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BRZE.OQ - Q2 2023 Braze Inc Earnings Call

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PRESENTATION

Operator

Welcome to the Braze Fiscal Second Quarter Results 2023 Earnings Conference Call. My name is Luke, and I'll be your operator for today's call. (Operator Instructions) I'll now turn over the call to Christopher Ferris, Head of Braze Investor Relations.

Christopher L. Ferris *- Braze, Inc. - Head of IR*

Thank you, operator. Good afternoon and thank you for joining us today to review Braze's results for the fiscal second quarter 2023. I'm joined by our Co-Founder and Chief Executive Officer, Bill Magnuson; and our Chief Financial Officer, Isabelle Winkles. We announced our results in a press release issued after the market closed today. Please refer to our investor website at investors.braze.com for more information and a supplemental presentation related to today's earnings announcement.

During this call, we will make statements related to our business that are forward-looking under the federal securities laws and safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include, but are not limited to, statements regarding our financial outlook for the third quarter and full fiscal year ended January 31, 2023; the impact of our planned sales initiatives; our planned product and feature development; our competitive landscape and the behavior of our competitors; our anticipated market opportunity; the impact of current macroeconomic trends; our anticipated customer behaviors; our growth plan; our vision; and our long-term financial targets. These statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations and reflect our views only as of today.

We assume no obligation to update any such forward-looking statements. For a discussion of the material risks and uncertainties that could affect our actual results, please refer to the risks identified in today's press release and our SEC filings, both available on the Investors section of our website.

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I'd also like to remind you that today's call will include certain non-GAAP financial measures used by management to evaluate our ongoing operations and to aid investors in further understanding the company's fiscal second quarter 2023 performance in addition to the impact these items have on the financial results. Please refer to the reconciliations of our non-GAAP financial measures to the most directly comparable financial measures calculated in accordance with U.S. GAAP included in our earnings release under the Investor Relations portion of our website. The non-GAAP financial measures provided should not be considered as a substitute for or superior to the measures of financial performance prepared in accordance with U.S. GAAP.

And now I'd like to turn the call over to Bill.

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Thank you, Chris, and good afternoon, everyone. We delivered a strong second quarter, generating $86.1 million in revenue, up 55% versus the prior year and 11% compared to the prior quarter. For the first 6 months of this fiscal year, we've grown revenue 58%, a testament to the power and scale of the Braze customer engagement platform. We also continued to demonstrate the ROI and stickiness of the Braze solution through an exceptional renewals performance, even during turbulent macroeconomic conditions. Further, we achieved solid customer growth, increasing our total customer count by 96 sequentially or 43% in the last 12 months. While our number of large customers, which is defined as those generating over $500,000 annually, increased 70% year-over-year.

Notable recent new business wins and upsells include Roku, TelevisaUnivision, IBM and Pizza Hut Australia, among others. I want to particularly highlight Roku, one of the most widely used streaming platforms in the world with 63 million monthly active users. We'll be powering critical holiday e-mail efforts, integrating our iOS and Android SDKs to extend their customer reach and partnering with them to expand their messaging across multiple channels. We believe this speaks to our ability to land large global enterprises even in an uncertain environment, and I'm proud of the efforts made across our organization to deliver these strong results.

However, the quarter was not without its challenges. Like many of our software peers, we saw elongated deal cycles and greater scrutiny on customer spend as some prospective and existing customers took a wait-and-see approach to the economy before committing to new investments. This effect was most acute as the quarter came to a close in July and affected our new customer ACV in the quarter.

Notably, this period of rapid evolution in the sales environment overlapped with the ramp period for a large class of account executives hired earlier this year, resulting in sales productivity, landing short of where we expected it to be in the quarter. We are adapting quickly, identifying areas where execution faltered and making appropriate adjustments.

In sales, we have returned to in-person training and mentorship while developing skills and presenting new tactics designed to help our account executives better navigate this dynamic environment. Specifically, we have launched new certification programs, engaged in more active competitive training, organized in-person sales boot camps for all new account executives and are regularly hosting in-person role playing, demo sessions and more. These are training opportunities that are far more available to us now that the world has largely reopened, and we are excited to be arming our salespeople with the knowledge required to further differentiate our offerings from those of both our legacy marketing cloud and startup competitors.

Over the long term, we believe an enduring focus on customer ROI and product differentiation is the most effective way to beat our competition, but we're also adapting to short-term changes in buyer behavior by increasing the emphasis of Braze's rapid time to value and the outsized ROI of investing in first-party data with the goal of driving buyer urgency and materializing the opportunity cost of allowing suboptimal status quo solutions to persist. Supporting this message is our enduring differentiated product offering, including our unmatched ability to deliver omnichannel messaging at scale through real-time stream processing and our ever-expanding reporting and analytics capabilities.

We believe that our platform and vision is increasingly defining the customer engagement space that we can become the de facto file format for the space and that our continued robust investment in R&D and our customer community will drive us forward as a generational brand.

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Despite the challenges we've recently encountered, we feel good about our pipeline, and new opportunity generation was strong in the quarter. Pipeline quality is a function of robust discovery and a strict qualification and inspection process. We continue to refine and improve our qualification criteria and are optimizing our middle-of-the-funnel nurture techniques.

We also believe continued progress developing our customer and partner community is helping generate high-quality inbound pipeline with increased steel velocity and higher win rates. This bolsters our faith in our full year outlook, which Isabelle will discuss in more depth later.

We also continue to invest heavily in our solutions partner ecosystem, particularly with the marketing agency holding companies and leading global systems integrators, or GSIs. We are deepening these relationships to help us land and expand within enterprises and to better serve our existing customers with complementary strategy, integration and managed services.

As Braze's presence and importance grows across the ecosystem, the GSIs and agencies are motivated to build Braze practices to serve their existing clients and help them compete for new ones. As those practices mature in scale and sophistication, a self-reinforcing flywheel dynamic can take hold that builds complementary value for Braze, our customers and our partners. This win-win-win speaks volumes about the power of our product, our ability to feed the services ecosystem and the increasing influence we are achieving with large enterprises around the world.

