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MANAGEMENT DISCUSSION SECTION

Operator: Good day. My name is Victoria [ph] and I will be your conference operator. At this time, I would like to welcome everyone to the Salesforce Second Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to turn the call over to John Cummings, Vice President of Investor Relations. Sir, you may begin.

John Cummings
Vice President-Investor Relations

Thanks so much, Victoria [ph] , and good afternoon, everyone, and thanks for joining us for our fiscal second quarter of 2017 earnings results conference call. Our second quarter press release, SEC filings and a replay of today's call can be found on our IR website at www.salesforce.com/investor. With me on the call today is Marc Benioff, Chairman and CEO; Keith Block, Vice Chairman, President and COO; and Mark Hawkins, our CFO.

As a reminder, our commentary today will primarily be in non-GAAP terms. Reconciliations between our GAAP and non-GAAP results and guidance can be found in our earnings press release. Also, some of our comments today may contain forward-looking statements which are subject to risks, uncertainties and assumptions. Should any of these materialize or should our assumptions prove to be incorrect, actual company results could differ materially from these forward-looking statements. A description of these risks, uncertainties and assumptions and other factors that could affect our financial results are included in our SEC filings, including our most recent report on Form 10-Q.

So with that, let me turn the call over to you, Marc.

Marc Russell Benioff
Chairman and Chief Executive Officer

Outstanding, John. Thank you very much, and thank you to everyone joining us on today's call. I am absolutely delighted to be here to talk about our second quarter results and to tell you about everything that is going on at Salesforce.

So revenue, as you see, has grown 25% in dollars and 26% year-over-year in constant currency to more than $2 billion, and just congratulations to everyone at Salesforce. This is a first $2 billion quarter and also, no other enterprise software company of our size and scale is delivering this kind of growth rate. Congratulations to everyone.

Deferred revenue was $3.8 billion, up 26% in dollars and 27% in constant currency. The dollar value of booked business on and off the balance sheet is now $11.8 billion, which is up 28% from a year ago. We're raising our fiscal 2017 revenue guidance to $8.325 billion, at the high end of our range, up 25%, and we're delivering on this strong pace of top line growth even as we continue to improve on our non-GAAP operating margin.

Salesforce continues to be the fastest-growing Top 10 software company in the world, and last week Forbes ranked us as one of the most innovative companies in the world for the sixth year in a row and has named Salesforce "the innovator of the decade". Thank you, Forbes. That's a great tribute to our amazing employees, especially our technology and product teams.

Dreamforce is coming up, and you're going to see an incredible level of new innovation when we introduce Salesforce Einstein, the world's first comprehensive artificial intelligence platform for CRF [ph] . The Salesforce side signed as AI for everyone. It's going to democratized artificial intelligence. It's going to make every company and every employee smarter, faster and more productive. We are going to deliver the world's smartest CRM.

And as you know over the last few years we've acquired a number of AI companies, incredible companies like RelateIQ, MetaMind, Implicit [ph] , PredictionIO, Tempo, AI and more, with amazing, amazing people and technology. We've been able to stitch all this together into this incredible AI platform. And this focus on AI and on the critical aspects of AI is the next wave of our industry, has resulted in a machine learning team of more than 175 data scientists, who have built this amazing Einstein platform. And that's really why I am so excited and why everyone at Salesforce is so excited.

And when you come to Dreamforce, you're going to see how this fits together and how we are delivering Salesforce Einstein. And we're going to have some great new products like Sales Cloud Einstein and Service Cloud Einstein, Marketing Cloud Einstein. We're going to have our Analytics Cloud Einstein and many other artificial intelligence capabilities in all of our clouds. And our customers will be able to build their own AI capabilities using Einstein extensions and Heroku. This is going to be a huge differentiator and growth driver going forward, and it puts us well ahead of our CRM competition once again.

Salesforce Einstein is also a perfect example of how we've been able to combine organic innovation with some amazing acquisitions. We came into this year with a lot of excitement and energy around the investments we made in our own technology. Earlier this year, as you know, market conditions did change, and my leadership, the Board and I were presented with some incredible opportunities that we just never thought would be available to us. We took a look at these amazing acquisitions, and our strategy was simple. We will acquire one-of-a-kind companies with unique technologies, amazing engineering teams and of course visionary leaders that fit with our mission and our strategic plan to help our customers connect with their customers in new ways.

And some of these acquisitions are helping us build out our CRM today. Others are laying out the foundation for our future. A great example is Demandware, a company we've had a great relationship with and have admired, and there is no company like Demandware. It's the clear leader in the multibillion-dollar cloud e-commerce marketplace, a natural extension of our platform. It expands our CRM offering of capabilities our customers have been asking for.

And when we talk to customers like Louis Vuitton or Brunelli Cuccinelli [ph] , or See's Candy [ph] or even Adidas, they talk about Demandware as the critical part of their e-commerce cloud, and that's how it became the Salesforce's e-commerce cloud. It's the solution that our customers drove us to, and we are absolutely thrilled with this great new family of e-commerce products at Salesforce.

We also take advantage of opportunities to invest in our future with incredible companies like Quip, and everyone knows the great leader of Quip, Bret Taylor, the creator of Google Maps and also the former CTO of Facebook, who has created this next generation technology of Live Documents, bringing a new level of contents, communication and collaboration right into our platform. And with all of this, we are creating the world's smartest CRM through sales service marketing community, analytics, e-commerce and IOT.

