Q322 Opening Commentary

Simon Mays-Smith, VP Investor Relations

Thanks operator and good afternoon. Thank you for joining our conference call to discuss the results of our third quarter of fiscal year 2022. On the line with me are Andrew Anagnost, our CEO, and Debbie Clifford, our Chief Financial Officer.

Today's conference call is being broadcast live via webcast. In addition, a replay of the call will be available at Autodesk.com/investor. You can find the earnings press release, slide presentation and transcript of today's opening commentary on our investor relations website following this call.

During the course of this call, we may make forward-looking statements about our outlook, future results and related assumptions, acquisitions, products and product capabilities, and strategies. These statements reflect our best judgment based on currently known factors. Actual events or results could differ materially. Please refer to our SEC filings, including our most recent Form 10-K, for important risks and other factors including developments in the COVID-19 pandemic and the resulting impact on our business and operations that may cause our actual results to differ from those in our forward-looking statements.

Forward-looking statements made during the call are being made as of today. If this call is replayed or reviewed after today, the information presented during the call may not contain current or accurate information. Autodesk disclaims any obligation to update or revise any forward-looking statements.

During the call, we will quote a number of numeric or growth changes as we discuss our financial performance and unless otherwise noted, each such reference represents a year-on-year comparison. All non-GAAP numbers referenced in today's call are reconciled in our press release or Excel financials and other supplemental materials available on our investor relations website.

And now, I will turn the call over to Andrew.

ANDREW ANAGNOST, CEO

Thank you, Simon, and welcome everyone to the call.

Our third quarter results were strong, driven by one of our best-ever quarters for new subscriptions, record subscription renewal rates, a net revenue retention rate towards the high end of our range, and a solid competitive performance. We also grew RPO and billings 18 percent and 16 percent respectively, despite a tougher compare versus last year. Relative to the first and second quarters, the rate of improvement decelerated during the third quarter more than we expected. While demand is robust, we believe supply chain disruption and resulting inflationary pressures, a global labor shortage making it harder for our customers to staff new projects, and the ebb and flow of COVID are contributing to the deceleration, as well as documented country specific disruption to AEC in China. Our conversations with customers and channel partners reinforce our view.

We're encouraged that embracing digital transformation to drive efficiency and sustainability remains a priority for our customers. Our end-to-end solutions, business model flexibility and platform position us well competitively and enable more customers to enter and remain in our ecosystem. As you heard at our recent investor day and at Autodesk University, we are rapidly innovating and optimizing our business to increase and realize the opportunity ahead. Notable milestones during the quarter included the launch of our Flex consumption model and our plans to combine technologies, connect processes, automate workflows, and unlock valuable insights for customers through our Forge platform.

The recent report from the Intergovernmental Panel on Climate Change and the United Nations Climate Change COP26 meeting in Glasgow both underscored the urgency of reducing carbon in the earth’s atmosphere and the role that everyone, including corporations, needs to play. Sustainability needs to be designed, made and, in many cases, retrofitted in construction and manufacturing. This cannot be achieved efficiently or effectively without end-to-end software like ours to drive the process. This organizing principle affects not just how we deploy capital, for example through our investments to develop sustainable tools and our recent acquisition of Innovyze, but also how we source capital. Many of our largest equity holders already align to our sustainability goals and in the third quarter, we began to align our debt holders by issuing our first sustainability bond linked to our sustainability goals.

Now let me turn the call over to Debbie to take you through the details of our quarterly financial performance and guidance for the year. I’ll then come back to provide an update on our strategic growth initiatives.

DEBBIE CLIFFORD, CFO

Thanks, Andrew.

As Andrew said, our third quarter results were strong. Several factors contributed to that, including robust growth in new product subscriptions, rapidly expanding digital sales, and increasing subscription renewal rates.