Most importantly, we have continued investing in the evolution of our product to deliver on the promise of world-class customer engagement. This quarter, we launched a major leap forward in the power, usability and performance of Braze's orchestration capabilities through the release of Canvas Flow. Canvas Flow is the latest generation of our visual programming environment and has been met with positive feedback and rapid adoption by our customer base.

With Canvas Flow, even nontechnical customer engagement practitioners are able to build incredible experiences for their customers and easily experiment with them over time. We're extremely proud of our track record of simultaneously improving both the usability and power of Canvas through environment upgrades and are excited to see our passionate customer base unleash their creativity and innovative spirit with the new capabilities that Canvas Flow provides.

To provide just one example, EverWash, a mobile app that connects drivers with car washes, wanted to create a more valuable onboarding experience in order to maximize customer retention. Prior to Braze, EverWash employed an in-house tool that only supported e-mail. By implementing Braze, they were able to get their data organized and streamed directly into the platform, set up push notifications, developed an SMS strategy and quickly began creating dynamic customer journeys via Canvas Flow. In addition, they use the Braze intelligent timing solution to optimize messaging for when a user is most likely to engage and they use liquid personalization in most of their campaigns, driving further customization based on each consumer's revealed preferences.

In the case of a holiday car wash, multichannel push and e-mail campaign, EverWash experienced an impressive 37% conversion rate. Braze technology is also helping customers drive efficiency and reduce costs in the increasingly scrutinized ad buying ecosystem through our audience sync features, which are integrated with Facebook and Google's advertising tools. These integrations allow our customers to leverage the real-time first-party data flow managed by Braze to optimize their usage of expensive advertising channels by targeting high-value users via multiple channels, populating real-time suppression list and building finely tuned look like audiences.

One customer, a European travel and tourism company, has used these Facebook and Google integrations for suppression and look-alike audiences and has seen strong positive results, reducing their typical cost per acquisition by up to 40%. Canvas Flow is just one of the many new product updates and features we recently introduced. Often, R&D organizations succumb to tech debt and experience growing pains as they scale, resulting in slower product velocity and reduced agility over time.

In contrast, Braze product development has only accelerated over the past few years through foundational infrastructure investments and nimble organizational design. Transformative features like Canvas Flow are critical to generating differentiated value for our customers and building a moat against competitors while we work to cement Braze's position as the industry's file format for customer engagement.

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Look for us to debut new features and continued enhancements to our vertically integrated data flow and stream processing system in the coming months, particularly at our Forge Customer Conferences in New York in October and London in November.

Before turning it over to Isabelle, let me just reiterate how confident I am in the long-term trajectory of Braze. When we started this company over 11 years ago, my co-founders and I shared a dual conviction about the change that mobile was catalyzing: first, that fast-growing new businesses reborn and build to be mobile first; and second, the generations old brands would be driven by changing consumer behavior to transform the way they deliver products and services.

In the ensuing decade, our opportunity has only grown larger as the field of customer engagement and the Braze platform have evolved in complementary support of each other. Recent challenges have not altered that vision, and we remain committed to delivering industry-leading customer engagement solutions for customers and high growth at scale for our shareholders.

And with that, I'll turn the call over to Isabelle.

Isabelle Winkles - *Braze, Inc. - CFO*

Thank you, Bill, and thank you, everyone, for joining us today. We reported a strong quarter, with revenue up 55% year-over-year to $86.1 million. This was driven by a combination of new business sales, expansion of existing customer contracts and renewals. Our subscription revenue remains the primary component of our total top line, contributing 95% of our second quarter revenue. The remaining 5% represents the combination of onetime configuration and onboarding fees as well as other professional services that are subject to similar annual contract terms as our subscription-based revenues.

Total customer count increased 43% year-over-year to 1,599 customers as of July 31, up 96 from the prior quarter and up 480 from the same period last year. Our total number of large customers, which we define as those spending at least $500,000 annually, grew 70% year-over-year to 139, and as of July 31, contributed 55% to our total ARR compared to a 50% contribution as of the same time last year. Sequentially, this reflects an 8% increase from 129 large customers, contributing 54% of our total ARR as of April 30.

Turning to dollar-based net retention. As a reminder, our dollar-based net retention represents a 12-month trailing statistic. And sources of upsell dollars include increases to precommitted volumes of monthly active users and messaging entitlements, signing new business units as we continue to further penetrate our existing customer base through both geographic and brand expansion, and the addition of add-on features and recurring professional services.

Our renewal rate, combined with upsells from our successful land and expand motion, drove strength in our dollar-based net retention statistics. Measured across all customers, dollar-based net retention was 126%. Dollar-based net retention for our large customers, those spending at least $500,000 annually, was 130%.

Expansion was broadly distributed across industries and geographic regions. Our global footprint continued to expand through Q2, and revenue outside the U.S. contributed 42% of our total revenue in the second quarter, up from 41% in the prior quarter and 40% at the end of fiscal year 2022.

Moving to our remaining performance obligation. In the second quarter, our total remaining performance obligation rose 53% year-over-year and 5% sequentially to $411 million. Current RPO rose 52% year-over-year and 7% sequentially to [$274] million (corrected by company after the call). These increases were driven by contract renewals and upsells, term extensions and signing of new customer contracts. Overall, dollar-weighted contract length remains at approximately 2 years.

Now I'd like to review the income statement in more detail. As a reminder, some of the metrics I will discuss are non-GAAP. And we have provided a reconciliation of GAAP to non-GAAP financials in our earnings release and accompanying earnings presentation.

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Non-GAAP gross profit in the quarter was $59.7 million, representing a non-GAAP gross margin of 69.3%. This compares to a non-GAAP gross profit of $37.2 million and non-GAAP gross margin of 66.7% in the second quarter of last year and 67.8% in the first quarter of this year. Gross margin percent improved 260 basis points year-over-year due to continued economies of scale in our core technology expenses and ongoing efficiencies related to our customer support functions.

