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EDITED TRANSCRIPT

CRM - Q3 2018 Salesforce.Com Inc Earnings Call

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OVERVIEW:

Co. reported 3Q18 revenues of more than \$2.7b and non-GAAP EPS of \$0.39. Expects 2018 revenues to be \$10.43-10.44b and non-GAAP diluted EPS to be \$1.32-1.33. Expects 4Q18 revenues to be \$2.801-2.811b and non-GAAP diluted EPS to be \$0.32-0.33. Co. is initiating FY19 revenue guidance of \$12.45-12.50b.



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PRESENTATION

Operator

Good afternoon. My name is Doris, and I will be your conference operator today. At this time, I would like to welcome everyone to the Salesforce Q3 Fiscal '18 Earnings Conference Call. (Operator Instructions) Thank you. I will now turn the call over to our host, Mr. John Cummings, SVP of Investor Relations. Sir, please go ahead.

John Cummings - *Salesforce.com, inc. - SVP of IR*

Thanks so much, Doris. Good afternoon, everyone, and thanks for joining us for our fiscal third quarter 2018 results conference call. Our third quarter results 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 is Marc Benioff, Chairman and CEO; Keith Block, Vice Chairman, President and COO; Mark Hawkins, President and CFO. And also joining us today is Bret Taylor, President and Chief Product Officer.

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.



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

Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Well, thank you so much, John, and thank you to everyone attending today's earnings call. As we all get in together here and gathering for the call during Thanksgiving week, this is definitely a unique time, and I just want to especially say on behalf of everybody at Salesforce that we have much to be grateful for. We're certainly aware, especially now that we have more responsibility, to focus on helping others, and that was especially felt by all of us at Dreamforce.

Honestly, that's why our thoughts remain so deeply with the victims and those who have lost their homes just this quarter in Hurricanes Harvey, Irma and Maria and the 6,000 families in our local Bay Area who have lost their homes in these tragic wildfires. And we know that, that's especially difficult as we head into the holidays.

Salesforce, with the help of 80 companies in solidarity on these efforts, is really doing its part. And less than 2 weeks ago with the Band Together concert held in San Francisco during Dreamforce, we, with all of you, helped raise \$17 million for the fire victims with 100% of the funds going directly to the families affected, and I wanted to say thank you to all of you for helping out on that.

After Thanksgiving, we are going to announce another very exciting new program, and I will ask all of you to help me in raising even more money for these families who have lost everything. So thanks again to all of you who have contributed so much, and thank you to your support in the future as well.

Now as we move on, I want to just say that we've been able to do well in our business while helping those less fortunate than us. And to that end, we are now going to talk about the results for the third quarter, which were a record for Salesforce.

Revenue rose to nearly \$2.7 billion, up 25%, and that was just incredible. We are organically adding the revenue of most other cloud companies now every year, and you can see that as we start to deliver guidance for next year.

We have nearly \$15.9 billion in booked business on and off the balance sheet. That's up 31% from a year ago. In fact, we added more than \$3.8 billion to this balance since last year. And based on these strong results, we're raising our full year top line revenue guidance by \$40 million to \$10.44 billion at the high end of the range, 24% growth this year and delivering durable top and bottom line well into the future. And I think if you look back to where we were a year ago when we first gave guidance for this year, we've dramatically improved what we thought we were going to be able to do, and it's really thanks to our incredible team at Salesforce and to all of our customers and partners as well.

Now looking ahead, we told you Dreamforce for next year, we're now guiding revenue to \$12.5 billion. This is at the high end of our range. And I'm especially proud that Fortune Magazine just ranked Salesforce #1 on its inaugural Future 50 list of companies best positioned for breakout growth, and we're very excited about that recognition that we've received and other recognition from them as well just this week. In fact, as the fastest growing enterprise software company ever to reach \$10 billion, we are now targeting to grow the company organically to more than \$20 billion by fiscal year '22, and we plan to do that, to be the fastest enterprise software company ever to get to \$20 billion.

As -- and as we continue on this path, we're going to invest in a new generation of leaders at Salesforce to continue to power our growth, and that's why I'm so excited to make this announcement that we have a tremendous promotion. Bret Taylor is taking on the role of President and Chief Product Officer, and Alex Dayon has been also promoted to position of President and Chief Strategy Officer. Both of these tremendous executives are now reporting directly to me and are really a critical part of our management team. And in these new roles, Bret is going to drive our product vision, design, development, go-to-market strategy, and Alex is going to lead strategic initiatives, working more closely with our customers on product direction and transformation. And I'm sure everyone on this call agrees that we are fortunate to have 2 amazing leaders at Salesforce to help us lead this next wave.

And Bret is in the room with us, and we're going to talk to him in a second. Alex is on vacation in Asia with his family, but we are just thrilled for both of them.



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In closing, I just want to appreciate everything that you have done for all of us. We appreciate everything that -- and know how hard all of you work to make Salesforce successful as well. And also, thank you for coming to Dreamforce. We want to send all of our best wishes to your families for a happy Thanksgiving.

And with that, I'm going to turn it over to Keith.

Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Thanks, Marc, and thanks again for joining us during Thanksgiving week. We appreciate that very much. It was great to be with so many of you at our Investor Day just a few weeks ago at Dreamforce. And those of you who were there saw firsthand the power of the platform to connect companies and their customers, the energy of our Trailblazers and our deep commitment to giving back to our communities as Marc has talked about. And as Marc said, we are clearly building a company for the ages.

Our Q3 results were outstanding, and that's because, every day, Salesforce is helping more and more companies transform and connect with their customers in a whole new way.

Our customers want to deliver next-generation experiences for their customers who are always on, always connected. And to do this, they need a unified CRM platform, and that's what Salesforce is all about. They want industry-leading products in sales, in service, in marketing, in commerce and more, and that's what we've delivered. We've also delivered innovations like Einstein, Lightning and Trailhead that elevate the entire platform. No other enterprise technology company in the world is delivering innovation at this scale, and that's why so many companies, including Hilton, DuPont and MasterCard, are turning to Salesforce as their trusted partner in digital transformation. In addition to delivering these innovative solutions, we continue to fuel our growth through international expansion, speaking the language of our customers and growing our partner ecosystem.

