S&P Global
Market Intelligence

HubSpot, Inc. NYSE:HUBS

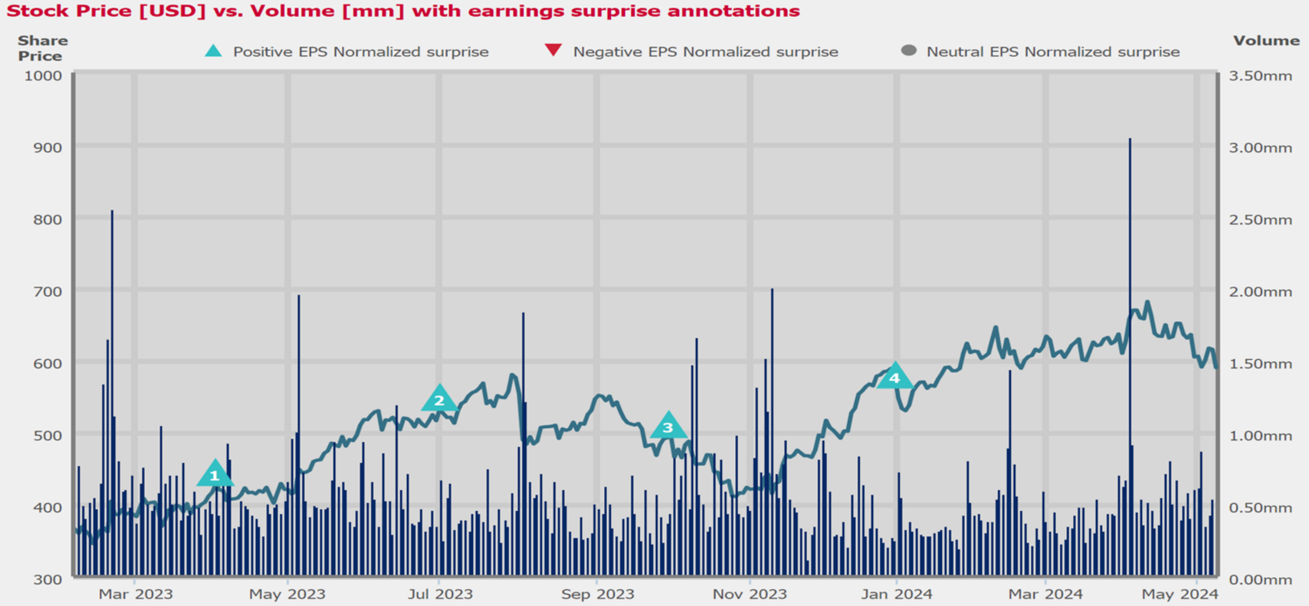
FQ1 2024 Earnings Call Transcripts

Wednesday, May 8, 2024 8:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2023-			-FQ1 2024-	-FY 2023-			-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	1.55	NA	NA	1.50	5.68	NA	NA	6.97
Revenue (mm)	558.75	NA	NA	598.23	2147.01	NA	NA	2564.88

Currency: USD
Consensus as of May-07-2024 4:04 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2023	0.83	1.20	1 44.58 %
FQ2 2023	0.99	1.34	2 35.35 %
FQ3 2023	1.24	1.59	3 28.23 %
FQ4 2023	1.55	1.76	4 13.55 %

Table of Contents

Call Participants

EXECUTIVES

Dharmesh Shah
Co-Founder, CTO & Director

Kathryn A. Bueker
CFO & Treasurer

Ryan Burkart

Unknown Executive

Yamini Rangan
CEO, President & Director

ANALYSTS

Aleksandr J. Zukin
Wolfe Research, LLC

Bradley Hartwell Sills
BofA Securities, Research Division

Elizabeth Porter

Gabriela Borges
Goldman Sachs Group, Inc., Research Division

Hoi-Fung Wong
Oppenheimer & Co. Inc., Research Division

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Keith Frances Bachman
BMO Capital Markets Equity Research

Kirk Materne
Evercore ISI Institutional Equities, Research Division

Mark Ronald Murphy
JPMorgan Chase & Co, Research Division

Michael H. Berg
Wells Fargo Securities, LLC, Research Division

Rishi Nitya Jaluria
RBC Capital Markets, Research Division

Samad Saleem Samana
Jefferies LLC, Research Division

Tyler Maverick Radke
Citigroup Inc., Research Division

Unknown Analyst

Presentation

Operator

Good afternoon, and welcome to the HubSpot First Quarter 202 Earnings Conference Call. My name is Harry, and I'll be your operator today. [Operator Instructions]

And I will now hand over to Ryan Burkart, Senior Director of Investor Relations, to begin. Please go ahead.