Turning to operating expenses. Non-GAAP sales and marketing expense was $44.3 million or 51% of revenue compared to $25.5 million or 46% of revenue in the prior year quarter. This reflects our continued investment in head count to support our strong growth and global expansion as well as increased travel and entertainment expenses as COVID-related travel and event restrictions have eased.

Non-GAAP R&D expense was $16.3 million or 19% of revenue compared to $10 million or 18% of revenue in the prior year quarter. The dollar increase was primarily driven by head count to support the expansion of our existing offerings as well as to develop new products and features to drive growth.

Non-GAAP G&A expense was $16.5 million or 19% of revenue compared to $8.1 million or 15% of revenue in the prior year quarter. The dollar increase was driven by investments to support our overall company growth and public company expenses.

Non-GAAP operating loss was $17.5 million compared to a non-GAAP operating loss of $6.5 million in the prior year quarter. Non-GAAP net loss attributable to Braze shareholders in the quarter was $15.2 million or a loss of $0.16 per share based on 94.1 million weighted average basic shares outstanding during the period. This compares to a loss of $6.6 million or a loss of $0.32 per share based on 20.3 million weighted average basic shares outstanding in the prior year quarter.

Now turning to the balance sheet and cash flow statement. We ended the quarter with $510.7 million in cash, cash equivalents, restricted cash and marketable securities. Cash used in operations during the quarter was $16.3 million compared to a use of approximately $4.6 million in the year ago quarter driven by higher net loss and increased cash used in working capital. Combined with higher capital expenses, free cash flow was negative $24.7 million during the quarter.

As we have stated in previous quarters, we expect our free cash flow to fluctuate from quarter-to-quarter given the timing of customer and vendor payments.

Before I turn to guidance, I would like to outline our long-term approach to managing our cost structure, realizing operating leverage and ultimately achieving profitability. Over the past several years, we have been successful in improving our gross margins by realizing efficiencies in our core expenses.

Specifically, we expect to continue realizing economies of scale in our technology infrastructure costs as well as personnel efficiencies related to customer support functions. Therefore, we are raising our non-GAAP long-term gross margin target range from 65% to 70% to 67% to 72%. Within our operating expenses, we expect to realize incremental cost efficiencies as we execute on our cost optimized location strategy and achieve scale across our existing global office footprint.

In addition, we are seeing the early signs of success across more efficient go-to-market motions, which should specifically drive greater efficiencies in our sales and marketing expenses. These include the expansion of our reseller programs, new OEM and co-sell arrangements and expanding GSI partnerships, all of which should enable us to realize strong top line growth while driving efficiencies in our sales and customer success head count over time. As a result, we reiterate our long-term operating margin target of approximately 20%.

I'll note that over our history, we have consistently improved our operating leverage while growing revenue until fiscal 2023, which, as we have indicated since our IPO, represents an investment year.

Moving to guidance for Q3 and fiscal 2023. As Bill discussed, our pipeline remains strong, and we continue to see solid demand for customer engagement solutions. We're mindful of a more uncertain macro environment and have embedded appropriate risk adjustment into our guidance.

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For the third quarter, we expect revenue to be in the range of $90 million to $91 million, which represents a year-over-year growth rate of approximately 41% at the midpoint. Third quarter non-GAAP operating loss is expected to be in the range of $23 million to $24 million. Third quarter non-GAAP net loss is expected to be $21 million to $22 million, with third quarter non-GAAP net loss per share in the range of $0.22 to $0.23 per share based on approximately 97.4 million weighted average basic shares outstanding during the period.

Our Q3 operating expense forecast includes the impact of the company's upcoming Forge event in New York scheduled for October 12 through 14. This event also includes Braze's first Analyst Day scheduled for October 13. Total expenses for the event are expected to be in the range of $4 million to $5 million.

For the full fiscal year 2023, we expect total revenue to be in the range of $347 million to $350 million, which represents a growth rate of approximately 46% year-over-year at the midpoint. We're pleased that we are in a position to raise our full year revenue outlook. But given the dynamics I discussed, we believe it's prudent to do so only modestly. Fiscal year 2023 non-GAAP operating loss is expected to be in the range of a loss of $76 million to $78 million. Non-GAAP net loss for the same period is expected to be in the range of a loss of $74 million to $76 million. Fiscal year 2023 non-GAAP net loss per share is expected to be a loss in the range of $0.77 to $0.79 per share based on a full year weighted average share count of approximately 96.4 million shares.

In summary, we remain excited about our long-term opportunity to deliver best-in-class customer engagement, and we remain focused and committed to delivering revenue growth at scale.

And with that, we'll now open the call for questions. Operator, please begin the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question will come from Brent Bracelin with Piper Sandler.

Brent Alan Bracelin - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Can you hear me?

Operator

Yes, we can hear you, Brent.

Brent Alan Bracelin - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

I guess the big question for me, it looks like your large customers continue to expand aggressively here. It sounds like landing maybe some larger customers are taking longer. But could you just talk a little bit about the pace of expansion at the large customers over 70% growth there? Are you seeing any sort of slowdown in existing customers tied to the macro? Or is it isolated mostly to just lengthening sales cycles?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes, of course. I'm happy to provide that additional context. So when we look across the customer base and splitting it between, obviously, the preexisting customer base, I mentioned the exceptional renewals performance that we had in the quarter, and we're seeing a ton of strength there.

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There are certain upsells that happen as customers expand into new channels and do new use cases. They are potentially bringing in more data over time in order to support those use cases. And those types of upsells were definitely very robust during the quarter.

There are other upsell expansions that potentially go out to new lines of business or new geographies, et cetera. They tend to operate a little bit more like new business. And as we mentioned, we definitely began to see elongation of some of those deal cycles emerging, especially as we got into the end of July, and we saw that kind of more prevalent wait-and-see approach on a number of those.