Now as we discussed at Investor Day, we are increasing our investment in our international go-to-market resources, our operations, our infrastructure to deliver the highest-quality service to our customers around the world. We've increased our international headcount nearly 30% annually since FY '14, and year-to-date, nearly 40% of new hires have been made outside the Americas.

In the quarter, Salesforce also went live on AWS in Sydney in Australia, where we recently were named the #1 CRM provider by Gartner. And Amazon continues to be a key partner in our international expansion and a very large customer.

Now speaking of Australia, I'm very excited that, in Q3, we expanded our relationship with National Australia Bank, one of the country's largest financial services institutions. And as you may recall, we closed a significant deal with AMP last quarter, so clearly, we've got great momentum in financial services in Australia and our broader APAC region.

We had another very strong quarter in Japan, deepening our relationships with Hitachi, Seven & i, EBARA and Mitsui Sumitomo Insurance. APAC continues to be one of our fastest growing regions with 27% growth in constant currency in Q3.

In EMEA, we grew 33% in constant currency. And in the quarter, we expanded relationships with marquee brands, including BP and Groupe PSA, the second largest automotive group in Europe. We also formed a new relationship with another leading car manufacturer in Europe, and they're going wall to wall with Salesforce to manage every aspect of the customer journey from marketing to sales to service. In Q3, we significantly expanded our relationship with a leading global telecommunications company also headquartered in Europe and is leveraging the Salesforce Platform to attract new business, simplify payment to vendors and get a 360-degree view of their customers. So it's pretty clear that our international investments are paying off.

Now around the world, speaking the language of our customers is giving us incredible momentum. In fact, 57% of customers who buy our industry products are brand new to Salesforce. And in Q3, we launched the Financial Services Cloud for retail banking to enable banks to deliver highly personalized, intelligent and connected banking experiences for their consumers.



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We also deepened relationships with PNC, KeyBanc and ING, one of the largest financial institutions in the world. ING is expanding with Salesforce globally to meet their goal of becoming a one platform bank. In fact, today, 17 of the top 20 U.S. and European banks rely on Salesforce.

So we continue to see momentum in other areas, including health and life sciences. Last quarter, I mentioned that 15 of the world's 20 largest pharmaceutical companies rely on Salesforce, and this quarter, we added another marquee customer to that list. And incredibly, we deepened our relationships with 13 of those firms. We also expanded our relationship with Anthem, one of the largest health insurers in the United States.

And in Q3, we closed one of our largest public sector deals to date with the Department of Homeland Security. This follows a large transaction with the VA last quarter.

With respect to retail, the holiday season is the most important time of the year as we all know, and 3 years from now Black Friday is expected to be the busiest digital shopping day in U.S. history. I'm sure we will all participate in that. With the addition of Commerce Cloud and Salesforce DMP to our portfolio, we now have an incredible B2C platform that enables our customers to deliver brand experiences that are seamless, connected and personalized. And that's why international cosmetics retailer L'OCCITANE has chosen Commerce Cloud to replace their homegrown e-commerce solution to accelerate their global growth. And finally, as you may have seen at Dreamforce, adidas deepened their relationship with Salesforce in Q3 to drive their global expansion, deliver a hyper-personalized experience that today's customers all expect.

Our partner ecosystem continues to expand, as more than half of the new business today has generated new partners. And Salesforce is the highest growth practice for the top systems integrators. This was not the case just a few years ago, and we continue to build deeper, more strategic relationships with our partners.

At Dreamforce, we announced a new strategic partnership with Google, and that was to connect Google Apps and Analytics with Salesforce, making our customers even smarter and more productive. We also selected Google Cloud Platform as a preferred public cloud provider, and Google, of course, runs their business on Salesforce.

So in closing, I want to express my gratitude to our customers, our partners, our employees for their continued trust in us. And I want to wish those of you in the United States a very, very happy Thanksgiving.

So I'd like to turn the call over to Mark Hawkins, who will outline our financial execution in Q3. Mark?

Mark J. Hawkins - *Salesforce.com, inc. - President & CFO*

Great. Thanks, Keith. As you've heard from Marc and Keith and as you've seen in our Q3 results, we delivered another quarter of outstanding growth. At Salesforce, we deliver customer success and help our customer grow. And in turn, Salesforce grows as well, and that's what we saw in the third quarter. Revenue grew 25% in dollars and 23% in constant currency, excluding a year-over-year FX tailwind of \$39 million. We also saw a sequential FX tailwind to revenue of \$12 million.

We delivered a strong year-over-year subscription and support revenue growth across each of our clouds in the third quarter. Sales Cloud continued its strong growth at 17%. Service Cloud reaccelerated to the quarter to 25%. Platform and other also accelerated to 34%. Marketing Cloud, including Commerce Cloud, grew 40%, and keep in mind, this growth is organic as it's the first full quarter comparison with Commerce Cloud in the base period. Commerce Cloud contributed \$64 million in subscription and support revenue.

Dollar attrition for the third quarter, which is now including Marketing Cloud, was approximately 10%, which is flat from a year-on-year basis. We expanded our third quarter non-GAAP operating margin by 360 basis points year-over-year, driven by improvements in sales and marketing and G&A.

Non-GAAP EPS was \$0.39, up 63% over last year. Operating cash flow was \$126 million, down 18% year-over-year. Our third quarter operating cash flow result was impacted basically by continued invoice and seasonality and the timing of Dreamforce and given the strength of the quarter, higher



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commission payouts. Deferred revenue ended the quarter at \$4.39 billion, up 26% in dollars and 24% in constant currency, excluding an FX tailwind of \$60 million.

On a sequential basis, deferred revenue benefited from an FX tailwind of \$4 million. The strong Q3 result was driven by deals closing earlier than we had anticipated.