We have never been better position for the future. You're going to see that at Dreamforce it is going to be a rush of innovation. There has never been more new product and more capabilities released at Dreamforce. And you're never going to see a better place to see how all of this amazing innovation and products comes together. This is our biggest customer event of the year, coming very, very soon, October 4-7. We've got more than 2,300 customer speakers, inspiring, motivating, empowering, education our amazing community of customer trailblazers.

We also have an amazing lineup of speakers, including Melinda Gates [ph] , and General Motors' Mary Bara [ph] ; Congressman, John Lewis; and many, many more. And you're not going to want to miss U2 performing at our Dreamfest UCSF benefit concert, to raise $10 million for children's hospitals. It's going to be an unforgettable event. Three-fourths has already sold out, so talk to John to get registered, and I'm going look forward to seeing everybody there.

Now let's turn it over to Keith and talk about our customer highlights for the quarter. Keith?

Keith G. Block
Vice Chairman, President & COO, salesforce.com, inc.

Thanks, Marc, and thanks, everybody, for joining the call today. Overall, we delivered a solid second quarter. Our results reflect our continued focus on becoming more strategic with the enterprise, expanding internationally, investing in our partner ecosystem and broadening our penetration in our target industries. In each of these areas, we made good progress in Q2.

Now at the same time, we saw some softness at the end of the quarter, primarily in the United States. And after a thorough operational review of the United States business from sales to products to marketing, really all aspects of our business, I am confident in our plan for the year. We have a proven and tenured sales leadership team. We have industry-leading products. We have continued high win rates, and our second half pipeline is very strong. We also are seeing very high levels of customer engagement.

So let me take you through some of the highlights of the quarter. We continued to close some of the biggest and most strategic transactions in the industry. In fact, we closed another nine-figure transaction in Q2 with a Fortune 50 customer. For those of you who are counting, this is now the third quarter in a row where we've established these very strategic nine-figure relationships.

On the international front, over the last few years, we have been steadily increasing our distribution capacity, expanding our partner ecosystem, investing in offices and infrastructure and opening new data centers, and all of these investments are clearly paying off.

Europe was our fastest-growing region, powered by some great strategic wins with Celcom [ph] and Post Nord [ph] and TNT, AXA and Nestle; great brands. Asia-Pac had some great wins with Shinze Bank [ph] , Meizhe Yzuda [ph] , Samsung and Telstra. And in Latin America, we expanded our relationship with the largest private bank in Brazil, Itau.

And in every region, our partners, which is so critical to our strategy, have been a huge part of our success. Our ecosystem continues to expand with incredible ISVs and global and regional SIs. In fact, partner certifications reached 38,000 in the quarter, up 25% from a year ago, which is proof positive that our partner strategy is working and adding to our additional overall capacity.

We continue to gain traction from our vertical focus, which furthers our momentum in each of our major industries, and I'd like to share a few of those stories.

In healthcare, UnitedHealth Group significantly expanded with us to help build its next generation of patient and customer engagement for more than 125 million people. This is an incredible vision to make healthcare more cost-effective, efficient, predictive and intelligent.

In retail, one of the world largest brands expanded with us to consolidate their entire guest experience to turn the billions of messages they send to customers in one-to-one journeys that are seamless, intelligent and predictive.

Macy's is another great example of how a retailer can transform with us. They started with Heroku for just portions of their mobile and e-commerce websites. Now they are bringing Salesforce to 185,000 employees and 1,000-plus HR call center agents. And our momentum in retail is only going to get supercharged with Demandware, our Salesforce Commerce Cloud.

In financial services, we expanded with State Farm and Nationwide and Farmers and The Advisors Group, one of the largest networks of independent broker-dealers in the country, and they are rolling out the Salesforce Financial Services Cloud to thousands of affiliated advisors. As you know, this is a product we launched just last quarter, and the early interest has been remarkable.

These are all incredible stories. I could go on and on, and at Dreamforce, you're going to hear even more from our customers and how they are transforming their business with Salesforce.

Before I close, I'd like to thank the team and the company for their hard work and their efforts driving customer success in the quarter, and of course, to our customers and partners for their trust in us. And I look forward to a strong second half.

And with that, I'd like to turn the call over to Mark to talk about our financial performance in the quarter.

Mark J. Hawkins

Chief Financial Officer and Executive Vice President

Great. Thanks, Keith. Our total revenue for the second quarter was up 25% in dollars and 26% in constant-currency, excluding the year-over-year FX headwind of $25 million. Demandware contributed $9 million to revenue in the second quarter, which was near the high-end of the guidance we provided in June. Our dollar attrition for the second quarter which excludes Marketing Cloud remains below 9%, supporting top-line revenue growth.

Looking at revenue by cloud, Sales Cloud grew 13% year-over-year in dollars, Service Cloud grew 29%, App Cloud and Other grew 43%, Marketing Cloud grew 28%, which now includes the subscription and support revenue from Demandware.

While many enterprise software companies are aspiring to achieve a billion-dollar run rate in one product, we already have three products with revenue run rates of more than $1 billion today with the Marketing Cloud soon to become our fourth. This gives us multiple levers of growth and provides additional business diversification.

This was another quarter of consistent year-over-year constant currency revenue growth in our regions with EMEA growing 32% and Asia Pac growing 29%. During the second quarter, FX drove more revenue pressure than expense relief, so I'm very pleased that we were able to still deliver 25 basis points of non-GAAP operating margin improvement year-over-year, our ninth consecutive quarter of expansion. And we achieved this even while we began integrating Demandware and other recent acquisitions.

