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DocuSign, Inc. NasdaqGS:DOCU

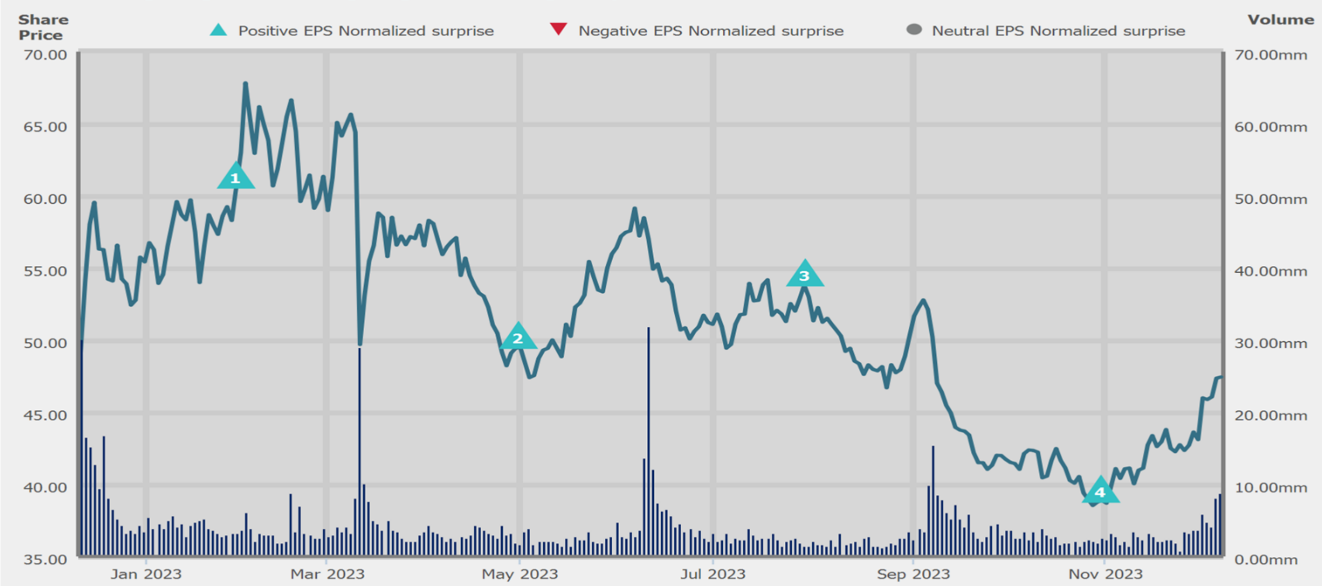
FQ3 2024 Earnings Call Transcripts

Thursday, December 07, 2023 10:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2024-			-FQ4 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.63	0.79	▲25.40	0.59	2.65	2.73
Revenue (mm)	690.12	700.42	▲1.49	693.69	2733.00	2915.50

Currency: USD
Consensus as of Dec-06-2023 5:34 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ4 2023	0.52	0.65	▲25.00 %
FQ1 2024	0.56	0.72	▲28.57 %
FQ2 2024	0.66	0.72	▲9.09 %
FQ3 2024	0.63	0.79	▲25.40 %

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Table of Contents

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Presentation

Operator

Good afternoon, ladies and gentlemen. Thank you for joining DocuSign's Third Quarter Fiscal Year '24 Earnings Conference Call. [Operator Instructions] As a reminder, this call is being recorded and will be available for replay on the Investor Relations section of the website following the call. [Operator Instructions] I will now pass the call over to Heather Harwood, Head of Investor Relations.

Please go ahead.

Heather Kalista Harwood
Head of Investor Relations

Thank you, operator. Good afternoon, and welcome to DocuSign's Q3 Fiscal Year 2024 Earnings Call. I'm Heather Harwood, DocuSign's Head of Investor Relations. Joining me on today's call are DocuSign's CEO, Allan Thygesen and our CFO, Blake Grayson.

The press release announcing our third quarter fiscal year 2024 results was issued earlier today. And is posted on our Investor Relations website. Now let me remind everyone that some of our statements on today's call are forward-looking. We believe our assumptions and expectations related to these forward-looking statements are reasonable, but they are subject to known and unknown risks and uncertainties that may cause our actual results or performance to be materially different.

In particular, our expectations regarding the pace of digital transformation and factors affecting customer demand are based on our best estimates at this time and are therefore subject to change.

Please read and consider the risk factors in our filings with the SEC, together with the content of this call. Any forward-looking statements are based on our assumptions and expectations to date. And except as required by law, we assume no obligation to update these statements in light of future events or new information.

During this call, we will present GAAP and non-GAAP financial measures. In addition, we provide non-GAAP weighted average share count and information regarding free cash flows and billings. These non-GAAP measures are not intended to be considered in isolation from, a substitute for or superior to our GAAP results. We encourage you to consider all measures when analyzing our performance. For information regarding our non-GAAP financial information, the most directly comparable GAAP measures and a quantitative reconciliation of those figures, please refer to today's earnings press release which can be found on our website at investor.docusign.com.

I'd now like to turn the call over to Allan. Allan?

Allan C. Thygesen
CEO & Director

Thanks, Heather, and good afternoon, everyone. DocuSign's third quarter operating results reflect progress on our initiatives to expand beyond new signature into agreement management. And our financial performance underscores our ongoing focus on driving profitability and sustaining healthy free cash flow. As I reflect on our journey over the last 12 months, the 3 key pillars of our strategic vision remains the same. First, to accelerate innovation towards agreement management, which we believe will further expand market opportunity; second, improving the reach and efficiency of our omnichannel go-to-market efforts; and third, strengthening our financial and operational efficiency.