We obviously have strong confidence in those 2 eventually close because they're with existing customers where we've got very strong relationships. But definitely -- you're definitely seeing scrutiny out there in the enterprise in terms of new outlays, whether those are with existing vendors or in net new relationships.

Brent Alan Bracelin - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Helpful color. And then just one quick follow-up for Isabelle here on -- CRPO growth was basically stronger, much stronger than billings. So could you just talk through the puts and takes? Why you had north of 50% growth in CRPO? But billings obviously moderated much more meaningfully. What's the delta there?

Isabelle Winkles - *Braze, Inc. - CFO*

Absolutely. So I'll just focus really on the deferred revenue component that impacts the calculated billings statistic. So deferred revenue in the quarter, it's impacted by a few factors: how long we give our customers to pay; the extent to which we're able to actually bill on annual upfront terms; the contract start date relative to the signature date; and then, of course, the overall bookings that happened during the period. So during Q2, we saw greater demand for semiannual, quarterly payment terms. We saw more contracts with some delayed start dates. and then to a lesser extent, you have some requests for some additional time to pay. And so these factors taken together compounded the impact of some of the elongations of the sales cycles that you saw. And that -- those things taken together drove the deferred revenue as a result that was sort of, I think, a little bit lower than where we had sort of hoped it would be.

That being said, the bookings that we're actually booking during the quarter, that continues to fuel the RPO and the CRPO growth. So we were very happy to see consistent growth in both RPO and CRPO in line with last quarter.

Operator

Our next question will come from Ryan MacWilliams with Barclays.

Ryan Patrick MacWilliams - *Barclays Bank PLC, Research Division - Research Analyst*

Just on the guidance, could you touch on the decision not to pass through the entire revenue beat to the guide? Like were there any considerations that play here like FX? And is this guide as you see things today? Or does it factor in macro conditions getting worse?

Isabelle Winkles - *Braze, Inc. - CFO*

Yes. So thanks for that, Ryan. We definitely thought it was prudent. We are consistent in approaching guidance with appropriate risk adjustment. And so we thought it was prudent not to pass through the full amount of the beat in Q2 all the way through to the back half of the year and the full year.

I think that being said, FX is a fairly small component for us. We bill almost entirely in U.S. dollars. We have a small component as our Japanese entity continues to ramp up of sales in Japanese yen. That entity continues to perform extremely well. We're very happy there and not concerned

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about particular FX headwinds in that area. So it's not that. It's really more the -- we're very aware of the overall uncertainty that continues to plague the macroeconomic environment. And we just felt it was prudent not to pass through the full amount of the beat.

Ryan Patrick MacWilliams - *Barclays Bank PLC, Research Division - Research Analyst*

Excellent. And then you talked about some macro headwinds and pockets of bookings challenges, but anything to call out from a geography standpoint? And also just like kind of housekeeping. Any changes in your monthly active user base at this point?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes. So we saw largely similar behaviors globally. As Isabelle mentioned, there was particular strength in Japan as one example, but I think it would be hard to discern the difference between just a brand-new market growing into a huge TAM off of a small base, which is the situation going on in Japan as it's only been open for a little bit under 2 years now versus the rest of the world. And I think just what we saw broadly was that wait-and-see approach from a number of management and leadership teams, especially in the enterprise around the world.

Operator

Our next question will come from Arjun Bhatia with William Blair.

Arjun Rohit Bhatia - *William Blair & Company L.L.C., Research Division - Analyst*

I know you guys mentioned that renewals were strong, which is obviously great to hear given the recurring revenue model that you have here. But when customers are coming up for renewal, I'm curious what you're noticing in terms of just the volume of users and messaging that they're renewing at. Are you able to retain or maintain those volumes for existing customers that are renewing? Are those -- is there a downtick there at all from a cost savings perspective that customers are engaging? And just any color on that would be super helpful.

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Absolutely. So I think that when you look at trends like this, it helps to kind of look at the convergence of all the factors that are happening. And so there are certainly cases where certain clients don't hit their own internal growth targets. And so maybe they've purchased a monthly active user account for a year that upon renewal, they don't feel that they're going to achieve that anymore or there other situations where maybe they were planning on rolling out a new channel like e-mail or SMS and maybe they don't pace as far ahead. And so at renewal time, we look at rightsizing those allocations.

I would say that historically, because of the continued expansion of the product, whenever we run into circumstances like that, there's also, in almost all of those cases, appetite for customers to continue to purchase new enhancements of the Braze product, whether those are looking at our data features around things like Currents or maybe our intelligence features, experimenting with the new channel like Content Cards or adding SMS or other things that we've continued to add to the bag of goods for our sales team to be out there selling.

And so at renewal time, even in historical situations where there's been under consumption on one of those, the product footprint has been expanding so quickly that we've really been able to, in those situations, maintain or, in many cases, increase the size of those contracts with existing customers.

We similarly have continued to achieve better pricing power over time as we continue to grow our awareness in the market and as we can point to the outsized ROI that the sophistication of a solution like Braze brings to our customers. And so those things all coming together have always been a -- an opportunity for us to continue to grow our customers, even when you potentially see things like a monthly active user account, prediction not being achieved or other similar circumstances like that.

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Broadly across the board as well, we are seeing very robust growth across all the messaging channels. I'm really excited to see, in particular, growth on either new or deepening channels, things like Content Cards or in-app messages. As you know, we rolled out surveys last year. We've also improved the editors. We've been improving the usability.

Canvas Flow launched in the quarter. And Canvas Flow is -- because of many of its usability improvements and some of the other upgrades in there, is making it even easier for customers to expand to other channels now. So that cross-sell motion continues to be really robust and, in many cases, under consumption on one volume-based entitlement or another is an opportunity to introduce those same customers to a new part of the product.