I've already discussed how FX impacted our P&L, but the more meaningful impact was to the cash flow statement and balance sheet. Cash flow in the quarter was $251 million, down 18% over last year. Operating cash flow was principally impacted by FX headwinds as well as continued deepening of the seasonality of invoicing and one-time costs associated with the acquisition of Demandware. However, I'm very pleased with our cash generation in the first half of the year of $1.3 billion, which is up 25% over the first half of last year. Deferred revenue ended the quarter at more than $3.8 billion, which includes approximately $23 million related to our acquisition of Demandware. This was up 26% in dollars and 27% in constant currency when excluding a year-over-year FX headwind of $35 million.

Sequentially, deferred revenue had an FX headwind of $41 million. This was the largest sequential deferred revenue headwind we have ever seen and highlights the dramatic effect that currency had at the end of Q2. In the quarter, approximately 78% of all subscription and support-related invoices were issued with annual terms. Q2 benefit to deferred revenue from the change in billing frequency was less than one percentage point of growth.

Moving on to guidance. Just as FX had a significant impact on our Q2 results, we now expect FX pressures to persist for the remainder of the year with a full year revenue headwind of approximately $100 million to $150 million. In this context, I'm pleased to raise our full year revenue guidance to $8.275 billion to $8.325 billion. At the same time, we're making minor adjustments to our operating model to absorb and integrate recent acquisitions in order to deliver the profitability we've committed to. As such, we continue to expect non-GAAP diluted EPS of $0.93 to $0.95, which implies approximately 70 basis points of non-GAAP operating margin improvement.

Finally, with FX volatility we've discussed, we are updating our full year operating cash flow guidance to a year-over-year growth rate of 20% to 21% which allows us to remain on track for our first $2 billion cash flow year. For Q3, we're initiating guidance for the revenue of $2.11 billion to $2.12 billion, non-GAAP diluted EPS of $0.20 to $0.21, and year-over-year deferred revenue growth of approximately 20%.

To close, we delivered a solid result in the second quarter and I'm very pleased to be raising our top line guidance while maintaining bottom line guidance for the year. As Keith said, with our strong pipeline of new business, and with three-fourths in October, we have a great set up as we move to the back half of the year. And I look forward to welcoming many of you at our analyst day at Dreamforce in October.

And with that, we'll open up the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll pause for a brief moment to compile the Q&A roster. And your first question comes from the line of Keith Weiss with Morgan Stanley.

Keith Weiss

Q

Thanks, Linda [ph] . Thank you, guys, for taking the question. Keith, you mentioned some weakness at the end of the quarter. I was wondering if you could dig into that a little bit for us. Was it from, like, a competitive impact? Was it in any particular product segment? Anything you could give us in terms of color in terms of what happened at the end of the quarter, and to the degree to which it's going to persist into Q3 and to the back half of the year. And maybe, Mark, if you could talk to us – Mark Hawkins – if you could talk to us about how much of that conservatism for that weakness at the end of the quarter is implied into the guidance that we have for Q3 and Q4, particularly the implied billing fetch for Q3?

A

Yeah, okay. Keith, thanks for the question. So, listen, we're – we had a solid quarter, our results were good, we did have some weakness and some softness, if you will, in parts of our business in the United States. As I had mentioned in my earlier comments, we conducted a very, very detailed operational review, which is, by the way, part of our normal cadence. It's what we normally do. But we took a deeper look, given that we had some softness in parts of the U.S., and look, at the end of the day what I would boil this down to is just a bit of blocking and tackling. And we've taken a look at it. We've made the adjustments.

We've looked at our playbooks. And we've tightened up on a few things, but in these quarters, things push out, things pull in and that's happened in every single quarter that I've ever been involved with, and as I think many of you know that I've been in this business for over 30 years. So as I said, we've taken a look at the operational aspects of the business.

I feel very, very positive about the second half. Our pipeline is strong. Our win rates were very strong the quarter. Our level of engagement has never been stronger. In fact, over the last two weeks, I have spent time with three of the CEO and COOs of the top 10 U.S banks in the United States. And all of them are talking to us about a transformation and raising their level of engagement with customers, and they view us as a trusted advisor and they want to know how we can help them. They are talking to us. They're talking to Salesforce. They're not talking to other customers. So when I look at the leadership team that we have in place, which has been a very high performing team historically, when I look at our second half pipeline, when I look at our level of engagement which is unprecedented, I feel very, very strongly about the second half of the fiscal year.

A

Now let me pick up on the second point, Keith, the question you asked around DR and I believe you asked about billings. Let me just talk about our DR, deferred revenue. Obviously, we have some impact for the foreign exchange. We talked about having such an impact in Q2. It's the biggest sequential change we've seen ever in the history of Salesforce. So that has to be factored in appropriately. The other thing that I know you'll get, Keith, also is the seasonality and the compounding effect that we talked about at Dreamforce last year. We showed all the math and the multi-year trend that's happening there, of course, that we would look at that as well. But I level it up basically and say that we think it's appropriate.

And when we look at the overall top line demand of revenue growth as described – and I'm just pleased to be able to add this is the third time this year that we've raised our annual guidance for revenue for the year, and we're doing that predicated on all the things Keith talked about: the second half pipeline, looking at things like our market share; we continue to gain momentum based on the most recent market share data that was released, win ratios. But at the end of the day, what I'm most pleased about doing is doing that for the third time in the face of $100 million to $150 million in FX headwinds at the top line, and yet we're still doing the third raise. So I think we have a good setup as Keith described, and obviously, we have to factor in all the things he covered. That's my point of view. Hope that helps.