Total revenue growth in the quarter accelerated to 18 percent, and 17 percent in constant currency, with subscription revenue growing by 21 percent. Looking at revenue by product, the growth we saw was broad-based: AutoCAD and AutoCAD LT revenue grew 14 percent, AEC revenue grew 22 percent, and manufacturing revenue grew 16 percent. M&E revenue grew 17 percent. Across the globe, revenue grew 18 percent in the Americas, 19 percent in EMEA, and 18 percent in APAC.

Direct revenue increased 34 percent and represented 35 percent of our total revenue, up from 31 percent last year, due to strength from both enterprise and eCommerce. As you heard at our investor day, about three quarters of new customers to Autodesk are now generated through our digital channels, reflecting the strength of our simplified buying experiences.

Our product subscription renewal rates reached record highs, and our net revenue retention rate was toward the high end of our 100 to 110 percent range.

Billings increased 16 percent to $1.2 billion, reflecting robust underlying demand and a tough comparison versus last year when we signed two of our largest ever EBAs, including a nine-digit deal. Total deferred revenue grew 14 percent to $3.3 billion. Total RPO of $4.2 billion and current RPO of $2.9 billion grew 18 and 21 percent, respectively.

Turning to the P&L, non-GAAP gross margin remained broadly level at 92 percent, while non-GAAP operating margin increased by 2 percentage points to approximately 32 percent, reflecting strong revenue growth and ongoing cost discipline.

We delivered healthy free cash flow of $257 million during the quarter against a tough comparison from last year, which benefited from pandemic-related payment term extensions.

Consistent with our capital allocation strategy, we continued to repurchase shares to offset dilution from our equity plans. During the third quarter, we purchased 980,000 shares for $287 million dollars at an average price of approximately $293 dollars per share. Year to date, we have repurchased 1.66 million shares at an average price of approximately $287 dollars per share, for a total spend of $476 million dollars.

Looking forward, as Andrew said, we're rapidly innovating and optimizing our business to realize the opportunities ahead. As we discussed last quarter, the shift of multi-year contracts to annual billings as we move into fiscal 24 will drive more predictable free cash flow and better price realization over time, which will make Autodesk a more valuable company. This quarter, we took steps to optimize our capital structure by issuing our first sustainability bond, which aligns our capital strategy with our sustainability goals while also extending our debt maturity profile by almost two years and reducing our weighted average cost of debt by 40 basis points. As we enter Q4, we intend to take steps to reduce our real-estate footprint because the pandemic has spurred changes in the way we work and we've moved to a hybrid workforce. As a result, we anticipate we will reduce the square footage of our facilities portfolio by approximately 20 percent worldwide and that we will take a GAAP-only charge of up to approximately $180 million, the bulk of which will be recognized over the next several months as we execute our plan. Optimizing our facilities costs will allow us to better deploy capital to further our strategy and drive growth.

Now, let me finish with guidance. Demand was robust in Q3 and we expect it to remain so in Q4. However, as Andrew said, macroeconomic headwinds such as supply chain disruption and resulting inflationary pressures, a global labor shortage, the ebb and flow of COVID, and AEC in China are impacting the pace of our recovery. As an example, the growth in new product subscription volume decelerated from approximately 30 percent in the first half to mid-20s percent in Q3, which is more than normal seasonality and a tougher comparison versus last year would suggest. This dynamic drove strong billings growth in Q3 that, nonetheless, fell short of our expectations. In light of this macroeconomic uncertainty, as we enter Q4, we're taking a pragmatic approach and are assuming that the supply chain, labor, COVID and country-specific challenges will persist. As a result, we're reducing the mid-point of our billings and free cash flow guidance by approximately $150 million and $100 million, respectively, for full-year fiscal 22. Given the nature of our subscription business model (and the greater degree of near-term visibility it provides to us) and our expectation of continued strong spend discipline, the mid-point of our full-year revenue and margin guidance is broadly unchanged.