And then I also realized I didn't speak to monthly active user counts for -- in response to the prior question and since you asked one that's kind of a long -- a flavor of that, I thought I could give some treatment to the monthly active user count right now and just to clarify that we pay attention to monthly active user trends overall, but we're not fixated on it. And there's a few reasons for that. One is that the overall monthly active user scale of Braze is influenced by a like -- it's influenced partially by a concentration of high MAU. In many cases, premium mobile apps and services, many of which date back to our early years as a company. And as the mobile market has evolved and as Braze has matured our enterprise sales motion, our pricing power over monthly active users, especially at high volumes, has improved drastically. Today's high-scale customers are more likely to have robust data flow and cross-channel messaging strategies across their entire customer base and value every one of their customers.

An easy example of this dynamic at play would be comparing a global freemium game with a large proportion of users that generate close to 0 revenue versus a media streaming platform with meaningful subscription or ad revenue across their entire customer base.

The second aspect of that is that as I mentioned before, as our channel selection has expanded as we rolled out additional AI and data-oriented products, our ability to monetize even constant sized customer bases has continued to grow. And finally, there's also seasonal effects in here, which you see in our gross margin, which we spoke about in prior earnings calls, where you see that because our revenue is recognized ratably and consistently throughout the year, but we know that there are seasonal increases in consumption as an example, in the fourth quarter, that's why you'll see some of those seasonal impacts on our gross margin percentage.

The same thing is true with monthly active users where we can see seasonal MAU trends show up, especially in some of our high-value end customers. Some easy examples of that would be retail and e-comm heading into the holiday season. And as we -- obviously, I just saw with the opening weekend to the NFL over the weekend, services like fantasy sports and gaming, which are tied to league schedules, can have some pretty big impacts on those numbers.

Arjun Rohit Bhatia - *William Blair & Company L.L.C., Research Division - Analyst*

Perfect. That's very helpful color. And one more, if I can, maybe for you, Bill. I know you mentioned just in terms of the go-to-market that you are investing quite a bit in the solution partner ecosystem with the GSIs and marketing agencies. Can you just help us maybe contextualize where you are today in developing that partner strategy? And where -- how big this can be for you in the future as a go-to-market motion and revenue driver?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes. We're at a really exciting stage in the evolution of this in the sense that I think that we felt like we were building momentum really, for the last couple of years. We've been chipping away at it. But we finally, I think, broken through in many places, and I've got that flywheel that I mentioned in the prepared remarks, is really starting to spin up.

And so we're continuing to deepen our relationships with solutions providers, including companies like Accenture, Deloitte, WPP and others to help us land and expand within large enterprises who are already clients to those partners or, in many cases, this is more exciting to us where we are the secret weapon that they bring in to some of those new customer pitches to land new customers for themselves with complementary strategy, integration and managed services that Braze is either doesn't offer today or, in some cases, we've actually been incubating new services like data services that we're able to kind of deliver the shape, the size and some of the cost ideas around on a silver platter to these partners as they are obviously interested in expanding that services ecosystem, and Braze continues to focus on scaling as a software company.

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We're seeing really great momentum here. We've hit an inflection point where large global brands are now seeking professional services from those GSIs, and they're stipulating to them that they need to be delivered through Braze. The GSIs are responding in kind or building up incredible practices there. We think that this could end up being not just a large portion of our business and high-quality pipeline, but also one that serves to be more fundamentally efficient from a customer acquisition cost standpoint and from a customer kind of maintenance cost standpoint, which are obviously key components of us achieving our long-term operating margin impacts.

And just to give a shout out to Forge and the associated Analyst Day that we'll be coming along with Forge later in October. You should expect to see a number of those solutions providers participating in Forge as sponsors.

Operator

Our next question will come from Andrew Sherman with Cowen.

Andrew Michael Sherman - *Cowen and Company, LLC, Research Division - Research Associate*

It's Andrew on for Derek. Bill, maybe just on the sales productivity. Was this mainly a function of the newer reps just ramping slower? Or what were the areas of the weaker execution there? And when do you expect the new training programs to start to kick in? And how is performance on the tenured rep side?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

I think that it was a convergence of a few things. One, we obviously -- as you've seen the hiring numbers, and we've been very happy to report on expanding sales capacity and continuing to invest in bringing new account executives and sales leadership into the business throughout the back half of last year and then also into this year and the kind of compounded challenge of a -- changing customer dynamics, changing macroeconomic dynamics, while people are still getting -- they're still trying to get their feet under them did lead to some challenges.

And to put it simply, it's like -- it's hard to teach advanced topics when you're still getting through the 101 and the 201 to lay the foundations. And so there's a couple of aspects there. One is that we're really -- that led to a, I think, a lengthened ramp. And we're working our way through that. The second is that, as I mentioned, we have actually pivoted to the vast majority of this training and enhancing it, bringing it together in person, making sure that they're stronger in-person consistent mentorship amongst our sales team and through the sales productivity efforts that are across business. We've got more leadership involved.

And the way that we look at this is that, well, certainly, the macroeconomic conditions are making things harder. They're making them harder for everyone. And the better job that we can do really leaning into the challenge, the better comparatively, we will emerge on the other side of it. We know that we're a fully funded business. We obviously went public ahead of our other startup peers, and we're looking to take advantage of the awareness benefits that, that provides as well as, obviously, the ability to continue to finance and fund for growth. We're excited about all of that. And so we're definitely investing in making sure that this additional capacity that we're bringing online is going to be as competitive and as effective as they possibly can be.

When we look at the more tenured reps, we didn't see the same types of kind of deal activity changes and things like that. But a lot of that wait-and-see that we referenced that we're seeing from the enterprise broadly as -- due to the macroeconomic conditions was pretty broad-based regardless of the tenure of an account executive.

Andrew Michael Sherman - *Cowen and Company, LLC, Research Division - Research Associate*

And impressive on the Roku win. And as we look into the holiday season, could this kind of be a catalyst for more B2C brands to invest more in customer engagement solutions? And do you see these kinds of deals in the pipeline in the second half?