Operator: Your next question comes from the line of Heather Bellini with Goldman Sachs.

Heather A. Bellini

Q

Great. Thank you so much. This question is for Marc Benioff. Marc, there's obviously been a lot of news coming out of Salesforce over the past 90 days. You also had a bunch of comments in the press surrounding LinkedIn. I guess what I'm wondering is, the last time I believe you set out a big public goal for the company was your $10 billion target several years ago, which obviously, you're – looks like you'll trip over very soon. I'm just wondering if you can share with everyone your vision for the company as you look out over the next three to five years, how you're thinking about the company's revenue potential and how important M&A will be going forward in achieving those goals? Thank you.

Marc Russell Benioff
Chairman and Chief Executive Officer

A

Well, Heather, I really appreciate that. Specifically, to the M&A question, when we came into this year, we didn't really have M&A on our forecast, and the reason why is because when we look at doing M&A, we look for really strategic great companies that are one-of-a-kind and also that we're going to get a great price. Then we have a tremendous process in our company that includes our Board of Directors' M&A committee as well as our internal corporate development group. And when we looked out, we didn't see that happening.

But then there were some pretty big changes that happened in the market, and the first one, I know you covered, which was that LinkedIn did not have a great quarter and their stock dropped by 50%. And when that happened, it really triggered our process because all of a sudden, they, a great company that is a unique asset that's strategic was available at a great price. And so we made a bid for LinkedIn, and another company, as you know, Microsoft, made a bid, and Microsoft outbid us. And that happened for a lot of different reasons, but we thought that that was a great asset at a great price.

Then, as the market has, continues to evolve, we had an incredible situation occur, which very similar – which is a company that we coveted for many years, Demandware, was all of a sudden approached by another company. And they had tried to acquire Demandware, and it came to our attention, would we want to buy them? And we put in a bid for Demandware because again, it's a great company. It was a great price, tremendously strategic fit for our company and our future. E-commerce platform, and I had just come back from a trip to LVMH, who uses Salesforce for CRM and is also standardized on Demandware. And they said those two solutions combined, that's all they needed to manage all their customer information. That was enough to me to go to the Board and say, look, we have been approached by Demandware. This is a one-of-a-kind opportunity. There is no other leader in cloud e-commerce, our customers, like LVMH, like others I could go through, are using Demandware. We should acquire this, and we were successful in that bid.

Now, as the summer kind of rolled on, I did not expect to get a call from someone who I have incredible respect for, Bret Taylor, who is the CEO of Quip. I've followed his career for many years. I try to have dinner with him once a month. Everyone knows the incredible work he did with Google Maps. Everyone knows he was the CTO of Facebook, and he had accepted an investment from Salesforce at this company, and we were talking about the possibility of Salesforce acquiring his company and him joining our team as one of our top technical leaders. And that's a dream that this company has had for several years. Everyone here and many people in the industry as well covet and love Bret. And when we had that opportunity, we took that.

And so our beginning of our fiscal year plan not to acquire any companies all the sudden turned into we acquired two very important companies with Demandware and also Quip. And we have also found a couple of other great companies as well. And the seven-day window, I talked about that I think on the last call and openly in the press, had the same staff open for the year. I think it will probably close probably at the end of this calendar year. But it's been an incredible time for us to acquire some phenomenal assets. And I've never been more excited about Salesforce and our product line and coming into Dreamforce, like I said, is just awesome.

And specifically on the goal, well, I'm not giving forward guidance, of course. But yes, you're right. Our IUP [ph] is going to do the math, and so can I. We are about to get very close to being able to start talking about our $10 billion year. We're not doing that on this call. And you can see it in our core numbers that when we pass through that, we are going to be taking a very aggressive goal to double the company. I am very committed to topline growth, as you know. I'm also very committed to bottom line growth. I will not grow the company without also growing the bottom line, and we've proven that. And you can see that on the press release that's in front of you, that the top and bottom line have grown really well this quarter. And we'll continue to do that, and we'll continue to do that while being able to participate in this M&A environment, because as you can see, not only did we acquire the companies, but we also beat our numbers. So we will continue to execute that. I hope that answers your questions.

Operator: Your next question comes from the line of Ross MacMillan with RBC Capital Markets.

Ross MacMillan

Q

Thanks so much for taking my questions. One for Keith, first of all, if I – I think I heard right that the Demandware revenue went into the Marketing Cloud segment. So if I took that out and looked at it organically, it seemed that that cloud decelerated to maybe something in the low 20% growth range. And I was just curious, Keith, if the Marketing Cloud in particular was an area of softness in the quarter? Or if there are any other dynamics going on there that are leading to that business decelerate here?

Keith G. Block
Vice Chairman, President & COO, salesforce.com, inc.

A

Yes. So thanks for your question. Honestly, some of this, you know Mark Hawkins can discuss it, but some of that effect would come from FX. But generally speaking, we are still very, very excited about Marketing Cloud. I think, as you know, we have had a strong push on industry focus and retail is one of our top industries. Marketing Cloud obviously plays a big role there, and when you add Demandware in concert with Marketing Cloud from a portfolio perspective, that just means that we are bringing a very, very compelling solution to retail. So we continue to be very competitive with Marketing Cloud. We're locked in a lot of deals, our win rates have remained the same, and, Marc, I don't know if you want to make a comment on the FX component?