Now before we discuss each pillar in detail, let me first highlight this quarter's financial results. Total Q3 revenue came in at $700 million, up 9% versus prior year. We're particularly pleased with the improvement in our overall profitability this quarter against persistent macro headwinds and delayed at customer caution. Specifically, our Q3 non-GAAP operating margin came in at 27%, a 400 basis point increase versus prior year, and non-GAAP operating income grew 27% year-over-year to $187 million. We

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also generated record free cash flow in Q3 coming in at $240 million, up significantly versus the prior year. We're focused on strengthening our profitability while making balanced investments in areas with strong long-term growth opportunities.

We're also seeing encouraging signs of business stabilization. With improvement in some metrics, notably customers with annualized contract value greater than $300,000. Blake will expand on the metrics further in his remarks. With respect to our first pillar, accelerating product innovation. Our focus is twofold. First, we continue to improve our core eSignature product capability. In Q3, DocuSign became the exclusive eSignature provider for Microsoft's Power Page integration, making it easy for website makers to incorporate signatures and forms without code, improving the client signing experience and opening the door to building pre- and post-signature workflows.

In November, we also launched a WhatsApp integration for eSignature. In an internal comparative study, we found that agreements delivered via WhatsApp are signed nearly 7x faster than those sent via e-mail. Given the ubiquity of WhatsApp globally, it's an important update to bring eSignature to markets outside the U.S. In addition, IDC recognized DocuSign as a leader in its 2023 eSignature assessment. DocuSign continues to hold the leadership position of IDC for eSignature based on having a complete portfolio of solutions for customers. And we're seeing existing customers grow and expand their use cases. Hantz Group, which is a Michigan-based wealth management firm is using eSignature to deliver a fully digital experience for its clients through a proprietary mobile app and is expanding their use of DocuSign products with notary, SMS, identity verification and monitor. Our APIs and strength in compliance made DocuSign the best choice for Hantz. And they've made DocuSign a standard across their entire organization which will approximately double their use of our products.

Second, we're also investing towards broadening our value proposition beyond eSignature and into agreement management. In Q3, we shipped embedded agreements that deliver a seamless signing experience directly on our customers' websites and applications. In addition, we launched Microsoft Power Automate for the generation of personalized professional-looking documents. For signing directly from Microsoft Power Automate flows. We also launched foundational features and functionality that help us expand beyond eSignature into wide-scale agreement management. These features deliver customer delight and remove friction from all aspects of the agreement process. We see the success of CLM as a proof point that there are broader agreement management use cases to address the customers of all sizes.

CLM continues to grow well, particularly with North American enterprise customers. And for the fourth year in a row, our CLM solution was recognized as a leader by Gartner in contract life cycle management. Noting our strong market understanding, product strategy and road map vision, including upcoming Generative AI enhancements. This quarter, we expanded a relationship that began more than 5 years ago with Veeco USA. Who's the leader in workplace innovation. Veeco began using DocuSign eSignature and has added CLM as part of this transformation into a digital services company. Our AI solution will help Veeco streamline and enhance search and review of executed customer contracts with actionable insights to better serve its customers.

Thank you to our partners at Spaulding Ridge, who are helping to strengthen our commitment and partnership with Veeco. As we look ahead, we envision serving similar customer needs not addressed by CLM via a broader agreement management platform designed for all of our customers in all segments. We are previewing with select customer now. I will have much more to share on our product road map and strategic vision at our Momentum User Conference in April 2024.

Across both our eSignature core and future agreement management products, we believe our investment will lead to even further differentiation in a competitive market. We're encouraged by steady win rates and excited for the impact we can create for customers. This past quarter also demonstrated execution against our second pillar, improved omnichannel go-to-market. Where we gained traction across our direct sales, digital and partner engagement. Our international business spends all channels as an important part of our addressable market. It's really an untapped opportunity for DocuSign expansion. In Q3, our international revenue grew approximately 3x faster than our North American business. We also saw traction in the

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adoption of our identity verification solutions, which meet stringent regulatory standards in the EU and elsewhere.

And in Q3, we launched a Japanese localized version of our CLM product. The recently launched WhatsApp integration also highlights our international ambitions. Our digital channel once again grew at a faster rate than our direct business during the quarter, a strong sign that our product-led growth initiative continues to drive new customer acquisition and top of funnel activity. We continue to optimize our site and remove friction from the try and buy journey while creating a more personalized experience with improved localization. We're seeing particular strength in new customer acquisition in our international markets, as well as improved conversion rates in the trial to paid license purchase conversion rates.

Our trusted brand and product strength continue to be assets for our direct sales team. Mountain America Credit Union, one of the biggest credit unions in the U.S. has reduced the time it takes to close a credit card application by 30% by integrating DocuSign with its proprietary loan origination system. Mountain America switched to DocuSign from a different electronic signature provider in part because our strong brand reputation inspires confidence from its members, but also because our rich catalog of best-in-class APIs. Give us developers the flexibility to create solutions that are customized to its exact needs.

That is enabling Mountain America to deliver a seamless, minimal click experience that aligns with the standards as members expect in their financial institutions. An important pillar of our go-to-market plan is strengthening our partner ecosystem. In October, we hosted our first ever partner day. It was fantastic to meet with our system integrators, resellers and software vendors from around the world, sharing our commitment to growing our business together. As an example, the ISV embed pay-as-you-go initiative we announced in Q2 is accelerating and driving new customer wins. Before I pass it to Blake, I want to address some progress on our third strategic pillar. Our company's focus on financial and operational efficiency.