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William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes. Absolutely. We've got a really robust pipeline, which I referenced in the prepared remarks. We've gotten -- we're constantly improving our qualification and inspection process on those opportunities. And there's a lot of excitement in them.

I also, am particularly excited by Roku because in addition to them becoming a client, we have also been investing in our Roku in-app message support as well for our large cohort of media and streaming customers. And so that's a really great opportunity for win-win collaboration in the future.

Operator

Our next question will come from Jake Titleman with Goldman Sachs.

Jacob T. Titleman - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

This is Jake on for Gabriela. Bill, a quick one for you. I guess how is the Braze pitch resonating with new customers in this type of macro environment? What are some of the tangible ROI metrics that your reps can share with prospective customers to help them convince them that Braze is a worthwhile investment in this type of environment?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes. So we remain -- I think that the core story and the core thesis behind Braze and the ROI that we can deliver and the approach of working on these problems with a sophisticated state of mind, with a error toward experimentation, bringing creativity and innovation to the process, bringing data into the equation and helping feed that experiment loop, those are all core parts of the Braze thesis and will continue to be.

I think in response to some of the macroeconomic headwinds and some of the changing buyer conditions, we've also been focused on creating buyer urgency and a compelling reason for them to decide to move forward. And a big part of that is really just building the case that there is a real opportunity cost to either going with maybe what they perceive to be a quick and cheaper solution at a time where maybe they're watching their budgets a little bit more closely or deciding to stick with a suboptimal provider today and really creating those moments to drive the urgency to make them see the opportunity costs.

We've obviously got the holiday season coming up for a number of our big verticals that we'll be using to create compelling events for people to be making those decisions and moving forward. We also obviously have a strong focus on improving our time to value and making sure that we can bring new customers up that on-ramp quickly, get them up and running with what are the early use cases in Braze and then inspire them to expand out into other use cases, which we've, of course, been able to see in so many of our existing customers.

We believe we're already head and shoulders above the legacy marketing cloud with respect to time to value. We're investing heavily to extend that lead by improving both our usability and the on-ramp into Braze. You saw that with the launch of Canvas Flow. You're going to hear more at our Forge conference as we continue to extend the vertically integrated real-time data flow that we have and continue to make improvements to the string processor environment.

We're also obviously helping out -- helping on the services ecosystem side, which is that one of the blockers that often exists is just not having enough internal technical resources to go through implementations. Everything you've heard me talk about with respect to the GSIs and the marketing -- the large kind of marketing agency holding companies, that applies at the top end to be able to help those enterprises be able to move when maybe they wouldn't have been able to otherwise due to resourcing. But across the rest of the business looking all the way down into the SMB segment, we are also cultivating a huge community of smaller growth agencies and digital agencies all around the world that are able to

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come in and really help complement the strategy and advice that Braze provides directly with hands on keyboard and with more specific services that really help them get up and running more quickly and more comprehensively.

So the simultaneous change in strategy and tactics in terms of the talk track with the customer showing up with the resources to help them and then also an R&D focus on usability and improving that on wrap are all coming together to help improve that situation.

Jacob T. Titleman - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

And just a quick follow-up on that. Beyond the elongating sales cycles that you talked about, are you seeing any other noticeable shifts in buyer behavior? And maybe are there any industry verticals that you would call out as either weaker or stronger?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

I wouldn't call out any verticals. And like I said, in response to geographies, we really saw this to be pretty broad-based. I think most of it is just a response to uncertainty that obviously exists broadly across the entire economy, and it's more of a wait-and-see.

In terms of just broader market dynamics, I don't think we're seeing fundamental shifts. A lot of the enduring tailwinds that have supported Braze's growth over the last few years are still perfectly intact. The shift from third-party ad ecosystem into the first-party data -- into building first-party data assets, building up direct-to-consumer relationship assets, continuing to invest in higher quality, delivery of products and services and experiences to customers as the competitive landscape across digital services continues to be more robust.

There's still tremendous opportunity for the brands out there that are doing this right. And when Braze comes into an environment, we're able to really multiply the agility and the velocity with which they can roll out really high ROI customer engagement strategies. And so I think that the core thesis remains entirely intact. We're really excited about all the tremendous R&D development that's coming in to both help us smooth that on-ramp for more customers and not just more customers but also new types of new customers, which we're really excited about continuing to build for even in the near future. And you'll hear more about that at Forge as well, but also continuing to smooth the rails by which our existing customers expand into new channels and expand into new use cases because across the customer base, we think we're still pretty underpenetrated from that perspective.

So a lot of excitement in terms of growth. We definitely understand that these challenging macro conditions have led to a little bit of analysis paralysis in certain pockets. We've seen some of that soften up already in August, as Isabelle referenced. And we're really looking forward to continuing to invest for growth.

Operator

Our next question will come from Taylor McGinnis with UBS.

Taylor Anne McGinnis - *UBS Investment Bank, Research Division - Equity Research Analyst for Software*

Maybe one on margins. So you lowered the second half margin guide by 70 basis points. And it looks like most of the impacts in 3Q. So can you just provide more color on what are the drivers there? Because I know you talked about a couple of things in your prepared remarks with the event and rep productivity and T&E expense. So just curious what the incremental area of spend is there. And maybe as a second part to this question, I guess, how do you guys think about balancing growth and margins and hiring and a weaker macro and what might be embedded in the guide?