Marc Russell Benioff
Chairman and Chief Executive Officer

A

Yeah, no, there's – I think there is that, and the only comment I would add is that we – as recently reported, we continue to take market share in this area as well, and that bodes well and it supports your win ratio.

Operator: Your next question comes from the line of Karl Keirstead with Deutsche Bank.

Karl E. Keirstead

Q

Yeah, hi. Thanks for taking my question. Maybe I'll start with Keith. Keith, you mentioned the second half pipeline looks pretty strong, it gives you confidence, but the 3Q deferred revenue enhanced billings guidance doesn't imply that much strength, actually. So are we to interpret your comment that you're looking at a fairly strong 4Q print? I guess that's my question. I'll stop there. Thanks.

Keith G. Block
Vice Chairman, President & COO, salesforce.com, inc.

A

Yeah, let me address the pipeline issue, and then of course, Marc, if you want to weigh in that's fine. So we are coming into a second half of the year where we feel very, very strongly about our pipeline. Of course we've got our big event with Dreamforce coming up in October, and that obviously will help super charge our quarter, and we get an incredible turnout from our customers and our partners. But we feel very, very strongly about that pipeline, and what gives me so much confidence about the second half is not just the pipeline but it is also, as I mentioned earlier, the level of engagement that we are seeing. I mentioned the three executives that I recently spent time with.

I'll tell you a very quick story about the gentleman named Stephen Hemsley [ph] , who is the CEO of UnitedHealth Group, who spent hours with me talking about his vision for healthcare and his industry and why he was committed to working with us, hence signing an agreement with the quarter. But there are dozens and dozens of those conversations that are taking place. Marc recently came back from Europe, where he was surrounded with other CEOs that he may want to comment on, talking about the opportunity to drive transformation and customer engagement in their businesses.

So I think the level of engagement is very strong. The pipeline feels very, very good. As I mentioned earlier, again, this is a very high-performing leadership team that we have that has delivered quarter in and quarter out and obviously I have enormous confidence, we all do, in the company and those folks, and with respect for the forward guide, I'll defer that to Mark Hawkins and let him respond.

Mark Hawkins

A

Yeah, sure. Absolutely, Karl, and I think at the end of the day when you take the most significant FX sequential headwind to deferred revenue that we've ever experienced in Q2, obviously that has to be factored into our overall plan. All the context that Keith gave you as well gets factored into our plan for the second half. But certainly in Q3 we had to factor in the foreign exchange, and don't forget that what we talked about, I know you know this well, too, the continued compounding effect of invoicing that we describe mathematically at Dreamforce continues, and those are things to think about as well. But certainly the FX has a real bearing.

Operator: Your next question comes from the line of Brent Thill with UBS.

Brent Thill

Q

Thanks. Keith, on the deals in Q2 that slipped in the U.S., it seems like just implying from your comments that those deals are still in the pipe, you didn't lose them competitively, it's just a matter of timing, it wasn't an issue of those deals going somewhere else.

A

Yeah, so I want to make sure that I'm very clear that when we saw the softness in parts of the U.S. business it was at the end of the quarter, really in July, and our win rates continue to be very, very strong. As far as these deals that slipped, again, typical of my experience, some of these deals will close in the next quarter or the next quarter or the next quarter. None of these deals are going away, none of these deals have been lost. They may take different shapes and sizes and forms, but all of these deals are very, very much in play.

Operator: Your next question comes from the line of Kash Rangan with Merrill Lynch.

Kash Rangan

Q

Hey, guys. Thanks for taking my question. I guess a fair question to Marc Benioff, given that this pertains to about three years back. Well three years back I think Q1 your business was a little weak and everybody was worried on Wall Street and then subsequently the next three or four quarters, billings growth had gone from 17% to 19% in that quarter to well north of the high 20s, 30s. So is it just a temporary phase with slippage of deals? Or could there be some broader macroeconomic forces at work that have a fair bit of probability? Just want to get your feel for that. And also secondly, more strategically, what could be the impact of Einstein? Could there be a replacement cycle within your base or new TAM opportunities that could be open to Salesforce that were previously not available? Thank you so much.

A

Well, thanks, Kash. And yeah, you're right. And I mean, we've been – Keith and I have had a lot of conversations about this because Keith and I have both been in the enterprise software business for 25 years or more, 30 years. And I think we both started at Oracle in 1986. And we've – you do get a quarter now and then with some specific geography, in this case, the United States, has some softness, and it's just the nature of enterprise software and that's where we are. I don't attribute it to any other factor than that and that's just what – it is what it is. And you move on to the third quarter and assess your pipelines and ours are full and rich. And you assess your competitive position, and our win rates are strong.

And you look at where your innovation cycle is, and we've never had a bigger new product cycle, as your question indicates, which is at – when we roll into Dreamforce, we are going to have an incredible release of Einstein. You're going to see dramatic enhancements to our Salesforce Lightning platform, new mobile capabilities and enhancements with Salesforce1. Of course, the productivity tools available through Quip, which is remarkable live documents and if everyone hasn't downloaded and started using Quip, whether it's on your phone or your iPad or on your laptop, I mean, it's just a remarkable piece of technology. And then we, of course, have some of these incredible new platforms that we did not have a year ago, like eCommerce cloud. So all of that together provides for a very exciting Dreamforce.

