So last year, fiscal '19, we announced the prices changing in the middle of September. In fiscal '18, we announced prices right at the start of September. So what we've done this year, fiscal '20, is really announce the price increases much more in line with the timing of fiscal '18. And what we saw play out in fiscal '18 was that most of the pull-forward benefit occurred in Q1. There was some in Q2. Whereas last year because there was a couple of week lag, if you will, in terms of when the prices were announced, we really saw that benefit in terms of pull-forward activity play out in Q2. So I would expect if customers act as they have traditionally that fiscal '20 would look more like fiscal '18's structure in terms of timing.

Now perhaps a couple of other thoughts, though, along that line because I think this is an important point. What we saw playing out last year was in the aggregate quite a bit larger than the effect in fiscal '18. It was as though more of the partners, in particular, were ready and raring to go, if you will, in terms of lining up their customer activity and so forth. So we saw the overall level of movement in billings to be larger than was the case in fiscal '18. And then we also saw, again, particularly partners convincing customers on some occasions to pull forward on a multiyear basis. And you saw that in how our sequential long-term deferred line played out higher because that's usually a very, very modest part of the Atlassian business model. So you can see quite clearly how that jumped a bit last year in fiscal '19 relative to previous years.

So the other thing I would note that is different in fiscal '20 is that we have been rolling out data center price increases for the first time. So that would be an increment. So again, we'll see how partners and customers generally react to these price increases. And obviously, we'll do our best to explain all of that as we proceed through the year.

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

Running a little bit low on time, maybe a question, one more question? Last shot anybody? All right. Maybe I'll just close it out with something on AgileCraft, because I think that's one of the more interesting acquisitions. Yes, I mean how should we think about the opportunity there? And does it make sense that a customer would spend about the same dollar amount with AgileCraft as they would with, say, something like Jira Software?

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

I think it does because AgileCraft brings, again, a lot of value. And when you look at the price/value equation, we're very comfortable that we're offering a very significant value to our customers. And what AgileCraft is so helpful at doing is for those who are going through Agile transformation in a material way, it allows them to pull together the effects of all the different projects that they're running with very often Jira Software being used to manage a particular initiative, it allows them to pull all of those projects together to really get an aggregated view on, is an organization achieving their broader, larger Agile transformation objective? And so we're finding customers to be very enthusiastic about that. It's a way to thread together what is otherwise difficult to accumulate and be able to report on to senior management, to the Board and so forth.

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

Okay. Very good. James, thank you very much for coming today. Really appreciate it. Thank you, everyone.

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

Yes. Thank you for having us. Thank you for everyone's time.