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Isabelle Winkles - *Braze, Inc. - CFO*

So specifically on Q3, Taylor, that was really related. So we never provided Q3 guidance before. And so we had never talked about sort of the specific timing and what we were deciding to do around Forge. And so really, the relative point to the guidance -- or to the consensus number rather is really just the incremental spend associated with Forge, which we didn't know earlier in the year if we would be able to actually do this in person. We're really excited that we can. And so we're really sort of back to our roots of kind of that in-person engagement, both in New York and in London. The Q3 specifically is impacted by the New York event just because of the timing. The London event is a Q4 event in November, but that's really what you're seeing in terms of what looks like a below consensus number for Q3. So that's all you're seeing there. Is that (inaudible)

Taylor Anne McGinnis - *UBS Investment Bank, Research Division - Equity Research Analyst for Software*

Yes, it does. And then just lastly, if we look at the second half guide for revs, it appears that most of the guide down is more in 4Q. So could you maybe just maybe talk about like the level of conservatism and guidance philosophy assumed in 3Q versus 4Q? And just as we think about new logo adds, dollar-based and expansion rates and the potential for those metrics going forward, anything you would highlight there?

Isabelle Winkles - *Braze, Inc. - CFO*

So we don't guide on dollar-based net retention. So I would just -- the only thing I would say there is it is a 12-month trailing statistic. And so looking back historically, we do have some higher numbers that we'll be rolling off. And so we'll have to contend with that. So we don't guide on that, but just certainly take that into consideration.

And then as it relates to the guide, I think I've answered this in sort of a prior question, but we've embedded what we believe to be an appropriate conservatism. We were prudent in not passing through the full amount of our beat in Q2. And so we're really confident in our ability to achieve the numbers that we've put out both for Q3 and the back half of the year.

Operator

Our next question will come from Yun Kim with Loop Capital.

Yun Suk Kim - *Loop Capital Markets LLC, Research Division - MD*

Bill, can you just talk about any trend around the type of messaging channels your customers are more focused on in this current environment? Are they opting for lower cost marketing channels like e-mails and push notifications and perhaps away from higher-cost channels like SMS text messages and whatnot? And if that is the case, is there any -- how that's impacting the gross margin dynamics?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes. So I think that the impacts that we see in our customer base with respect to those trends, which I think, in general, are happening from a buyer pressure perspective, are not likely to impact our gross margin for a couple of reasons. One is that we are still early with SMS as a channel. It is still a relatively small percentage of not just our overall volumes, but also our revenue, but also the types of SMS volumes that Braze takes on.

We've always been focused on making sure that they are going to make sense for our overall company's gross margin profile, that they're high-value strategic messaging. We've never gone and tried to just sell really high-volume SMS for utilitarian use cases like, for instance, sending like large numbers of 2 factor off codes and things like that. So we're really focused on making sure that we're tackling the right use cases in places where SMS really makes sense as part of a cross-channel strategy.

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I think the other aspect of that is that there's a lot of single channel providers out there in the world. And frankly, when you buy a piece of software that can -- that's focused on one channel, you've got a hammer and everything looks like a nail. And that leads to people over extending on those channels. By contrast, when you work with Braze, our customer success team and our integration and onboarding teams will work with you right out of the gate to make sure that the messaging channel mix that you are utilizing makes sense for you from an ROI perspective.

And so I think Braze doesn't necessarily see changes really with in individual customers shifting around volumes like that. But as evidence of that broader trend, I do think that we're seeing a lot more in some of the integrations with the advertising platform, which I mentioned during the prepared remarks. We've got increasing adoption of that, and we also have a lot of customer demand for us to expand beyond just Apple and Google. And I won't share exactly which partners those are going to be. But again, I'll flag that you may hear more about that at Forge, and we're excited to continue investing into that space because, as you heard at the customer anecdote in the prepared remarks, improving cost per acquisition by double-digit percentage points is a massive deal, especially in situations like this.

So when we look at the overall ROI of what Braze is delivering, we can start to layer things like that in even before you start to talk about delivering messaging and everything else the customer engagement does.

Yun Suk Kim - *Loop Capital Markets LLC, Research Division - MD*

Okay. Great. Real quick, Isabelle, is there any change in the initial land and expand dynamics in the current environment? Are you perhaps seeing a smaller land deal size and maybe perhaps customers looking to expand more through smaller -- higher volume of smaller expansion deals?

Isabelle Winkles - *Braze, Inc. - CFO*

Not necessarily. I think there's still the opportunities out there. I mean our pipeline is still very, very robust. And we have certainly some larger lands and some larger expands that are on the horizon. So I don't think we're necessarily seeing anything there.

I think where we're seeing a little bit of analysis paralysis generally is just kind of getting that initial deal through the door that can be on a brand-new logo, a parent company that we've never had and also sometimes on an existing parent company, but maybe further penetration into a new brand or a new region. So that can impact both lands and the expands since those are 2 different -- one is the land and one is the expand. But we're not necessarily seeing material degradation in that, certainly not in our pricing or our ability to entice customers with our product.

Operator

Our next question will come from Brian Schwartz with Oppenheimer.

Brian Jeffrey Schwartz - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Bill, did you see any changes to the win rates during the quarter?

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

So we saw changes in some of the overall win rates that we track in pipeline because of just -- when we push things out, when I went back to that robust inspection and qualification process in our pipeline, we need to make sure that there are compelling date events and that there are -- there's a compelling reason for the business to make the change for us to spend our time on it. And so we certainly saw a few more of those as wait-and-see. If a wait-and-see kind of pushed out more than 3 months, we would prefer to close that out of the pipeline and then regenerate it once we have the compelling event coming back in.

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We also did see some pockets of customers choosing to go -- to stick with their existing providers or potentially go to much lighter weight solutions just because of some of the budget pressures that they're under. We've seen historical competitive situations like that, especially with -- especially if we're in a vertical or an industry or a geography that happens to be more price sensitive. And what we've really noticed over time is that as those companies mature, as those geographies or those verticals continue to mature, that those customers come back. And when they do, they're ready to really pick a premium option, invest more in it, get more out of it. And so we did see some isolated instances of that in the quarter, but nothing that I think we haven't seen historically in other similar circumstances.

Brian Jeffrey Schwartz - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

And then, Isabelle, one question for you. You just commented on the last question, the pipeline remains robust. Is it fair to assume that the top of the funnel trends -- pipeline trends that they have not changed since the last quarterly update?