And in regards to how we price it, you've seen that Sales Cloud continues to do really well, even though it's a monster in terms of revenue, and one of the reasons that growth continues is because we have these amazing options available with the Sales Cloud, like of course, Pardot. We all know that, which is an incredible product that we picked up with, when we bought ExactTarget three years ago. We also have another amazing option on Sales Cloud which is a CPQ [ph] or SteelBrick, which is another amazing option that we picked up last year.

And there will be another amazing option with Einstein for Sales Cloud to give you this incredible intelligence. So you're going to see some awesome capabilities. You can also have those kind of opportunities, like for example, the Analytics Cloud will have the Einstein option available as well to make machine intelligence part of your analytics journey. So there's a lot of exciting things coming for Dreamforce.

And nobody likes to see softness in any particular region. This did seem quite isolated, in my opinion, to the U.S. Like I said, we really saw some great growth and deal flow in the United States, but we did get a bit of softness at the very end of the quarter. And then we had a great performance in Europe. We great performance in Asia-Pacific. We had great – I mean Japan had a record quarter and a record month in July. So you know, it's just, it's an incredible part of the enterprise industry, and it's something that you learn to not only just manage through, but use to make your company stronger and stronger and stronger, which is exactly what we did the last time that we saw that, which was in the quarter that you talked about.

Operator: Your next question comes from the line of Alex Zukin with Piper Jaffray.

Alex J. Zukin

Q

Yeah, hey, guys. Thanks for taking my question. So maybe, Marc, one for you kind of on this theme around digital transformation projects. As you speak to CEOs, do you see – do you sense, at least in the U.S., any change in the pace of those digital transformation projects? And then maybe one for Mark Hawkins; within your framework of growth of profitability, what is the triggering mechanism to kind of start showing incremental leverage if there is some moderation of kind of growth?

Marc Russell Benioff
Chairman and Chief Executive Officer

A

Well, it's a great question. Last week I was with a lot of customer CEOs, the CEO of Unilever and ABB and Coca-Cola and PricewaterhouseCoopers and the CEO Bank of America, and in each and every case, those customers are not only absorbing more and more of our technology than ever before, but they're getting more aggressive about their digital transformation.

I mean, today, ABB, which is an incredible manufacturing company based in Switzerland, they deployed now more than 20,000 users and are connecting all of their machines and building an incredible customer network using Salesforce. When I look at the work that Brian is doing at BofA, again, it's a huge fundamental transformation of his business to be customer-first and to be digital and to be integrated, and both of those companies and the other companies I have mentioned have chosen Salesforce as their CRM platform to do that work. And I could go through dozens and dozens and dozens of others.

I think that that pace, not just digital transformation, but what I would say is customer transformation, creating a customer-first environment that is intelligent and mobile and one that's – allows their companies to build these one-on-one relationships with either their B2B customers or B2C customers as well, this is a pace of change that I've never seen, and I don't think that there's a company that's – that we're working with today who is reducing their digital transformations. If anything, I think almost every single one that I met with this quarter – and I have even spent a couple weeks in Japan this quarter – are accelerating it.

Mark J. Hawkins
Chief Financial Officer and Executive Vice President

A

All right. So Marc, let me pick up the second part of the question. Alex, thank you for the note on full revenue operating margin framework and how do we think about profitability and triggers and such. As Marc said, we think about that a lot. Growth is number-one. And as he showed and we showed this quarter with a beat at the bottom line as we're showing for the year with our guide, operating margin expansion is important to us as well; very consistent with our framework.

Clearly, when you think about the trigger points of that framework, it's growth rates. And we think about those three categories. And what that brings to mind for me for this quarter and this information that we're sharing with you, we have a guide that's in the 25%-ish revenue growth rate for the year, again, as we said, the third, you know, raise of the year. And that's what that number looks like.

And then of course what we haven't talked about as much is $11.8 billion of billed and unbilled deferred revenue that grew, that big number at 28% in aggregate. So we think about growth a lot. We think about profitability a lot. We think about the revenue framework that's very much intact. You've heard from Marc and heard from me, but clearly, it's keeping growth number-one and – but also delivering the profitability consistent with that framework. But clearly, growth is the trigger.

Operator: Your next question comes from the line of Kirk Materne with Evercore ISI.

Kirk Materne

Q

Thanks very much. Just first for Marc Benioff, I guess a follow up on Alex's question around your conversations around digital transformation. Did this conversation already start gearing into AI as well, meaning I'm curious with Einstein coming out, do you think that the customer base that's already thinking about digital transformation, are they asking questions about AI from you all?

And then, Keith, just on your commentary around the pipeline looking good, you know, as you mentioned, it's your last company, you guys have been around this industry for a while. Your last company had a lot of seasonality in the fourth quarter. Are we just starting to see more seasonality in the business as well as you guys get into larger deals? Thanks a lot.

Marc Russell Benioff
Chairman and Chief Executive Officer

A

Yeah, well I'll tell you that you're absolutely right, and it's obviously one of the reasons that we have invested so significantly in artificial intelligence. We strongly believe that when we look at the future of Salesforce, when we look at the future of our industry, of course we've seen the evolution from the cloud. We've talked about that on many calls. We've talked about social. We've talked about mobile.

I think we're really now evolved into kind of four key areas, and my employees and executives all know that I feel very strongly around this.

But of course, the absolute first one is intelligence. That is, companies demand that your software is going to be intelligent, smart; that you're going to have machine learning and deep learning and machine intelligence built-in. That it's going to be excellent, that that machine intelligence is going to be declarative as well as programmatic; that you're going to leave no customer behind. If a customer is a programmer, they can use it. If a customer is non-programmatic, what we call declarative, they're going to be able to use it. This is very important going forward, and I really believe we are going have the best artificial intelligence platform in the industry.