Ryan Burkart

Thanks, operator. Good afternoon, and welcome to HubSpot's First Quarter 2024 Earnings Conference Call. Today, we'll be discussing the results announced in the press release that was issued after the market closed. With me on the call this afternoon is Yamini Rangan, our Chief Executive Officer; Dharmesh Shah, our Co-Founder and CTO; and Kate Bueker, our Chief Financial Officer.

Before we start, I'd like to draw your attention to the safe harbor statement included in today's press release. During this call, we'll make statements related to our business that may be considered forward-looking within the meaning of Section 27A of the Securities Exchange Act of 1933 as amended and Section 21E of the Securities Exchange Act of 1934 as amended.

All statements other than statements of historical fact are forward-looking statements, including those regarding management's expectations of future financial and operational performance and operational expenditures, the ability to realize the anticipated benefits of the Clearbit acquisition, expected growth, FX movement and business outlook, including our financial guidance for the second fiscal quarter and full year 2024.

Forward-looking statements reflect our views only as of today. And except as required by law, we undertake no obligation to update or revise these forward-looking statements. Please refer to the cautionary language in today's press release and our Form 10-Q which we expect to file with the SEC on Friday, May 10. For a discussion of the risks and uncertainties that could cause actual results to differ materially from expectations. During the course of today's call, we'll refer to certain non-GAAP financial measures as defined by Regulation G. The GAAP financial memos directly comparable to each non-GAAP financial measure used or discussed and a reconciliation of the differences between such measures can be found within our first quarter and fiscal year 2024 earnings press release in the Investor Relations section of our website. Now it's my pleasure to turn the call over to HubSpot's Chief Executive Officer, Yamini Rangan. Yamini?

Yamini Rangan
CEO, President & Director

Thank you, Ryan, and welcome to everyone joining us on the call. I'll begin by sharing our Q1 2024 results, update you on what we are seeing from a demand perspective and wrap up by highlighting our recent product launches from the spring spotlight and our ongoing efforts to accelerate innovation for our customers.

We kicked off the year with solid revenue growth of 23% year-over-year in constant currency. We delivered another good quarter, operating margin growth with 120 basis points of margin expansion year-over-year, driving our operating margin to 15%. Total customers grew by 22% year-over-year to over 215,000 customers globally, driven by over 11,700 net customer additions in the quarter. I am thrilled to see more customers consolidating on HubSpot as their preferred customer platform for growth.

Our Q1 results highlight consistency in why we win. Customers across all segments are consolidating on HubSpot because it is easy to use, easy to scale and delivers fast time to value. In the lower end of our segment, we saw continued strength in net customer additions driven by free users upgrading to starter and pricing optimization plays, including our seats model change, driving starter and pro customer growth.

In upmarket, the big themes of the quarter were continued strength in Sales Hub and multi-cup as customers consolidate on HubSpot as their platform of choice. Sales Hub is emerging as a clear winner driven by the innovative features we launched at INBOUND. Our customers are adopting the new prospecting workspace and advanced sequences as a way to drive better alignment between marketing and sales. In addition, we have opened up our smart CRM to support UI customization, deliver broader governance and permission capability and deeper integrations like the sync with LinkedIn Sales Navigator, which is driving up-market momentum.

Our land and expand strategy is working, and we have 3 main front doors for customers. Marketing Hub, our original hub, where we continue to innovate. Sales Hub, where we see huge momentum. And multi-hub as customers consolidate on HubSpot. Over 35% of

Pro plus customers are now on 3 or more hubs, and we have more room for growth as we drive innovation. We're thrilled to see the continued momentum in Sales Hub and multi-hub and it's a clear validation that our strategy of going from app to suite to customer platform is working.

Switching gears to macro. After a strong finish in Q4, we saw a return to weaker demand conditions in the first quarter, similar to what we experienced in 2023. The buyer urgency that we saw in December did not carry over into Q1. Instead, we saw a return to higher scrutiny of budgets, more decision-makers getting involved and a need for more demos and proof of concepts before signing on purchase decisions. At the top of the funnel, we saw lead flows shift away from higher quality inbound and partner-sourced leads to lower quality rep source leads. This shift plus the lower buyer urgency slowed down deal progression and, in some cases, push deals out of Q1 and into Q2. While deal close and upgrade rates remain under pressure, we continue to see strong customer dollar retention in the high 80s, which underscores the value that our unified customer platform delivers for our customers.