We continue to target $2.4 billion of free cash flow in fiscal 23 in constant currency because we believe the current macro headwinds we're seeing are transient. But if the growth deceleration and strengthened dollar continue through next year, we could see potential risk to that target of about $100 to $200 million based on what we know today. FX volatility is a big factor: rate moves in the first half of the year created about $55 million in potential headwind to fiscal 23 cash flow. Since then and in the last 90 days alone, further rate moves created about another $45 million in potential headwind to cash flow. We're obviously watching FX rates closely but it's clear that if the current rates persist through next year, that risk could materialize in free cash flow. Beyond cash flow, if you further take the risk into account, revenue growth could end up at the low end of the CAGR we talked about at investor day and fiscal 23 margins could be impacted by about a point. We will, of course, update you on our next earnings call when we expect to have more visibility into any impacts from macro or FX movement on our fiscal 23 outlook.

We remain optimistic about our growth potential beyond fiscal 23, continue to target double-digit revenue growth, non-GAAP operating margins in the 38 percent to 40 percent range, and double-digit free cash flow growth on a compound annual basis. These metrics are intended to provide a floor to our revenue growth ambitions and a ceiling to our spend growth expectations.

Andrew, back to you.

ANDREW ANAGNOST, CEO

Thank you, Debbie.

Now let me turn to our strategic growth initiatives. Sustained and purposeful innovation to enable digital transformation in the industries we serve has changed our relationships with our customers from software vendor to strategic partner. And that is enabling us to create more value through end-to-end, cloud-based solutions that connect data and workflows, and through business model evolution. Our model is scalable and extensible into adjacent verticals: from architecture and engineering, through construction and owners; and from product engineering, through product manufacturing and product data and lifecycle management. By helping our customers grow and navigate their digital transformation, we will grow, too.

For example, Bouygues Construction and Colas are leading construction and infrastructure firms based in France with over 100,000 construction employees operating in 60 countries across the globe. In the third quarter, they significantly increased their commitment to Autodesk products such as Revit, AutoCAD and Civil 3D following an accelerated move to BIM and digital work flows over the last three years, which significantly increased monthly average users.

Similarly, Obayashi Corporation, one of the largest construction firms in Japan, which operates in 16 countries worldwide, is accelerating its global consolidation around BIM and a unified 3D technology platform to enable greater efficiency and sustainability. In the third quarter, it expanded its EBA with us. Over the last two years, it has more than doubled the number of Revit users and expanded its usage of Autodesk Construction Cloud to connect workflows from design through construction.

We are further extending our reach into the construction mid-market with the recent launch of Autodesk Build, introduction of an account-based pricing business model and distribution through our channel partners.

For example, this quarter, Jacobsen Construction Company, an ENR 400 general contractor in the United States, was looking for a long-term technology partner and to consolidate around a single project management solution that would increase the efficiency of its field teams while also seamlessly integrating with its accounting solution. While it had previously used a competitor solution for some projects, Jacobsen ultimately chose Autodesk Construction Cloud because of Autodesk Build's robust field and cost management functionality, and the opportunity to integrate it smoothly with existing technology.

With new Autodesk Build features and capabilities launched every two months or so, and the recently launched ACC bundles for pre-construction and construction operations, we remain optimistic about the opportunities ahead.

We're connecting the dots in infrastructure, too. For example, the Administrator of Railway Infrastructures in Spain, or ADIF, selected Autodesk products over competitor offerings to support its digital transformation. Backed by our common data environment, ADIF will leverage the Autodesk Construction Cloud to collaborate on project information, on-site development, and model coordination to ensure efficient and accurate construction of their railway network. Infrastructure remains an important opportunity for Autodesk across the globe. Our end-to-end solutions, which boost the efficiency and sustainability of customers like ADIF, as well as our ability to seamlessly integrate vertical and horizontal design and construction, give us a competitive advantage. Much needed additional investment in infrastructure in the United States and across the globe will restore aging infrastructure and increase the productivity of the economy. Perhaps more consequentially in the long term, provisions in the U.S. infrastructure bill, which encourage Departments of Transportation to digitize their processes, should accelerate adoption of digital workflows and enable all infrastructure investment to become more efficient and sustainable.

Turning to manufacturing, we sustained strong momentum in our manufacturing portfolio this quarter.