Before moving on to guidance, I'd like to update you on the status of the adoption of the new and revised accounting standards, including ASC 606, ASC 340, ASU 2016-01, all of which will be adopted on February 1, 2018. Regarding ASC 606, the new revenue recognition standard, we expect the impact of the opening balance sheet as of February 1, 2016, due to the recast of revenues to be immaterial. We are still working to determine the impact to revenue after the opening balance sheet.

For ASC 340, the commission accounting standard, the new standard will require us to capitalize more cost such as payroll tax and amortize them over a longer period than we do today. For new business, we expect to amortize the commissions over a 4-year period rather than over the contract term.

ASU 2016-01, which addresses the fair market value of accounting for venture fund investments may result in greater variability in the OIE line of our P&L due to changes in market prices and our publicly held investments and the timing of additional rounds of financing for our privately held investments. It's important to know that these standards will not have an impact to our operating cash flow.

Moving on to guidance. We are raising our full year 2018 revenue guidance to \$10.43 billion to \$10.44 billion for 24% year-over-year growth. We're also raising our FY '18 GAAP diluted EPS guidance to \$0.12 to \$0.13 and non-GAAP diluted EPS guidance to \$1.32 to \$1.33.

We remain on track to deliver the 125 to 150 basis points of non-GAAP operating margin improvement in FY '18. We're also maintaining our full year operating cash flow guidance of 20% to 21% year-over-year. For Q4, we're expecting revenue of \$2.801 billion to \$2.811 billion, GAAP diluted EPS of \$0.03 to \$0.04 and non-GAAP diluted EPS of \$0.32 to \$0.33 and year-over-year deferred revenue growth of 19% to 20%.

Please note, as part of the adoption of ASC 606, we will be providing a roll-forward schedule of billed deferred revenue along with additional disclosures for unbilled deferred revenue. In that context, we do not expect to provide deferred revenue guidance going forward. And as you've heard at Dreamforce, we initiated revenue guidance for fiscal 2019 of \$12.45 billion to \$12.5 billion based on the current accounting standard. And as a reminder, we will provide operating cash flow, EPS and non-GAAP operating margin guidance for FY '19 when we release our Q4 results in February.

To close, we delivered a very strong financial result on -- in Q3, and I'd like to thank all of our Trailblazers, our employees, our customers, our investors and the community that we serve for their continued support and wish all of you an enjoyable holiday season.

And with that, I'd like to open up the call for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Heather Bellini with Goldman Sachs.

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

I was just wondering if you could share a little bit. Looking at the trends in your Marketing Cloud business, what do you see as the key drivers of that business accelerating like it has been? And what are you -- I guess, one of the other things, you commented that now your attrition rate includes Marketing Cloud, so -- and that's 10%. Is that the rate we should be thinking of kind of normalized going forward?



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Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Well, let me take the first part of that, and then I'll turn it over to Mark Hawkins to comment on the attrition rate and how he's calculating that. Yes, I think what we saw at Dreamforce really speaks to this question, and I tried to address this in my opening comments at Dreamforce. But I've had so many incredible experiences with customers but especially in the last 6 months. And I'll tell you that when we look at the transformations that our customers are going through, all of them are trying to connect with their customers in incredible new ways. But for many of those companies, it means that they themselves have to transform and go through what we call this digital transformation. But for so many of these customers, this digital transformation really begins with the customer. And I think you can look at Ducati, where we profiled at Salesforce and at Dreamforce and really look at what is going on with them. Here's an incredible product. They have an incredible community. They have the ability to directly connect with them through the product. And this is transforming Ducati. That's why they would come to Dreamforce and have their CEO there and have the bikes there and show how -- that they don't just have motorcycles. They've got Connected Motorcycles. That is all driven by the Marketing Cloud. It's a one-on-one relationship between Ducati and the consumer, the community, the commerce, the one on one, the ability to have messaging, direct interactions. I think that every company is becoming this -- I don't care if it's a B2B company or a B2C company. Every company's becoming a B2B2C company, and that is driving this forward. And I think if you saw the huge innovation that happened at Dreamforce with the Marketing Cloud especially in regards to Journey Builder and other aspects. And this is actually a great way actually for me to leverage now and to introduce you to Bret Taylor, who's our new Chief Product Officer, who's sitting at the table here with us. And Bret, you and I were just talking yesterday about the huge innovation that's coming in the Marketing Cloud, and it is driving this amazing growth. So can you just touch on that?

Bret Steven Taylor - *Quip, Inc. - Co-Founder*

Yes, sure. I mean, the trend we're seeing with so many customers, like Marc mentioned, is not just being a B2B company or a B2C company but sometimes both, whether it's Ducati connecting with their customers or customers that sell directly and sell to distributors. And what I really think is so powerful about the Salesforce Platform is we're the one CRM platform that can do both, whether you're a B2B company, which is where we started or you're a B2C company doing traditional marketing through our Marketing Cloud or you're a company that's a hybrid. The reason our vendors -- the reason our partners are choosing us as their vendor is because we offer a platform that can do both now and also grow them in the future. And it's really unique in these capabilities to truly provide that single view of the customer whether or not you -- they bought their product directly or indirectly. And it's something I think is a real strategic advantage for our product line and the area that we're investing in primarily.

Mark J. Hawkins - *Salesforce.com, inc. - President & CFO*

Okay. Let me -- if I may just jump in to the tail end of that question, Heather. Also, I mean, obviously, Marketing Cloud was completely covered. In terms of the attrition rate, we've had core attrition that we've been reporting. We added on also Marketing Cloud and Pardot as part of the -- as we keep integrating the different acquisitions, and that trend has been flat year-on-year. So in aggregate, the more aggregated number taking our core plus adding in the Marketing Cloud and Pardot is 10%, and it's stable year-on-year.

Operator

Our next question is from the line of Mark Murphy with JPMorgan.