We have phenomenal executives, phenomenal minds. The progress so far has been incredible. And I think when you see Einstein you'll see that it is on par and capable of any other AI platform that you've seen, like Watson and others, but with Einstein it has these capabilities like non-programmatic capabilities as well as programmatic capabilities that is built into our applications as well as being independent. And I think that will be very powerful.

Two, platform. I think everybody knows that I strongly believe you can't just build a platform – just can't build an application, you have to build platforms. And these platforms also have to be declarative as well as programmatic. And I of course am biased, but I believe their Lightning platform is the best in enterprise software. You can build applications that run on any device, whether it's any phone, or any tablet, or any PC, or any type of IOC capability. And I believe that Lightning will be an incredible capability for us going forward.

And three is mobility. That is Salesforce now has millions of users on its mobile platforms. I know many people on this call you Salesforce1 every day. We have many other key mobile technologies, like Salesforce Inbox and others available as well, and Mobility remains a huge focus for Salesforce. And when you come to Dreamforce, you're going to see more and more capable capabilities on mobility as billions of users around the world go online on their phones, they want to be able to do that with Salesforce to run their business from their phone. And Salesforce1 remains I believe the absolute most popular application development deployment vehicle for mobile.

And finally, productivity. We have to have productivity built in. All of our applications need to have core productivity applications, whether it is email or like with Salesforce Inbox or spreadsheet, or word processors was like Quip, live documents. All of that has to be an integrated part of what we are doing. We believe that strongly. We've obviously done a lot of great work with Microsoft as well with their product. We have now our own product in this category, and this is going to be really important for us going forward. And it's the reason that we bought Quip, is because we believe the productivity is the fourth leg of the stool, and that when you look at artificial intelligence platform, mobility and productivity.

And then you look on top of that, our core applications and sales service marketing community analytics apps, IOT and e-commerce, you could even break productivity out as its own application category, I think all of you know the productivity itself has a huge TAM $26 billion a year TAM, those nine applications differentiated by these four capabilities. That's how I look at where our product line is going and what I hope to be able to articulate that in a much simpler, much easier to understand way when we get Dreamforce for our customers.

A

Yes. Just to add to the respond of the second part of the question, as you know, over three years ago, Mark and I had many, many conversations about coming onto Salesforce, which I was super excited about, and I continue to be super excited about being here. But a couple of the charters coming on board here was obviously to continue the outstanding operational excellence of our broader market, our SMB business, but really to accelerate into the enterprise. And I think we have made excellent progress there. But as you continue this SMB business and accelerate into the enterprise, of course you're going to be balancing out the portfolio. And by definition the nature of enterprise typically is back ended in the second half of years. So I think it's natural to expect that that will drive some degree of seasonality for the second half of the year, but we run a balanced portfolio business. And that's what we strive to every single day.

Operator: Your next question comes from the line of Mark Murphy with J.P. Morgan.

Mark R. Murphy

Q

Yes. Thank you very much. A question for Marc Benioff. So essentially all of the major services firms experienced problems recently, and that included Cognizant, and InfoAssist, at Gentrack and a whole bunch of others. And I do believe several of them mentioned softness in digital projects in the month of July. I think some of that was attributed to the big banks that were counting on a mid-year interest rate increase, which did not happen, partially as a result of the Brexit vote. I'm just curious, do you look at all of that as purely coincidental relative to what you've mentioned at the end of the quarter in the U.S.? Or is it possible that there was a bit of a brief pause, maybe a little macro induced that just potentially may have pushed some number of transactions out of Q2 and perhaps is leading into a bigger second half of the year?

A

I honestly really believe in kind of manifest destiny, that this is always about us and that we always have to just look at our own ability to execute. And as we're driven this company forward over the last 18 years, that I always come back to that, and that this is the most important thing is that regardless of what the environment is, whether it's incredibly strong, robust, or whether there's a bit of softness, regardless of what geography you're in, whether it's the U.S. or Japan or whatever it is, that it's ultimately always about you. If I always went to kind of these macroeconomic views and oh well, it's a low growth rate environment or it's a low interest rate environment or it's this or it's that, you're not able to really just focus on it and work on your own business.

And as an example of that, is Japan this quarter. I spent two weeks in Japan. Japan is a very exciting IT environment. It still is a huge part of the enterprise software industry, and we're just still getting going in Japan. We're at the beginning of our Japan journey. And yet we have these incredible relationships with some of the most – Japan's most important companies and government agencies and that's how I look at it. If I had listened to what everyone told me about Japan in the last 18 years, we wouldn't even be doing business there. I just don't believe in that stuff. I believe that you get what you focus on and you have to answer the question what do you want, and then you focus on that and achieve it and keep it positive. And keep – well, Keith, how do you look at it?

Keith G. Block
Vice Chairman, President & COO, salesforce.com, inc.

A

Well, I think you're right. I think you have to stick to your knitting, and our knitting is all around the customer and growth for the customer. Specific to our partners, I go back to the statistic I mentioned earlier. We have 38,000 partner certifications, that's up 25% year-over-year. And I don't think it's appropriate for us to comment on what they're seeing in their business or the softness in their business, but I think that the indication of that level of certification growth says that they are betting on the long term, on salesforce, and I think that is something we all should pay attention to.