In the quarter, we delivered record operating margin and free cash flow. While we continue to invest for long-term growth, we will also continue to be strong financial stewards of the business.

We still have a lot of work to do, but I am pleased with our progress over the past 12 months. I am more confident than ever in the value we can create for our customers in our business and the scale and strength of our customer base. We're in the early stages of our journey to expand beyond eSignature into agreement management. But there is very concrete customer validation of the market opportunity and meaningful progress towards our goals.

Thank you to the DocuSign team who's inspired me with their commitment to this transformation.

With that, let me turn it over to Blake.

Blake Jeffrey Grayson
Executive VP & CFO

Thanks, Allan, and good afternoon, everyone. As I approach my 6-month anniversary of DocuSign, I remain excited about the long-term opportunity. And our teams execution against the 3 key pillars we've outlined previously. Accelerating product innovation, enhancing our omnichannel go-to-market strategy and strengthening our financial and operational efficiency. We delivered solid results in Q3, demonstrating the stability of our business model. In the third quarter, total revenue increased 9% year-over-year to $700 million, and subscription revenue grew 9% year-over-year to $682 million.

We continue to drive solid new customer growth during the quarter despite the challenging macro and software buying environment, which is evidence of DocuSign's durable value proposition. In addition, I'm proud of our operational execution highlighted by strong profitability and free cash flow generation. While we have much work still to do, we are making progress. Third quarter billings rose 5% year-over-year to $692 million. As expected, expansion headwinds continued to impact year-over-year billings growth. These dynamics are also visible in our dollar net retention, which was 100% in Q3. Expansion rates continue to be tempered by spending optimization and IT budget scrutiny. We expect dollar net retention to trend downward in Q4.

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That said, we are encouraged by a few early data points evident in our results this quarter. First, we saw year-over-year consumption stabilization or improvement in a number of verticals, including business services, technology and insurance. Financial services by contrast, continue to be more impacted. Although real estate also continued to be pressured by the interest rate environment, it improved on a year-over-year basis for the third quarter in a row with significant opportunity for further improvement.

We're increasingly operating in a post-COVID environment, and I'm pleased that our weighted average contract duration continues to remain consistent at 18 months. Also, by the end of this fiscal year, we expect only around 10% of our book of business to be full contracts signed during calendar years 2020 and 2021. DocuSign's value proposition is broad-based, and we benefit long term by doing business with customers across a diverse set of sectors and segments.

Second, we are pleased with the early progress we are seeing from our investments in the omnichannel go-to-market efforts. Driven by our direct sales efforts, the enterprise segment showed some early potential relative to performance in previous quarters. The number of customers of annualized contract values greater than $300,000 rose slightly to 1,051 from 1,047 in the prior quarter and was approximately flat year-over-year. This increase is an improvement after 2 quarters of sequential declines. Also, our CLM business grew double digits year-over-year. As enterprise customers continue to optimize their eSignature spend, we are seeing some customers taking advantage of our CLM product. Enterprise customer adoption is encouraging because CLM is the early proving ground for investment in a broader agreement management use case for our entire customer base.

In addition, within our omnichannel pillar, international revenue grew 18% year-over-year, reaching $185 million in the third quarter, representing 26% of our total revenue. This was a slight acceleration in year-over-year growth from the previous quarter. Most international markets remain at an early adoption stage due to regulatory history and cultural habits. At the same time, however, international represents the largest portion of our TAM, and I'm pleased to see continued success of our hybrid go-to-market strategy. Related to the investments we're making in our PLG and self-serve motions, digital revenue growth outperformed direct. Digital remains the primary source for new customer acquisition, and we added approximately 36,000 new customers in Q3 and bringing the total customer base to 1.47 million, up 11% year-over-year.

This includes the addition of approximately 7,000 direct customers bringing the total number of direct customers to 233,000, a 15% year-over-year increase. Turning to our third strategic pillar. We delivered strong margin expansion and healthy cash flow during Q3 and highlighting our focus on operating and financial efficiency. Non-GAAP gross margin for the third quarter was 83%, in line with the prior year. Third quarter non-GAAP subscription gross margin was 86%. Also in line with the prior year. Q3 non-GAAP operating income reached a record $187 million, representing a 27% margin, up nearly 400 basis points from 23% and $147 million in the prior year.

During the quarter, we increased focus on investment prioritization, hiring plans and operating expenses. There will be continuing opportunities for greater efficiency even as we invest to drive long-term growth. Q3 non-GAAP EPS was $0.79, a $0.22 per share improvement from $0.57 last year. We ended Q3 with 6,945 employees compared to 7,522 the year prior. And up from 6,748 in Q2. We will remain disciplined with our head count investment. Hiring will continue to focus on opportunities to drive sustainable long-term growth like those in R&D. Operating cash flow for the quarter was $264 million compared with $53 million in the same quarter last year.

While an ERP transition impacted last year's cash flow results, I'm proud of the significant free cash flow we generated this quarter. Third quarter free cash flow was a record $240 million representing a 34% margin compared with $36 million or 6% a year ago. Over the last 12 months, we've generated over $750 million in free cash flow, underscoring the strong fundamentals of this business. With regards to the balance sheet, we exited Q3 with $1.7 billion in cash, cash equivalents and investments.

This includes the repayment of $37 million of convertible debt that matured during the quarter. Our balance sheet remains strong, and we have ample liquidity to address the remaining convertible debt of $690 million that matures next month. Turning to our share repurchase program. We redeployed excess capital during the quarter and repurchased 1.8 million shares for approximately $75 million.