Isabelle Winkles - *Braze, Inc. - CFO*

Yes, I think that's fair that those dynamics are generally in line. We haven't seen sort of huge changes at that level. I mean we're seeing the same trends of potentially these elongated deal cycles and being somewhat trigger shy in certain pockets that -- I think that will persist for a little bit, which is part of the reason why we've guided the way we've guided. But the top of the funnel also continues to show strength.

Operator

Our next question will come from Pinjalim Bora with JPMorgan.

Pinjalim Bora - *JPMorgan Chase & Co, Research Division - Analyst*

Isabelle, I wanted to ask you about the linearity of the quarter across the 3 months, I'm trying to understand the billings difference, which I understand the deferred revenue puts and takes. But RPO still seems pretty strong, I'm trying to think how your bookings might have worked out versus you're expecting for the quarter.

Isabelle Winkles - *Braze, Inc. - CFO*

Yes. So they were -- so I think if we go back to -- Q4, I think, was sort of fairly back-end loaded more so than we had experienced historically. I would say Q1 and Q2 both were still more back-end loaded. We typically do about a little more than 50% of our business in the last month of the quarter. And within that last month, we'll do most of that at the very end of the month. I would say that was fairly characteristic of this quarter from a month-to-month perspective. In that last month, we did an overwhelming amount of the business at the very end of the month. And so that dynamic is also coming into play.

Pinjalim Bora - *JPMorgan Chase & Co, Research Division - Analyst*

Understood. And one for Bill. On a high level, Bill, I remember you had a unique view about the CDP space. I think you had said that CDP -- stand-alone CDP is kind of add another layer of latency and that Braze, along with some cloud data warehousing companies like Snowflake, can actually kind of create the CDP effect with much better latency. Are you hearing those -- that kind of narrative kind of resonate with customers at this point? And could maybe the macro actually help that narrative instead of people trying to buy a stand-alone CDP separately?

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William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

Yes. So I think that there will continue to be a great role to play for CDPs as they -- for stand-alone CDPs, especially in environments where they're helping organize the complexity in a -- especially a heterogeneous data ecosystem that various types of customers tend to have. At Braze, we're really focused on a couple of things that I've mentioned or reiterated a couple of times on this call, which are the time to value, the ability to deliver differentiated capabilities with our real-time stream processor and also giving our customers the opportunity to continue experiment to enhance our ROI over time.

And so in order to do that, we need to be really thoughtful about the entire life cycle of any data point as soon as it's generated or as soon as it's knowable from the customer. And that means that we're going to continue to make investments to make sure that we can vertically integrate data sources. That enables us to get our customers up and running more quickly. It allows them to bring more robust data sets into Braze, in order to run a more versatile and flexible set of customer use cases.

And we're really focused on just making sure that we've got strong -- we have a strong ability to both access process and then store that real-time data flow of all the first-party data that's coming in. So you're going to hear more at Forge about the continued work on the data integration front coming out of Braze. But when you think about what motivates us there, the primary things are making sure that our customers are able to get the right data that they need into the Canvas environment, making sure that our stream processor has access to it as soon as it's generated because we all know that the value of data to your organization starts deteriorating as soon as it's generated, and we want to make sure that we're right there at the point of understanding and generation. And that includes really looking broadly at all the different places that data lives, that data is processed and where data is generated.

Historically, you've seen Braze integrated directly into our customers' end products, which is where much of that data is generated. We've continued to build into the data science ecosystem in a variety of ways, and that's places where data is being further processed, where things like AI/ML models are driving kind of bespoke or domain-specific judgments out of proprietary data sets at our customers. We want to make sure we continue to get closer and closer to those so we can deliver differentiated value to our customers.

Operator

Our next question will come from Brian Peterson with Raymond James.

Brian Christopher Peterson - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

I'll keep it to one. Isabelle, just -- it's great to see that the gross margin outlook long term is moving higher. I'd love to understand because I get the question a lot from investors, what are the biggest components of COGS and where are you expecting more long-term leverage? And how do we think about the gross margin target moving up, but the op margin target is staying the same? Any thoughts on that?

Isabelle Winkles - *Braze, Inc. - CFO*

Yes. Thanks. So the components of core broadly divide into 2 pieces. So there's the technology stack, which is the largest portion. It's sort of 2/3 to 70%, 75% of the total, and then the personnel cost. So we've already been working on, and you're seeing it in our numbers, achieving scale on the technology side. We're going to continue to do that.

On the personnel side, we have been working there to optimize. But as I mentioned in my prepared remarks on the call, one of the further areas of leverage is executing on our cost optimized location strategy, and there are individuals -- or there are roles rather on that -- on the -- in the core segment where as the organization grows, we will be able to find ways to grow into some of these cost optimized locations. So I think those 2 things taken together are both continuing to optimize on the tech stack and then on the personnel side as well.

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We're already basically operating in the high -- well above the low end of our range. We just thought it was appropriate to recalibrate that, and quite frankly, to hold ourselves internally accountable to that and continue to work on that.

I think just in terms of the overall margin, so I haven't actually indicated that we -- those numbers are sort of taking the extra expense. I've simply reiterated the approximately 20% profitability. And so I'm not making updates or comments to the specific decomposition of the operating expenses below core and simply reiterating that we plan to be approximately 20% in the long term from an operating profitability standpoint.

Operator

(Operator Instructions) And with that, if there are no more questions, the Q&A session has now concluded. I'll hand the call back over to Bill for closing remarks.

William Magnuson - *Braze, Inc. - Co-Founder, Chairman & CEO*

All right. Thank you, everyone. It was a great call. Thank you for all the great questions. In summary, we are extremely excited about the long-term opportunity here. We are overjoyed to be working with our customers, continuing to grow the global Braze footprint and continue to forge ahead to create new opportunities to deliver revenue growth at scale. So thank you, everyone. We look forward to seeing you at Forge or a number of you at Forge for our Analyst Day, and then we'll continue on from there with the next earnings call in a few months.

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