Mark Ronald Murphy - *JP Morgan Chase & Co, Research Division - MD*

My question is for Marc Benioff. Most of your CRM competitors are still relying on the older on-premise technologies or hybrid technologies, and so you had said recently that AI is going to be the future. Do you think those on-premise technologies could suffer a bit just from inability to handle AI if they can't kind of tap into the reservoir of data in the scalable compute capacity to power those algorithms in the way that Salesforce can? And I also wanted to ask, Keith, you mentioned closing one of your largest public sector deals with Homeland Security. Do you think the federal government has finally reached the tipping point where its adoption of cloud and Salesforce is going to begin to move faster?



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Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Well, I'll tell you, I'm going to tip that question actually to Bret if that's all right with you because I think that he could really address specifically this kind of -- what's happening with AI. Obviously, we've had a tremendous year with Salesforce with AI since releasing Einstein a year ago and now just releasing My Einstein at Dreamforce. We have seen an incredible advancement in artificial intelligence use at our customers. And I think you saw as well in the example I gave in my keynote of a Coca-Cola cooler and the dramatic advances that we can make with technology like that using Einstein Vision, what it means. And I think the speed that we are delivering and onboarding these customers with artificial intelligence, especially using our declarative model, that this has demonstrated to them the -- a lot of the advantages of going to the cloud. But let me tip it to Bret for his perspective.

Bret Steven Taylor - *Quip, Inc. - Co-Founder*

Yes. I think your -- the question was spot on. I think the artificial intelligence and the features we're launching with Einstein perfectly capture the power of the cloud. Our customers don't need to buy new hardware. With every release, they get these new capabilities automatically. And that is the power of the cloud. We are constantly re-architecting our systems to incorporate the latest and greatest technologies that our customers can use to transform their businesses. And because it's based on the cloud, it's just as simple as turning them on. And as Marc mentioned, it's not just cloud and on-prem. It's also the way we package them. You heard a lot about -- at Dreamforce about Trailblazers, and what this means to us is taking these technologies and enabling our customers to use them with clicks, not code. And fundamentally, our vision is to broaden the base of people who can adopt these new technologies within their companies beyond just computer programmers and experts and data scientists, but anyone with a domain expertise in their industry can actually adopt these new technologies. I think the combination of that declarative platform that Marc mentioned and that focus on clicks, not code, combined with the benefits of the release capabilities of the cloud, is truly unique to Salesforce in the CRM market.

Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Mark, this is Keith. So just to follow up on the second part of that question, which is really about the public sector, I do believe we are reaching a tipping point. This is an initiative, certainly in this country, where the modernization of technology within the governments has been discussed. I would argue that it was launched really under the Obama administration, and in fact, one of our former employees was a CIO, as you know, of the federal government who was really one of the people who lead the effort of cloud first, which is very important. But now we're seeing increased momentum around this digital transformation. The deal that we signed with the Department of Homeland Security is certainly an indication of the modernization of the government. This is on the heels of the VA that we did last quarter. In fact, I had opportunity to spend quite a bit of time with the VA folks at Dreamforce. And some agencies are ahead of others. I think Homeland Security is ahead of some of the others. Thankfully, I think, we would all say. But I think it is the beginning of the public sector kind of catching up to where the private sector has been going for quite a few years now. So it is pretty exciting around the transformation.

Operator

Our next question is from the line of Keith Weiss with Morgan Stanley.

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

A question for Keith and a follow-up for Mr. Hawkins. Keith, you used a phrase wall-to-wall deals describing one of the deal that you guys signed this quarter. How prevalent has that become in sort of what you guys are selling today and what's in your pipeline? How often are you guys going for sort of across-the-board the entire suite? And then kind of related for Mark Hawkins, this was a really strong quarter ahead of the seasonality that we've seen in prior years, and these big deals have been pushing more and more business into the Q4. Was Q3 anomalous in terms of sort of going against that seasonality? Or is -- are we seeing just more back half business overall, perhaps not all in Q4?



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Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Okay. So let me take the first part of that, and obviously, Mark can respond to it. So what wall to wall really means is a multi-cloud deal. It's a solution that means it includes sales, service, marketing, cloud, community analytics, Einstein, et cetera. Depending on whether it's a B2B customer or a B2C customer, it may include Commerce Cloud and DMP. So as you know, our selling motion is to initially establish a beachhead with Sales Cloud, which is typically a leading indicator of new logos. And we will paint a vision of transformation, and the customer will start with the deployment of Sales Cloud. And then we expand out to the right. And that will typically include Sales Cloud to Service Cloud to Marketing Cloud, et cetera, to Platform. More and more customers are deepening our -- their relationships with us, and it's becoming more and more strategic around embracing this notion of digital transformation, which, again, means more multi-cloud solutions. And certainly, the strategic relationships that we expanded this quarter or established as new are an indication of satisfying that requirement and painting a vision for those customers and driving tangible business benefit. Mark, I don't know if you...

Mark J. Hawkins - *Salesforce.com, inc. - President & CFO*

Yes, sure. Yes, let me jump into the seasonality. I think, Keith, I think you make a really good point. The first thing that gives you context, we see this persistent trend about evolving seasonality as you're touching on, and at the same time, it's informed in any given period, in any given quarter by what happened in that quarter. And we had a very strong quarter as we talked about. And it's evidenced by our total DR growing 31% in aggregate, and you can see the delta even to what our prediction was earlier, so very strong Q3 '18. And then you put that in juxtaposition to when you look at Q4 and last year's very, very tough compare, and that just adds a little bit of context, which is why the DR guide makes sense, 20% at the high end after applying that context. So that -- I think the pattern is persistent by this context with a very, very strong Q3 and a tough Q4 compare. We feel great about the 20%. We think it's the biggest new business renewal quarter of the year, and we think the guide's appropriate.

Operator

Our next question is from the line of Kash Rangan with Bank of America Merrill Lynch.