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In addition to our share repurchase program, during the quarter, we used $36 million to pay taxes due on RSU settlements, reducing the diluted impact of our equity programs. We remain committed to opportunistically returning capital to our shareholders.

With that, let me turn to guidance. For the fourth quarter and fiscal year '24, we expect total revenue of $696 million to $700 million in Q4 or a 6% year-over-year increase at the midpoint. And $2.746 billion to $2.750 billion for fiscal '24 or a 9% year-over-year increase. Of this, we expect subscription revenue of $679 million to $683 million in Q4. Or a 6% year-over-year increase at the midpoint and $2.670 billion to $2.674 billion for fiscal '24. Or a 9% year-over-year increase.

For billings, we expect $758 million to $768 million in Q4. Or a 3% growth rate year-over-year at the midpoint. And $2.835 billion to $2.845 billion for fiscal '24 or growth of 7% year-over-year.

We expect non-GAAP gross margin to be 81% to 82% for Q4 and 81.5% to 82.5% for fiscal '24. We expect non-GAAP operating margin to reach 22.5% to 23.5% for Q4. And 24% to 25% for fiscal '24. We expect non-GAAP fully diluted weighted average shares outstanding of 207 million to 212 million, for both Q4 and fiscal '24.

In closing, we're pleased to report a quarter of consistent execution against our 3 strategic pillars: accelerating product innovation, enhancing our omnichannel go-to-market strategy and strengthening our financial and operational efficiency. We have a strong foundation with well over 1 million customer relationships and improving product momentum. We remain focused on creating shareholder value by investing in durable long-term growth, delivering on our profitability goals and generating sustainable free cash flow. We look forward to keeping you updated on our progress as we focus on helping our customers accelerate their business growth, mitigate risk and enable customer experiences that are easier and more delightful.
That concludes our prepared remarks. With that, operator, let's open up the call for questions.

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Question and Answer

Operator

[Operator Instructions] Our first question is from Jake Roberge with William Blair.

Jacob Roberge
William Blair & Company L.L.C., Research Division

I understand NRR is a trailing metric, and I appreciate the color that Q4 will see another decline. But are we starting to get visibility in the trough for that metric now that you're putting those headwinds from the multiyear COVID contract behind you and maybe the new product investments start layering in more meaningfully next year?

Blake Jeffrey Grayson
Executive VP & CFO

Sure. I'll take a stab at this and Allan, if you want to jump in, feel free. So just a quick reminder, dollar net retention or DNR is our direct business only in greater than 1 year.

Like you said, the trend downwards in line with our previous communications. And as covered in our prepared remarks, for me, we have -- we expect to see continued pressure in Q4.

It's a tough macro environment still where companies continue to scrutinize investments and leading to smaller expansion opportunities for us. It's a bit of a lagging indicator. So the thing that I'm focused on mostly and the company is focused on is what are the efforts we're making to stabilize and improve it over the longer term. And so -- like you said, things like the intelligent agreement management and the new product innovation, including CLM and pricing and packaging enhancements and stronger PLG motions that we're working on in self-serve, which can help us improve those win or renewal wins, if you will, over time is what we're focused on.

And as you heard in the prepared remarks, we are seeing some very early signs of potential, I would call it passive optimism, right? Like consumption up across a number of verticals. We saw sticky future adoption improve from last quarter on a year-over-year basis. And that's the percentage of our direct customers using 5 or more kind of incremental features that -- was at 58% in Q3, up from Q2, and it was up about 12 points year-over-year. So they're just -- they're early signs of potential optimism, but I think it's too early for us to put any type of a target or a specific time line out there. But focusing on those product management efforts and those go-to-market efforts, I think, is how you get excited about the future.

Jacob Roberge
William Blair & Company L.L.C., Research Division

Okay. Helpful. And then just a follow-up on those products you were talking about. When do you think CLM becomes a more meaningful part of the business where it actually starts impacting expansion rates instead of NRR just being really driven by eSignature consumption. It seems like you've been talking about the potential for that product suite for a few years. But what do you need to do to get that product to more main stage with customers?

Blake Jeffrey Grayson
Executive VP & CFO

Yes, I'll take a crack at that. So first, I'd say that if you look -- if you think about our broader vision, CLM is really a leading indicator or early instantiation of our broader vision for intelligent agreement management. It is very heavily focused on the enterprise. And I think we and everyone else providing CLM solutions have been held back by the required significant services and customization investment that the current generation of CLM products mandate.

And -- so our opportunity is to make that significantly more lightweight and delightful, lowering the bar for companies of all sizes really to take advantage of that platform. That is a huge part of our focus right

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now. We're in early access on some important pieces of that. And so over the next few quarters, you will see that going to roll out to a much broader set of customers on CLM. DocuSign or any other vendor can address today. And we think that unlocks opportunity, as I said, everywhere.

Operator

Our next question is from Josh Baer with Morgan Stanley.

Joshua Phillip Baer
Morgan Stanley, Research Division

I wanted to dig in on margins and the margin outperformance. I was hoping you could provide a little bit more context on the source of upside in the quarter? And then how to think about the trajectory of investments going forward? Like the full year guide was raised. Just wondering if there's been sort of any changes in the investment philosophy pulling back in any areas or just letting more of the upside flow through to the bottom line?

Blake Jeffrey Grayson
Executive VP & CFO

Sure. I appreciate the question. So with regards to the outperformance on the operating margin, we made a concerted effort I would say, starting kind of like late September to inspect and rationalize investments across the business. It's really just about increasing focus on, what I would call, disciplined spending while we continue to invest in the areas that -- where we have longer-term growth aspirations. During Q3, we prioritize investments. And so that includes the rate of hiring, the value opportunities for organizational efficiency, but then also overall operating expenses with focus on leveraging existing resources where possible, but still being able to invest for longer-term growth.