In automotive, we continue to grow our footprint, beyond the design studio into manufacturing and connected factories, as automotive OEMs seek to break down work silos and shorten hand-off and design cycles. Ford, one of the largest automotive OEMs in the world, renewed and expanded its EBA with Autodesk during the third quarter, growing users of Alias and VRED in design and AutoCad, Inventor and Navisworks in manufacturing, while adding Autodesk Construction Cloud and Autodesk Build in facilities and manufacturing to enable field access to plant drawings during maintenance and operations and equipment change over.

Fusion 360 commercial subscribers again grew strongly without any systematic sales promotions, ending the quarter with 175,000 subscribers. While still early days, our new extensions, including Machining, Generative Design, and Nesting & Fabrication are performing well and there is major interest in our upcoming simulation and design extensions. Fewer promotions and growing demand for Fusion 360’s extensions are enabling us to capture more of the potential market opportunity and accelerate our growth.

Fast Radius is a leading digital manufacturing and supply chain company. The company's proprietary Cloud Manufacturing Platform combines software and advanced microfactories that enable its customers to flexibly design, make and move certified parts. Fast Radius already uses several Autodesk products. This quarter, it added Fusion 360 with the Machining Extension to support its in-house CNC operation and integrate it alongside its existing additive manufacturing offering. Fusion 360 enables Fast Radius to program a wide variety of parts more quickly resulting in faster product cycle times.

Outside of commercial use, there is a large and rapidly growing ecosystem of users that are taking Fusion 360 from education and home into the workplace. These will fuel commercial usage in the future. As one measure of this ecosystem, we ended the third quarter with 1 million monthly active users, up over 50 percent year over year. And they are doing some amazing work.

On September 12, the Technical University of Munich’s “TUM Boring” team beat more than 400 applicants and 12 finalists to win the inaugural “Not-a-Boring Competition.” As Haokun Zheng, one of five leads responsible for project operations, said: “Fusion 360's cloud-based solution enabled our 60-member team to collaborate remotely during the pandemic and design and build an award-winning 40-foot long, 22-ton tunneling machine. Throughout the year, we were repeatedly told by industry experts that the timeline we were aiming for was borderline impossible. But Fusion 360's ease of use and integrated CAD, CAM and FEM enabled rapid simulation and improved the speed and efficiency of the design workflow.”

And finally, we continue to enable more users to participate in our ecosystem more productively, through business model innovation and our license compliance initiatives. For example, a sustainable building engineering design solutions consultant in Australia, which has been an Autodesk AEC customer for more than a decade, added our Premium offering in the third quarter to enable it to better manage its subscriptions and provide more secure single sign on across multiple offices. Across Autodesk, the number of Premium subscribers increased more than 500 percent year over year.

And in the Middle East, a large telecoms company undertaking its own digital transformation was seeking to increase efficiency and sustainability by adopting BIM standards and streamlining digital workflows while also ensuring license compliance across a fragmented employee base. During the process, we became the trusted partner of choice resulting in a significant investment in AEC Collections, AutoCAD, Revit, and 3ds Max. Year to date, license compliance billings across Autodesk as a whole are up 20 percent when compared to the same period two years ago and almost 50 percent year over year.

In speaking with customers, partners and employees, we are very optimistic about the future. They have demonstrated grit and determination, inspiration and innovation, and agility and transformation during the pandemic. And while there will certainly be twists and turns on the road ahead, in many ways the pandemic has accelerated the future and increased my confidence that we are on the right path. We are executing well in challenging times and believe we have only significant opportunities ahead of us.

I am reminded again that Autodesk's purpose has never been more important or urgent. Empowering innovators with design-and-make technology so that they can achieve the new possible also enables them to build and manufacture efficiently and sustainably. Together, we can meet the challenges posed by carbon, water, and waste while also advancing equity and access to the in-demand skills of the future. Autodesk's central role in meeting these challenges underpins my confidence this year and my confidence in the future.

Operator, we would now like to open the call up for questions.