Kasthuri Gopalan Rangan - *BofA Merrill Lynch, Research Division - MD and Head of Software*

One question for Benioff, one for Hawkins. First, for you, Marc Benioff, as the company becomes larger and larger, you've seen historically in tech core businesses at larger companies get more and more emphasis. In your case, you've got 3 products that are multi-billion-dollar products that you've nurtured organically. So when you look at the opportunity -- the emerging opportunities in business intelligence/analytics and even the products like Quip, how do you, as CEO, make sure that these are nurtured and achieve their full potential, which I personally believe that Quip is an exciting product and we saw it at Dreamforce? How can these products be nurtured to be potentially multi-billion-dollar businesses in the future? And one for Hawkins. When I do a calculation -- rough calculation of your margins, if you reported margins like a perpetual license software company that is taking your bookings and billings, I get about 40-plus percent operating margin adjusted for the fact that you -- if you had been doing business like a perpetual license company. Help us reconcile the margin performance. As it is, it's extremely strong. So at \$20 billion in revenue, which is your long-term target, what could your reported operating margins look like?

Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Sure. Okay. Well, thank you for that question, Kash. It's something that I think about all the time, which is that we have a rich portfolio of products, and it is constantly getting enhanced and extended and also integrated as we build out our vision of a single CRM platform. And certainly, collaboration is part of that with Quip. And you can see the incredible capabilities, and I know that you were especially impressed with that at Dreamforce. And it's had a huge impact on so many businesses that we have spoken about and talked about, including our own. And Salesforce has a very rich product line in marketing, in commerce, in service, in communities, in sales, in collaboration, like you mentioned, in industries and across all these kind of core capabilities we have that we mentioned some of those on the call already like Trailhead and Einstein and Lightning and IoT and Heroku and Analytics and AppExchange. And there's more to talk about besides that as well. I mean, we could go on. And I think that



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the way we look at that at Salesforce is that we are managing that full portfolio and moving that full portfolio to our customers and showing them, as they're ready to accept each one of those components, how it can extend and complement and make their connection with their customers so much richer. There's no doubt that the core that we're in, which is customer, is enhanced by each one of those capabilities. And each customer is ready to accept those capabilities at a slightly different time frame, but this has really given us the ability with our direct sales organization to listen deeply to the customer, to understand where they are in their evolution, in their own capabilities and what they're ready to. And if they're not ready to go into sales, we'll show them service. If they're not ready to do service, we'll go to commerce. If they're not ready to go to commerce, we're going to go to collaboration. So we have a full set of cards that we can play and go forward. And Keith, would you want to just touch on that as well and talk about what it's like to sell the full cocktail?

Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Well, I think we're all ready for cocktails. But the -- no, look, the -- customers are ultimately looking for solutions. From internal to external perspective, as we manage the business and as we manage the portfolio, we are big believers in specialization. We organize around specialization, whether it's industry or our product lines so that we can make sure that we bring the best experience and the most rich content we possibly can to the customer. And from a customer perspective, when you think about their buying patterns, they want to buy a solution. If -- every customer is buying technology because they have a business problem to solve. So our job is to paint the vision for the future in a relative industry or relative size customer in a geography and paint that solution, mapping our technology capabilities, bringing the entire portfolio to bear to solve that business problem. And that's what we see every single day.

Mark J. Hawkins - *Salesforce.com, inc. - President & CFO*

Okay. Kash, let me take the third part of the question here. You had kind of a multi-dimension to that. But the first thing is in terms of your assessment of kind of unit economics, I can't exactly see the analysis that you're doing, but I think we've long affirmed on a unit economic basis that mid-30s operating margin long term is certainly viable. The -- and that's what we're experiencing. Secondly, in terms of Q3, I agree with your assessment, very strong operating margin expanding 360 basis points, good scaling both in sales and marketing and G&A as planned and -- as planned for the year, which keeps us intact for our whole plan for delivering the operating margin percent improvement for the year on higher revenue base of course. And I think that also sets us up for finishing the fourth year in a row of expanding our operating margin consistent with the way we said we would. And as I mentioned, as you touched on to the forward-looking periods for '19, on the call in February, I'll also communicate the fifth year in a row of operating margin expansion at the same time while we've been doing this durable growth and driving this incredible opportunity going forward. As you touched on the last point, which is FY '22, like what to expect, I think the thing that I would say to you is, again, we'll talk about operating margin in '19. But as I said at Dreamforce, if you want to get in the right ZIP Code, you should just think about the kind of operating margin improvement we've been delivering while delivering this durable growth in the last couple of years. I think that's a good reference point. We know that, that will be helpful, and we also know that we have an incredible \$105 billion TAM and a great setup in front of us. So hope that gives you the context.

Operator

Our next question is from the line of Michael Nemeroff with Crédit Suisse.

Michael Barry Nemeroff - *Crédit Suisse AG, Research Division - Director*

When you're talking to customers about digital transformation of their customer interactions, what percent of the talks nowadays are with customers that want to discuss their overall digital transformation strategy right at the beginning and go to wall to wall, as Keith described earlier, versus customers that are still only seeking a point product sale? And how has that trend been going over the last couple of quarters?



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Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

So I'll take this one. Look, the good news is that we have a very, very balanced portfolio. And as we've discussed on the call and Marc and I have seen this over the last 24 months, there is a very accelerated increase in CEO-level dialogue. So that dialogue is all about digital transformation. And in some cases, they have a position on the particular topic, but in many cases, they're asking us for our point of view as I said earlier and for us to paint a vision about what that digital transformation. That is becoming a more, I would say, more frequent dialogue. Now Marc alluded to this earlier. The appetite to digest a full wall-to-wall digital transformation from the first interaction with a CEO is actually very, very rare. Typically, it is we love the vision, we understand what the future brings, whether it's our B2C platform, our B2B platform, what artificial intelligence and Einstein can bring, but let's start off incrementally and prove the value. And then we can go wall to wall. But the level of dialogue has up leveled significantly with respect to what levels in the organization we're talking to and what our capabilities are. I mean, just last week, I was in Europe and met with over 50 CEOs, and the topic was all about digital transformation and how these companies move. So it's becoming more and more frequent.

Operator

Our next question is from the line of Terry Tillman with SunTrust Robinson.