With regard to your question on the trajectory and the investment philosophy, we're all big believers here in a balanced outlook, which is we need to be able to invest to get the long-term growth and achieve those aspirations that we have. But at the same point in time, we need to be efficient and productive with the assets that we have. And so I really am proud of the team for embracing that. And so I don't think no investment, I would say, philosophy changes from our part. I would just say a little bit maybe kind of more executed focus on that for us, and we were able to show some pretty good performance, I think, this quarter, and I'm really proud of the team for that level of execution.

Allan C. Thygesen
CEO & Director

Yes, I would just echo -- if I can just echo Blake's point that the entire management team, not just Blake, is very focused on this balance that he referenced. We absolutely want to free up capital and that is a team effort to look everywhere in the company to free up resources where we can then invest more, particularly on the product side. We did some of that earlier this year, as you know, but it's an ongoing continuous effort, not just onetime thing, and I think that's reflected in the results.

Operator

Our next question comes from Brent Thill with Jefferies.

Luv Bimal Sodha
Jefferies LLC, Research Division

This is Luv Sodha on for Brent Thill. Maybe first, just wanted to ask, obviously, you're guiding to 7% year-over-year billings growth for fiscal '24. I guess -- I know you're not guiding to fiscal '25 just yet, but how should we think of the growth trajectory for next year, especially as you come through some kind of trough on the NRR side?

Blake Jeffrey Grayson
Executive VP & CFO

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Sure. So I'll take a stab at that. I'm really proud of the progress we've made in a short period of time. When I say that, I mean across our business, both in just operational efficiency but also accelerating product evolution and innovation. In Q3, particularly, we improved operating margins, we generated significant free cash flow. And I think we're evolving our mindset across the company.

As I mentioned earlier on the question that was just asked before this, in terms of our long-term approach, we're going to balance driving durable long-term growth with operating efficiency. Top of our priority is to make the right strategic investments to drive business momentum and, frankly, to billings, which is, I think, what you're referring to in the coming years.

And it doesn't happen overnight, especially at the business of the scale. But we believe we have the right product and go-to-market focus and we've got a good leadership team in place to make that happen. And you alluded to this, but given that we're still working through our planning and forecasting process for next year. We'll provide our standard formal fiscal year '25 outlook in our Q4 earnings call 3 months from now. But as you think about next year, I imagine you want to consider the Q4 exit rate trends as you think about next year and at the same time, we believe there's further opportunity to drive improved efficiency in our existing business and our operating expenses and then also taking into account historical seasonality changes as we go from Q4 to Q1 with fewer days in the quarter and things like that, just all kind of the basics that you would want to pay attention to.

But other than that, we'll provide our full year -- our fiscal '25 formal guidance in our next quarter's call.

Luv Bimal Sodha
Jefferies LLC, Research Division

Got it. And one quick follow-up, if I may. Just wanted to ask about your philosophy around stock-based compensation?

Blake Jeffrey Grayson
Executive VP & CFO

Sure. So I mean I think the philosophy on stock-based comp is generally you want to be able to provide the incentive and the ability to attract and retain the best talent possible to allow us to reach the aspirations for growth that we want to get to. I know that -- I think our soft-based comp as a percentage of revenue in the current quarter, I think was 23%. I think that was up slightly year-over-year from 22%. I would say that the driver of the increase is really most about the new management team. So it's driven by the executive comp that drove that year-over-year increase, not necessarily the other part of the company.

I think that -- for us, it's something we're slightly above our peer average, and so it's something that we are paying attention to. But it's a balanced approach, again, right? We want to be able to attract and retain the right people for the job that -- so we can get into this next chapter of growth for DocuSign. But it is something we pay attention to and are looking at.

Allan C. Thygesen
CEO & Director

Yes, I would just add, we have that. We discussed that topic with the Board and the Compensation Committee, and we will share our longer-term plans, but our goal, as Blake said, is to manage it down over time without fundamentally disrupting our ability to execute. It was necessary to attract a new management team and to rebalance our employees following the stock decline, but I think -- we think we're in a more normalized set now, and we should be able to manage to something more towards the benchmarks.

Operator

Our next question is from Brad Sills with Bank of America.

Bradley Hartwell Sills
BofA Securities, Research Division

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I wanted to ask about a comment Allan, you made earlier in the call that I think you're seeing increased conversion in the top of funnel business. Would love to get some more color on there. Do you feel like there's some learning there? I know this has been a priority for you since joining the company and building that top of funnel. So any color on that end of the business and the conversion uptick that you mentioned?

Allan C. Thygesen
CEO & Director

Yes. Well, so I think you all know, we acquire a tremendous number of new customers every quarter. And most of those -- vast majority of those come in via our website and onboard themselves. And then over time, we grow them. And as they show potential and opportunity, then we engage them with our sales teams and our support to customer success teams I would say that our digital motion has made significant improvements during the course of this year. So for customers that are in essence natively digital, we have improved that part of the funnel, not only you can buy more things, you can upgrade your existing plans.

All of that stuff is working much better now. We're adding more international currencies every quarter. So all of those things are helping improve the performance of our digital business. In addition to that, we are in the process of building out ability for customers who are currently serviced through our sales teams to handle a number of activities themselves without human assistance. And that is very -- has very high leverage, both in terms of providing a better offering to our customers.

And in terms of freeing up our sales teams to work on higher-value work. But I think we still have some quarters to go on implementing that and seeing the full benefit of that. So the benefits of this self-serve PLG project continue to accrue and will accrue into next year. But we're seeing really good progress and that business is growing faster than our direct business. And it's improving on most performance metrics. So that's -- yes, very happy with the progress there.