Marc Russell Benioff
Chairman and Chief Executive Officer

A

Keith, you had some amazing transactions in the quarter. We've talked about UnitedHealth Group as one of them specifically. But you had so many other really amazing companies that you were personally in. I know we talked a lot about the financial service companies that you spent a lot of time in in the quarter and you obviously also traveled a bit during the quarter as well, so when you're out there, what are customers really zero in on in terms of what they want from salesforce?

Keith G. Block
Vice Chairman, President & COO, salesforce.com, inc.

A

Well, I think the thing that really aligns us with our customers is if you look at the CEO agenda, and of course you're the CEO, number one is growth. And followed very quickly with shareholder value, and then of course the concern about the employee and the community and all that stuff that's important to us and our values. But the CEO agenda is growth. I mean, you listen for our story and our messaging and the value that we bring to customers on a daily basis, it is growth. So there's great alignment there. So when I'm talking to financial services institutions, if they're talking about streamlining processes around customer engagement and reinventing themselves, and they know that we are an innovative company, and because we drive innovation and we inspire customers that's why they want to have those conversations with us. And so that's pretty typical of what I see on a regular basis.

A

I think that's consistent with my viewpoint as well.

Operator: Your next question comes from the line of Sarah Hindlian with Macquarie.

Sarah Hindlian

Q

All right. Thank you for taking my question. It's Macquarie. First, a question for Keith and/or Marc B. I don't want to beat a dead horse, and I certainly understand the nature of large deals and enterprise software playing at this level and size in particular, but I was wondering as you guys examined the business, do you think there was any impact from the rollout of Lightning with its improved feature set and the subsequent price increases that may have caused some slowness at the end of the quarter? If you guys could talk a little bit about how the market is perceiving Lightening prices? That would be really helpful to us. And then the second one for Mark H., in regards to billing, Mark, how much of a factor is Demandware in your outlook? Thanks, guys.

A

Okay. Let me take the first part of that. Really with respect to the price increase that we've been talking about for some period of time – like when I did the full, and I do mean full operational review of the U.S., every element of the business was inspected six ways to Sunday. And naturally one would go to, well, was at pricing? Was it this? Was at that? And I'll tell you we did not see a material impact on the quarter in pricing. And the thing that we view on the pricing change that we've made is that it really demonstrate value our customers. And that was the impetuous behind it. Mark, I don't know if you want to comment?

A

Yes. Sure. Let me just carry on. In terms of the second question, sir, that you had asked about in terms of Demandware, let me just call out that Demandware in terms of revenue, we talked about when Keith and I were on the call in June that we expect revenue of around $100 million to $120 million for the year. That's what we called out when we set that guide. So that's something you should think about as you think about billings from that standpoint.

By the way, I just want to call out we're super pleased that Demandware is just an exciting added functionality, a unique asset as Marc called out, that we are super happy to have. So I hope that dimensionalizes and helps you to think about how to factor that into billings.

Operator: The last question comes from the line of Derrick Wood with Conan & Company.

Derrick Wood

Q

For Keith, you guys put more product out this year than we've ever seen. You've got SteelBrick, IQ. You've got New Wave [ph] apps. You've got Wealth and Health Cloud, and now you've got Commerce Cloud. I think IOT cloud is coming out. Certainly a lot in one year. And I imagine bringing all these products out, go to market varies by product, but you've got to do things like train the sales force, train the channel, and maybe create new dedicated teams. Maybe there's new ELA [ph] type of the engagements now coming into play. So I'm curious, do you think that all these product releases may have weighed on near term sales productivity or sales cycles? And what's your strategy over the next 6 to 12 months to help push greater adoption of these newer products?

A

Okay. Great. So that's an excellent question. Here's the way I would look at this. Number one, I am a big believer in innovation. It is at the core of this company. It's part of our DNA. And we are blessed to be, all of us, to be working in a company that drives innovation. And all these projects that you mentioned, whether it's IQ or SteelBrick, or IOT Cloud, these are things that our customers are very, very excited about. And by the way, the reason why we build these products or acquire these companies is because not only do we have a great strategy, but part of that strategy is because we listen to our customers. And we think about what's important to their future. So we have a whole portfolio of solutions. We will continue to enrich that portfolio of solutions.

Part of strategic weapon, if you will, of this country company is the focus, a relentless focus on what we refer to as enablement, which is training are people. We have an incredible platform for that call Trailhead, which you will continue to hear the company talk more, and more, and more about, because it's an exciting citing way to enable employees. And we use it on ourselves, and all of our people are subject to building trails and taking advantage of the incredible training and content. And I think we do that as well as any company that I've ever seen. And I think that's one of things that really separates us from the pack.

So again, when I talk about our optimism around the second half or our pipelines for the second half, it is because we have such a rich portfolio. It's because we have a high-performing organization, and it's because we know how to enable these people.

Now enablement, I will tell you, for a company like us, there is no end of jobs. Okay? So I think we all as leaders in the company, no matter what line of business we are responsible for, we wake up every day and think about what's the best way for us onboard our employees? What's the best way to continue to educate them on new product releases? What's the best way to make sure that they are prepared that they deliver value to customers? And that's why enablement is so important to us as a company, and that's why we focus so much of our attention on it.

Unverified Participant

Great. Well, thanks so much. Thanks, everyone, for joining us today. That concludes our call. Just remind everyone that we will look forward to seeing you on October 4 at our Analyst Day, and of course updating you again in November for our third quarter results. If you have follow-up questions, you can reach us at investor@salesforce.com. And thanks for participating today.

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