Terrell Frederick Tillman - *SunTrust Robinson Humphrey, Inc., Research Division - Research Analyst*

My question is for Keith. Thanks for the data point earlier in terms of more than half of new businesses coming from partners, and that's up dramatically. Is that an area of leverage you can actually get in your sales and marketing going forward? And maybe you could just give us an update on how productivity is with your Enterprise Salesforce.

Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Yes. So as you know, our whole ecosystem focus on partners is 1 of our 3 growth levers along with industry specialization and the international expansion. And when you think about specifically the SIs, and again, in my trip to Europe last week, I was with the CEOs of 2 of the 5 global firms. They have incredible reach. They're in the boardroom. They're able to paint a vision alongside with us. Many times, we go into the boardroom or with a C-level suite together. But just as important is our ability to drive the success of the customer, and that's where we need these very close relationships with the SIs. So it is a huge leverage point from us in terms of our ability to drive these transformations from both the selling and delivery perspective. And those relationships with the SIs are very, very healthy. Again, we enjoy a 360-degree view -- or, excuse me, relationship with these SIs. The top 5 all run their business on Salesforce. Their fastest growing practices are all the Salesforce practice, which is great news. And some of them, as you know, are actually transforming their own business and becoming ISVs and building product like Accenture has done traditionally and others have talked to us about as well. So it is a huge leverage point. It drives customer success, which is what we're all about. And it's a huge part of our strategy and it's paying off. You can see it in the results.

Operator

Our next question is from the line of Adam Holt with MoffettNathanson.

Adam Hathaway Holt - *MoffettNathanson LLC - Partner & Senior Research Analyst*

It's Adam Holt from MoffettNathanson. I had 2 questions about the very strong revenue, and congrats on that and a terrific Dreamforce. First, Keith, I guess, for you. It sounds like you continue to see good new customer adds out of the vertical business. I was wondering if you could talk about the dynamics of those new customers, either in terms of how big the deals are from a C count perspective and/or the attach rate to some of the other products. And then, I guess, my second question would be for maybe Marc Benioff. We heard a lot of activity around Lightning, Lightning upgrades, Lightning adoption at Dreamforce, and I wanted to get your sense for what that means to your customer base and any comments about the financial impact that, that Lightning migration would be terrific.



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Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Yes. Okay, so generally speaking, when we sell a vertical solution or a product, let's say, like Financial Services Cloud, that is more likely to err on the side of the transformation. So those have a tendency to be larger deals, which kind of goes to the second part of your question, which is every time we sell one of these vertical solutions, it drags the other components of our customer success platform. So it may drag Service Cloud. It may drag Sales Cloud. It may drag Analytics. It may drag Einstein. But there is a more likely chance that when we sell one of these products like Financial Services Cloud, that it will drive a pretty substantial sized relationship into the future. So it drives more of a transformation, and it also brings along other products with it.

Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

I'll just touch briefly on the Lightning, and then I'll tip it over to Bret. Salesforce has done something, I think, really incredible, which is that we've delivered a massive transformation in how we actually interact with our users. And that is moving from our traditional, classic user interface, which we called Aloha, to our amazing new user interface, which we call Lightning. And the power of Lightning, of course, is that it's not just a new user interface. It's an incredible platform. It's an experience. And it's built on an amazing componentized architecture, and our customers absolutely love it. As you saw at Dreamforce, I think every single demonstration that I saw in the show, whether it was on the floor or with customers, was on Lightning. And I think very few companies have gone through this transformation that we've gone through so successfully. It is -- impacted our customers very dramatically, and it still has a lot more value to unleash for our customers, specifically in the application development and deployment area. We have a huge vision for declarative developers, where these executives who maybe are not traditional computer science professionals can build very, very complex, rich customer experiences and deliver those with very high levels of productivity. And I think we're going to see that play out this year. Lightning far exceeded our expectations. We have still a huge amount of work to do to get all of our customers and all of our users up on Lightning, but we have made huge progress already. And Bret, do you want to fill in kind of your vision on where Lightning will go over the next couple years?

Bret Steven Taylor - *Quip, Inc. - Co-Founder*

Yes, sure. I mean, the one thing I'd add -- I mean, the one thing to emphasize, as Marc said, is the power of Lightning is it's not just a new interface. It's a declarative platform. And what we've talked about over and over again but it's really important to internalize is this means that people who are experts in their business who are not necessarily experts at computer programming can make meaningful business applications that transform their companies and transform relationship with their customers. So it's truly an enabler. And I think that you heard one of the themes is just helping companies with their change management as they transform their businesses from the classic interface to Lightning. And you saw that in our Dreamforce announcements with the continued investments in Trailhead. Trailhead is our learning platform. And at Dreamforce, we launched a platform called My Trailhead that's enabling companies to customize this learning platform to be accustomed to their businesses. And this is really -- feeds into our company strategies to move to this new platform and also feeds into enabling a broader base with their employees to participate as developers on the Salesforce ecosystem, which is a big part of our Lightning strategy.

Operator

Our next question is from the line of Abhey Lamba with Mizuho Securities.

Abhey Rattan Lamba - *Mizuho Securities USA LLC, Research Division - MD of Americas Research*

Congrats, Bret, for the promotion. So continuing on the theme that you're talking about, Bret, can you talk about 2 to 3 big product initiatives that you think should be at the top of your list as you're starting out in your new role?