Bradley Hartwell Sills
BofA Securities, Research Division

Great to hear. And then one, if I may on net revenue retention -- dollar based net revenue retention coming down next quarter, could you just help unpack that for us a little bit on gross versus expansion? Is gross kind of holding and this is mostly expansion related? I know it's a backward-looking metric. But if you could just help us unpack that a little bit on the growth side?

Blake Jeffrey Grayson
Executive VP & CFO

Yes, there's not much more, I would say, a level of detail that we're going to disclose publicly about it. I think it's just for us that it's a metric that we know if we can deliver on the product innovation and the road map and the self-service in the PLG motions that we have in front of us, we really believe we've got a chance to stabilize that metric and then reverse that trend.

Now -- for us, that's top of mind. Obviously, it is a lagging metric, so there's time that you're going to -- it's going to take to [SEDAR] occur. But I would say there was nothing that spoke out about Q3 that stood out that I would call it different than the prior quarter or 2.

Operator

Our next question is from Michael Turrin with Wells Fargo Securities.

Michael James Turrin
Wells Fargo Securities, LLC, Research Division

Blake, I wanted to spend some more time on the consumption commentary that you provided. Certainly helpful. I'm just wondering if there's anything else you can tell us in terms of the shape of those improvements, how that compares to prior periods? And when you're talking about consumption for

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DocuSign, is that mainly signature volumes or there other attributes of customer profiles we should be considering as part of that commentary?

Blake Jeffrey Grayson
Executive VP & CFO

Sure. And it's a good question. Thanks for asking. So when we talk about consumption today, it's primarily around the eSignature space, primarily around, if you will, the envelopes that are used. So what is the usage by our customers on a year-over-year basis. So those verticals that I highlighted at some of the stronger year-over-year growth in consumption that we've seen over the past quarter or 2.

So I think we're, again, cautiously optimistic about it. And just to be clear, too, there's still verticals that are more challenged, right? I highlighted financial services is one, and I also highlight real estate as the other one, which probably comes as no surprise to folks who are living in this interest rate environment. I think the thing that makes me -- I don't want to say happier, but you can see a little bit of light there is that real estate has improved on a year-over-year basis over the past 3 quarters.

So that's good, but it's not anywhere back to near where it was I would say, prior to the whole interest rate challenges that we've kind of entered in the past year or so. But so excited about that. But again, that's also, I think, in the prepared remarks, I made a comment about the significant remaining opportunity. And so a lot of it, I think, you're probably seeing is that as the macro environment returns to more normalcy in certain verticals, then we believe we're a beneficiary of that.

And I think that's relevant because we have such a broad-based set of verticals in such a diverse customer base as well. So it's something that when things improve, we think we're a beneficiary of that. And your guess is probably as good or better than mine on when that happens.

Michael James Turrin
Wells Fargo Securities, LLC, Research Division

I don't know if any of us have.

Allan C. Thygesen
CEO & Director

On that one maybe not. And I'll just add to what Blake said, I think consumption -- we think of consumption as an imperfect but important leading and predictive indicator of renewal. And -- so that's why we track it closely and talking about it. And we're seeing modestly encouraging signs there in consumption trends relative to the commitments customers have made. Maybe one other comment on that is we are also coming to the end of the COVID. We have a few quarters left of [COVID] renewals, but it is already significantly down and weight in our business, and so that's coming to an end, which is positive.

Michael James Turrin
Wells Fargo Securities, LLC, Research Division

That's all super helpful. And then maybe one more on just the leading indicator side. I appreciate it's noisy, but if we look at billings this quarter, it's down sequentially last quarter. You talked about -- it wasn't early renewals. It was just kind of the timing of renewals, having some improvements. So did that maybe help Q2 relative to Q3? Or just help us kind of square the seasonal trends and what can drive the volatility from quarter-to-quarter on that metric?

Blake Jeffrey Grayson
Executive VP & CFO

Yes, you bet. So right, Q3 billings growth of 5% relative to Q2 of 10% year-over-year. So really pleased with the Q3. We came in above our expectations on that. But the detail like you're asking about from Q2 to Q3, it's really driven, I would say, by 3 primary areas.

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The first is we have a hard comp in Q3. If you look back at our historical results, I think our Q3 billings growth in fiscal '23 was up 17% -- around 17% year-over-year. And that was the highest in fiscal '23. And that was driven by a year ago, we had a pretty strong early renewals kind of momentum that grew that billings number in Q2 of the prior year.

Now we're still doing well this year with regard to our renewals, it's just a hard comp that we're having to deal it. The second item is what you talked about, which is that on-time renewal impact. And as I discussed in the last call and my predecessor discussed on the call before that, the benefit that we've had in the higher on-time renewals in the first half of '24. It just -- you have a smaller impact as you go through the year in the second half. And so it's really primarily a timing issue. And so we're still doing actually really quite well on on-time renewal execution.

The team is doing a great job with it. It's just a smaller impact on year-over-year growth as we progress through the year. And then the final -- the third thing that impacts that billings number, frankly, is just lower expansion rates, right? I mean IT budget scrutiny and people that are sitting in my seat are asking the right questions, which is how do I do more with less, where are the places that I can manage costs well, it's -- I mean, I'm doing it here, frankly, in my role as an operational CFO.

And that, along with macro impacts overall billings growth, and it's evident in those DNR rates. But as Allan mentioned and I have mentioned already, like we are seeing those consumption trends that we saw some marginal improvement quarter-over-quarter. And it's still early for us. We got to see that hopefully hold here for the next few quarters. But things are also improving, but that's just really the dynamics of the decel and year-over-year growth between Q2 and Q3.

Operator

Our next question is from Tyler Radke with Citi.

Tyler Maverick Radke
Citigroup Inc., Research Division

Yes. I'm not sure if this is -- who this is for, but I guess as we think about the product set for next year, obviously, there's a lot of organic investments you're making on the Gen AI side. Can you just talk about how you expect that the product set available products and upsells to evolve next year? And with the launch of some of these Generative AI services, how does that kind of change the philosophy around still kind of offering an envelope base signature product rather than something more subscription base that's not [tight to] envelope?

Allan C. Thygesen
CEO & Director

Yes, there's several points in there. First, I'd just say, look, our CLM business is growing faster than our Signature business, and I expect as we launch this broader high intelligent agreement management platform to a broader set of customers that, that pattern of that broader category growing faster will continue. The second point you made about the envelope versus subscription basis. We are, in fact, already experimenting with should we say, unlimited envelope billing models for a variety of customers. So for very large customers, we have entered into some enterprise license agreements. And those have been, I think, quite helpful at one very large bank that we did one with as they -- after they signed that agreement, they proceeded to remove a competing solution from some of their workflows.

And I think we have that opportunity across some of our very large customers. And then in the commercial segment, the mid-market and SMB segment, we're now competing more directly with some of our lower-priced competitors who have offered unlimited envelope packages. And not surprisingly, if you give people a competitive unlimited envelope from DocuSign versus a lesser branded, less well featured product and they choose DocuSign. And so we're seeing really, really positive results and to the point where I expect that we will continue to broaden that rollout.

So overall, I'm feeling quite good about our evolution and our response to competition on multiple fronts. As well as the broadening of our product road map that you alluded to in the first part of your question.

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Tyler Maverick Radke
Citigroup Inc., Research Division

Okay. Great. And Blake, maybe a question for you on free cash flow. So very, very strong here in the quarter relative to consensus expectations. How should we be thinking about just free cash flow for the full year, was there any onetime items in that number? And as you think about next year, what seems to be kind of an increased operational discipline, should we be thinking about free cash flow margins expanding kind of consistently with operating margin expansion? Just any way to think about that medium-term framework?

Blake Jeffrey Grayson
Executive VP & CFO

Sure. So yes, really happy with the $240 million cash flow that was generated this quarter.

It's a combination of just ongoing strong operating results. But we also did have some working capital improvements that impacted that number. When you look at the cash flow statement, you're going to see there the changes in operating assets and liabilities, and we've really had a strong improvement on the collection side on AAR. And so that's great. And so that it drives it. And then I said this in the prepared remarks, comparing to prior year can be a little tricky because of the ERP transition that happened prior year.

So we had a more muted free cash flow generation number. But regardless of that, really excited about the free cash flow we got. Now to your question on the yield, it was really strong. It was 34%. And while I'm a big fan of the working capital tailwind and I'm really proud of the team for the discipline and the improvements there, that can be something that's challenging, right, to pile onto every year going forward. There's always some good working capital improvements you can make.

But I think that if you think about this business in the long term, it's probably fair to assume that your free cash flow yield trends a lot closer to your operating margin yield. So as long as you make operating margin improvements, you should be able to capture most of that right down to the free cash flow line. But then also in this business, the beauty of this business from a free cash flow perspective is that if you can drive operating margin improvement and you can drive reaccelerated billings growth because of the way our working capital works, your free cash flow generation can really accelerate.

And so like this is over much longer-term period that I'm talking about, but it is the power of this model, which is super exciting. And so I do think, though, like, I mean I think in the span of time, you would think free cash flow yield should trend closer to your operating margin yield that we've been. We've done better than that and free cash flow pretty significantly better than that and free cash flow this quarter, but it's mostly on the back of those working capital improvements or not mostly, but a large chunk of it. And so you have to be cautious about assuming that you're going to expand on those every quarter.

Operator

Our next question is from Karl Keirstead with UBS.

Karl Emil Keirstead
UBS Investment Bank, Research Division

Okay. Great. I'd love to go back to the comment when you were describing the puts and takes on the vertical side when you mentioned that FINS felt a little bit more pressured or impacted. Just curious, was that a comment about the more rate-sensitive mortgage-related transactions? Or was that a broader comment on FINS. And I'm wondering if your fourth quarter guidance reflects any anticipation of the FINS vertical stabilizing?

Allan C. Thygesen
CEO & Director

Yes. I'll just start, and Blake, you can add. Look, I think in terms of the mix impact of financial services, in that's mostly behind us, but we have experienced that over the last several years, both on the

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mortgage side and financial services industry. And we saw some in the smaller banks, for example, that IT spend froze with all the turmoil in the spring, some of the very largest banks have also had particularly aggressive cost management efforts. I'd say, overall, we've seen some modest recovery. It's still growing a little slower than the business overall, but trending better.

And we'll see what happens with interest rates. Our current forecast assumes that macro conditions continue as they are. I recognize there's optimism they may get better. We'd love that, but we don't want to include that in our guidance.

Blake Jeffrey Grayson
Executive VP & CFO

Yes. Just to follow up. My general philosophy is I don't make macro forecast as a team because it's just like I think we joked about it earlier on the call, it's a hard business to get into. And so we forecast what we see. And so if things were to change one way or the other, we would then have to -- we'd speak to that variance.

Operator

Our next question is from Patrick Walravens with JMP Securities.