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Bret Steven Taylor - *Quip, Inc. - Co-Founder*

Yes. I would say -- I mean, you're going to hear a lot of the same themes because I think they're truly transformational multiyear. The first is Trailhead. We really do think that our differentiator as a company is the community of people who've been built around it. There's a lot of folks here who have made mid-career transitions into technology because of the power of Salesforce and the power of Trailhead. We do believe it's an on-ramp for more people in our society to benefit from the economic opportunities of technology. And you see that when 170,000 people show up at San Francisco every year. They're there because they've defined their careers on Salesforce, and it really represents the opportunity we think we can provide just to really broad base of people beyond just the select few who have benefited from technology in the past. The second is artificial intelligence. We launched Einstein last year. You saw it was a big part of our Dreamforce announcements this year. We're just at the beginning stages of intelligence's impact on all of our businesses and all of our customers' businesses. We feel an obligation to help our customers navigate this, help employees navigate the changes to their jobs. And we know that as we sort of build not just products but platforms, help companies apply these very complex technologies in very simple ways. And that's always been our vision there. And then the final area of focus is our platform. Businesses use our products because they're customizable and extensible. It applies to our industry solutions that Keith was talking about. This is really the future for our growth, is enabling people not to have a "one size fits all" version of Salesforce but truly customize and extend and benefit from this ecosystem around Salesforce. So those are my areas of focus.

Operator

Our next question is from the line of Walter Pritchard with Citi.

Walter H Pritchard - *Citigroup Inc, Research Division - MD and U.S. Software Analyst*

I think questions for Marc Benioff. Was just curious on just geographic expansion with cloud, successful adoption of Amazon in Australia, in Canada. I'm wondering how you're thinking about potentially more aggressively expanding into new countries. I know that may be just part of the calculus there but be curious if we should expect more aggressive outside of the fairly limited countries that you've done over the last decade or more.

Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Well, thanks for that question. I think you saw at Dreamforce, we dramatically expanded our relationship and alliances across the level. You mentioned Amazon, which is a strategic alliance for Salesforce, and we have turned on our Canada and Australia data center. We also have announced a strategic relationship with Google, and the intention there is to be able to turn on additional countries as well. And we also have strategic relationships with other key providers that are extending our technology, infrastructure and capabilities, including key companies like IBM and Dell and Cisco. And when we look at these opportunities to partner with these companies, it gives us tremendous flexibility in how we deploy our infrastructure, whether it's natively here or whether it's on one of their platforms. And we have made tremendous gains in the ability to deploy Salesforce in a variety of clouds and capabilities, and this, of course, is completely transparent to our customers. The most important thing to our customers is that we give them the reliability and availability and security and foremost, the trust that they expect from us. And then we can deploy that through a variety of capabilities. So I think that, that's still very much an evolving process for our company, as many of these companies, they have so many new capabilities now for us to be able to take advantage of. And we're able to do that in many, many exciting new ways. Bret, do you want to -- you've been spending a lot of time studying this. Do you want to add to that?

Bret Steven Taylor - *Quip, Inc. - Co-Founder*

No. I think the main point is we're really excited to partner with all of these different vendors so that we can essentially apply the best infrastructure strategy for the region and customer that we're deploying in. And that kind of flexibility I consider a strategic advantage, and expanding partnerships has been a great opportunity to have more flexibilities and move forward.



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Operator

Our next question is from the line of Jennifer Lowe with UBS.

Jennifer Alexandra Swanson Lowe - *UBS Investment Bank, Research Division - Analyst*

Bret, first, congrats on the promotion. And I wanted to ask a little bit in the context of both Bret and Alex moving into more senior roles, C-level roles in the organization. Should we read anything into that in terms of the relative -- I mean, obviously, you're a product-centric company and always have been. But is there any sort of shift in how you're thinking about the investment in product or product management? And how should we think about their roles relative to what Parker Harris will be doing?

Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

That's a great question. So I think that we continue to make very significant investments in our innovation. I think that's one of the reasons why you saw both Forbes and Fortune say that Salesforce.com is the most innovative company in the world this year and why we have been selected on those most innovative list probably more than any other company in our industry in the last 5 years. And we continue to make both organic innovation. And you've seen us, and I think Bret is a great example of this, bring in organic innovation into our company as well. Even Alex Dayon is an example of that. Both Alex and Brett were CEOs of companies that we acquired. And I think as Parker and I have run the company together over the last 18 years, we continue to have what we call beginner's mind when it comes to innovation. That is we're constantly amazed at all the technology and innovation and capability that is coming through our industry, and we look at how can we use that technology, whether we build it internally or whether it's coming externally to benefit our customers. And that philosophy has really benefited us really dramatically, and we've tried to stay away from traditional kind of NIH type environments, not -- which kind of NIH stands for not invented here and kind of be open to new executives and new companies, new technologies coming to Salesforce. Parker continues to run, and as our Chief Technology Risk Officer, responsible for all aspects of technology and engineering. He's my Co-Founder of the company and runs all of our engineering efforts and infrastructure efforts. Bret is our Chief Product Officer and President and Chief Product Officer now. And he is responsible for the overall product management org and marketing organization and as well as clarity of all the products that we're building and responsibility for defining those products and delivering those products. And Alex is now taking on a new responsibility that I feel is extremely important for the company, which is why I asked him to take this position, which is our Chief Strategy Officer, to help us to map out not to \$20 billion because we have short-term clarity to that but really, beyond that, that Salesforce just has so much potential that as we really map out to become, I think, an extremely large company from where we are now, we need to have an executive team completely dedicated to mapping out the future. And Alex is going to be absolutely amazing in that role and has been -- done an incredible job since we first acquired his company. I think it's almost been a decade ago. So I want to congratulate both Bret and Alex on that, and Parker and I could not be more thrilled to -- with the state of our technology. And I don't think that there's a better mirror of that than Dreamforce, where, as Parker and I walk through together at the show, we were just amazed at the level of customer success.

Operator

Our next question is from the line of Derrick Wood with Cowen and Company.

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

I wanted to touch on Service Cloud. You've had some leadership changes over the last couple of years. You've had some evolving product focus, but you just reported a nice reacceleration in growth. So could you update us on the priorities to drive growth in Service Cloud and maybe what you've done recently to help strengthen that? And then a follow-up on Europe. We saw that highest growth in 3 years. You guys clearly are investing a lot in Europe. I'd be curious how much do you think the strength out of Europe is due to your own investments and how much is due to the macro or greater adoption of cloud in that region.