Patrick D. Walravens
JMP Securities LLC, Research Division

Great. And congratulations on the business turning here. It's great to see. So Allan how is DocuSign's relationship these days with Salesforce? Historically, I know it's been really strong. The reason I ask is during Dreamforce. This year, they had a session on sales force contracts, and we sort of laid out the road map for Salesforce contracts where they have AI functionality coming in the spring and then obligation management in the summer and then red lining the year after that. So I'm just wondering how are things with Salesforce?

Allan C. Thygesen
CEO & Director

I think our relationship with Salesforce is strong as ever. We renewed our strategic partnership this summer. I was just over there in meeting with one of the senior executives yesterday. It's a very healthy relationship at every level. And we have probably more -- we have certainly a more Salesforce enabled business then with any other software partner that includes other very large software companies. So Salesforce has been a terrific partner, and they remain that. On the CLM side, yes, they certainly have a contracts often covering out. They previously offered that in their vertical products, and now they're generalizing it somewhat.

I think that the challenge is that the market is moving to a horizontal model by which I mean 2/3 almost of all the CLM RFPs that we see are for cross-functional contract management. In other words, a single centralized contract management system across, let's say, procurement front of the house, HR, et cetera. And that will be hard for Salesforce or other even very large companies that are focused on one particular workflow or another.

And so I expect that we will continue to collaborate very closely with Salesforce on both the Signature side and the CLM side. And I'm not too worried about the Salesforce contracts piece. But never under estimate Salesforce. They're a fantastic company and partner.

Operator

Our next question is from Kirk Materne with Evercore ISI.

Kirk Materne
Evercore ISI Institutional Equities, Research Division

Allan, I was wondering you just double-click a little bit on the international opportunity. You called it out in the prepared remarks. Is that largely sort of PLG led right now? Or are you thinking about sort of bringing

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more direct sales into play over in certain geographies. Can you just give us some sense of how you view that opportunity, given you're obviously less penetrated outside the U.S.?

Allan C. Thygesen
CEO & Director

Yes. It's actually a full omnichannel thing and it's very market context specific. So first of all, we have a substantial amount of direct sales teams deployed in some of the major international markets U.K., France, Germany, Australia, and we service Canada, obviously, Brazil, a meaningful size team there as well and is patterning of folks in other markets. So historically, that was our principal go-to-market model. We're now really balancing that across direct investment where we can put enough wood behind the arrow and there's enough return on that investment. And then a combination of a digital motion which we can obviously serve 180 countries that way.

And then a partner motion in countries where we -- where it makes sense to leave with that. So you took a smaller developing market, let's say, it wouldn't make sense for us to put a direct sales team on the ground, but we wouldn't be able to fully exploit the opportunity strictly through a digital only motion. And so I think we have tremendous opportunity on both of those fronts. And we are seeing growth both in our digital channels, where international is growing faster than domestic and in our direct channels where it's growing fast and domestic.

So we'll continue on that. Just to return to a theme from prior calls, as we looked at prioritization and where we're really going to put additional investment, both from a direct sales standpoint, but also in all the various supporting functions that are necessary to really have an effective go-to-market motion. We prioritized investing in Germany and Japan, which were markets that where we had some level of direct sales investment where we hadn't invested in this aggressively in marketing and back-office functions like legal and finance or in product.

And so that has been a priority since the spring. And we're making really good progress in both of those markets. I mentioned last time, we opened our office in Munich. We have an office in Tokyo. We have launched localized products for several of those markets mentioned the Japanese CLM product that we shipped here a couple of months ago, a lot of the identity verification stuff, and were more stuff coming here shortly in that round. They're targeted at EU in general, in Germany, in particular.

And so we are investing aggressively I would say, in a direct sales motion maybe our top 10 markets globally and then a combination of partner and digital throughout other markets where we can. There'll be some very long tail countries where we can only serve with the digital motion but that's how we approach it.

Operator

Our next question is from Mark Murphy with JPMorgan.

Sonak Kolar
JPMorgan Chase & Co, Research Division

This is Sonak Kolar from Mark Murphy. Allan, can you provide an update on any changes you may be seeing in the competitive dynamics for the eSignature market, particularly towards the lower end market that you called out in the past? Just curious if there's a sense that DocuSign [indiscernible] efforts are helping with the retention and competitive wins, particularly within those users of basic eSignature use cases?

Allan C. Thygesen
CEO & Director

Yes. I think the dynamic is as I've described in previous quarters, I don't see a material change. So with larger clients, we may see local competitors in certain international markets, Adobe and some of them and then the smaller clients, it's just mattering of a variety of names that are maybe less familiar. And I think we are -- I'm not seeing any change in our win rates in competitive deals. And I'm cautiously optimistic

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with some of the initiatives I referenced earlier in terms of our new pricing and packaging that we are responding pretty effectively at both ends of the market.

And then lastly, I just mentioned at the very low end, if you will, where it's really being embedded in workflows, We've dramatically upgraded our solutions for ISVs to embed DocuSign, and we've adopted a more flexible billing model that we refer to as pay as you go and that saw some very nice accelerated growth here since the launch in Q2. So on multiple fronts. I'm feeling that we're doing pretty well, and I'm not seeing a material change in the competitive dynamic.

Operator

Thank you. There are no further questions at this time. I would like to hand the floor back over to Allan Thygesen for closing comments.

Allan C. Thygesen
CEO & Director

Thank you. Thank you, operator, and thank you all for joining today's call. So this quarter, DocuSign was especially effective at making progress on our product initiatives while balancing those investments with operational efficiency. So we are continuing to build on our considerable scale as we expand beyond eSignature into intelligent agreement management.

Thanks for your time. Look forward to seeing all of you next quarter.

Operator
This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation. Goodbye.

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