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Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Okay. I'll take the Service Cloud question, and then I'll throw it to Keith on Europe since he was there last week. I think on Service Cloud, this remains an incredibly exciting opportunity. I expect some of the acceleration numbers that you saw this quarter to continue for the next couple of quarters, and I'd be disappointed if they didn't. I -- Service Cloud has had a huge year for us this year, and we have some just amazing things happening with Service Cloud. You saw that at the show, especially in regards to some of the next-generation capabilities of customer service, including this idea of bots and Einstein bots that there's not just kind of traditional call center environment, not just the traditional customer service portal but that an incredible new customer channel is emerging with bots. So we're going to see that be a huge part, I think, of Service Cloud. Service Cloud has done a phenomenal job becoming the #1 customer service solution in the world not only by revenue but also rated by Gartner in their customer engagement Magic Quadrant. And as -- has grown so fast, you've seen a kind of an acceleration of that management team and growth of that management team. So as it went from 0 to \$100 million, it had a different management team. In fact, that was run by Alex Dayon at the time, went from \$100 million to \$1 billion. It had a different management team as it went from \$1 billion to \$2 billion. And now as it goes from \$2 billion to \$5 billion, I expect it will continue to accelerate and grow. And that management team just changed again, and we couldn't be more excited with the team that we brought in to run Service Cloud. And I'll turn it over to Keith.

Keith G. Block - *Salesforce.com, inc. - Vice Chairman, President & COO*

Yes. Just a quick comment on that as well. Listen, the innovation around Service Cloud has been fantastic. I think the product team has done a wonderful job. If you talk to any company, one of the ways that they differentiate themselves is service. And certainly, another accelerator on that business has been field service Lightning. KONE was prominently -- and the CEO of KONE was prominently on display at Dreamforce, talking about their own transformation and how they're leveraging field service. In fact, they're co-innovating around that product with us. So that has certainly helped accelerate our Service Cloud growth. With respect to Europe, again, I did my European tour last week, hitting 5 countries, and it was very interesting in talking to these CEOs. I think it's pretty clear that when you look at the macro environment, at least the governments, what's going on in the U.K., what's going on with the Germany -- in Germany, it's a little bit of uncertainty. So our great performance in Europe is just incredible execution. There is clearly a need and a thirst for digital transformation. There is a need and a thirst for customer engagement. That's why you have companies like adidas and KONE and ING and others in all these great industries and these great brands that want to take a step into the move or -- move -- future, excuse me, around this digital transformation. So it's great execution. It is a thirst for moving into this new era that we're in, this new fourth industrial revolution. And I don't believe this has anything to do with lift or any particular headwind one way or the other with the macro environment. We are just executing and taking share. I mean, if you look at the overall market data, again, IDC market data suggests that we are growing 3x that of the CRM market. So it's -- again, I think it speaks volumes about our products, our customers, our partners and our employee execution.

Operator

And our last question comes from the line of Karl Keirstead with Deutsche Bank.

Karl Emil Keirstead - *Deutsche Bank AG, Research Division - Director and Senior Equity Research Analyst*

Two for Mark Hawkins. Mark, can you briefly elaborate on the decision to no longer give DR guide? What is it about 606 that makes the DR visibility change to that extent? And then secondly, do you mind just touching on the seasonality of cash flow? Obviously, the same thing happened last third quarter when cash flow was a bit light and then you ended up crushing it in the fourth quarter. Apart from maybe Dreamforce dropping in 3Q this year, is anything else changing the cash flow seasonality that you can call out as we think about 4Q free cash?

Mark J. Hawkins - *Salesforce.com, inc. - President & CFO*

Sure, happy to do so, Karl. Thank you. First of all with ASC 606 for the new revenue standard, that would be live on the 1st of February. The key thing there is we will have a roll forward for the billed deferred revenue. That's for sure. And then we're also going to provide some information on the unbilled DR, so you'll have the information that you need. Obviously, things are changing, and the standard is such that the new information



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will be what you need effectively. So I don't know how to explain it better than to say that, fundamentally, the standard has changed. We're going to give good visibility to the information people need, and the world has just fundamentally changed in terms of what is expected, including the roll-forward balance sheet. That's the first thing I would say. The second thing I would say is in terms of the seasonality of the operating cash flow, you're absolutely right, Karl. You can see it on the compounding and the attachment on the IR slide deck, that continued compounding on the invoicing side and how that impacts, obviously, cash flow. The thing that I would say to you that's a little bit special this quarter, special context, if you will, a, you touched on Dreamforce timing. And then, b, you know we had a very, very strong quarter as evidenced by 31% growth in our total DR, both billed and unbilled, and there's commissions that come with that strong performance and including those commissions, have an impact on our cash in the short term. But the thing that I would say to you is the cash flow guidance is intact for the year. We're going to deliver the guidance that we had promised, and there's just a little bit of wiggle due to a couple of these different factors. That's what I would say.

Operator

That's all the questions we have in the queue. I'd like to turn the call back over to Mr. Marc Benioff.

Marc R. Benioff - *Salesforce.com, inc. - Co-Founder, Chairman & CEO*

Well, thank you very much. And in closing for the call, I really want to appreciate all of you who have joined us during Thanksgiving week and taking your time. And I wish all of you and your families the very best for this holiday weekend, and I hope that you all have a healthy and safe Thanksgiving.

At Salesforce, we have always been a company that believes in doing well and doing good, and as you know, that's because we're committed to a core set of values, trust, growth, innovation and the equality of every human being. And I'll tell you that it sees values and it's reminded at this time of Thanksgiving as much as these incredible technologies that bring so many amazing people, partners and yes, you, as well our investors, to Salesforce. You also know that's why 171,000 people registered for Dreamforce this year, the amazing energy that was there, incredible experience with so many people, and an additional almost 11 million people viewed it online with us. We're aspiring to build a company for the ages and a brand and a culture that will make the world a better place not simply for another quarter or another year but for decades to come. So with all of that, I want to thank you again for attending the call and to have a happy Thanksgiving.

Operator

Ladies and gentlemen, this does conclude today's conference call. Thank you for your participation. You may now disconnect.

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