Now for an update on seats. In early March, we introduced a pricing change based on seats to lower the price points to get started with HubSpot and remove the pricing friction for customers to upgrade from starter to professional edition. While we continue to be very excited about the model change for our customers on HubSpot, the timing and speed of the change caused a negative impact on our business in March that will likely persist for a couple of months. As a reminder, we expected this change to lead to lower initial ASP, higher volume of customers and higher rates of upgrades over time.

In March, we saw faster adoption of the seats model by customers, which led to a more immediate impact of lower ASPs, but a slower pickup in the volume of new customers. We're seeing more positive trends in April, but it's going to take a few months for the higher volume of additions to offset the initial lower price. Having said that, I want to be clear that we have high conviction that seats pricing change is the right decision for our customers as it will allow them to get started and scale more easily with HubSpot. And it is the right decision for HubSpot as it will allow us to bring many more customers onto our platform, grow our net revenue retention rate as customers add more seats over time and align pricing with the value we are creating from our AI-powered smart CRM

Okay. Let's talk about product innovation, which has been a consistent theme over the past few years and gives me high confidence in our ability to drive durable growth. The pace of innovation has accelerated in our industry with AI, and we are setting that pace for scaling companies. Innovation is happening in days and weeks, not months or years. Marketing sales and service teams are going through a major technology shift. But keeping up with that innovation can be a full-time job in and of itself. So to make it easy for our customers to stay ahead, we've decided to have not 1 but 2 big launches each year, INBOUND and Spring Spotlight. You all have seen INBOUND and our customers love the innovation that comes out each year. In April, we launched our first Spring Spotlight that featured over 100 new product releases with over 70 AI features. And we saw over 200 million earned media impressions and nearly double the engagement rate on social channels compared to INBOUND 2023. Super exciting.

I want to highlight 3 big areas of innovation from our Spring Spotlight for you: Content Hub, Service Hub and HubSpot AI. HubSpot give a better way to grow with INBOUND marketing, and we are now doing it again by reinventing content marketing. We're taking CMS Hub, which used to be about website and digital presence and transforming it into Content Hub, powered by to create and manage content across the entire customer journey. As part of Content Hub, AI content creation to make it easy to create multilingual content. Content remix to make it easy to create full pipeline of content based on a single asset. And brand voice to make it easy to generate content that has consistent brand voice. Our goal is simple. We want AI to power every content use case and light the way into the future of content marketing.

Let's talk about Service Hub. I'm really excited about the innovation here. We believe that delighting our customers is even more important than acquiring new customers. So we're relaunching for Service Hub to bring customers support and customer success teams together. To help scale customer support, Service Hub now includes advanced SLAs, more robust routing and support management tools. To help customer success teams drive retention, we launched a new customer success workspace that can help CSM track their pipeline and see customer health scores with clear next steps. Service Hub now includes more than a dozen ARR tools like GPT powered chatbot, real-time recommendations and call summaries to speed up resolution. We're embedding AI to make Service Hub even more valuable and delivering a unified customer platform. As one of our customers by bringing marketing sales and service teams together on HubSpot, we're removing the guesswork for our leaders and giving them the confidence that customers are getting what they need.

As we set the pace of innovation with AI and across all hubs and our customer platform, we are keenly focused on driving adoption and usage. Adoption has continued to increase with over 50% of enterprise portal using AI along with over 25% of Pro portals. Customers are leveraging AI for personalized content generation, call summarization and are automating their go-to-market motions to drive productivity and growth. There is a lot more room to drive repeat usage, and we are laser-focused on helping our customers grow with HubSpot AI.

Overall, we're still in the early innings of transforming from a suite to a customer platform. We're becoming the de facto standard for scaling companies, and we are setting the pace of innovation with AI. This gives me confidence in our ability to drive long-term durable growth. With that, I'll hand it over to our CFO, Kate Bueker, to take you through our financial and operating results.

Kathryn A. Bueker
CFO & Treasurer

Thanks, Yamini. Let's turn to our first quarter 2024 financial results. Q1 revenue grew 23% year-over-year in both constant currency and on an as-reported basis. Q1 subscription revenue grew 23% year-over-year, while services and other revenue increased 15% on an as-reported basis. Q1 domestic revenue grew 21% year-over-year. International revenue growth was 24% in constant currency and 25% as reported, now representing 47% of total revenue. We added over 11,700 net new customers in the quarter, including the onetime addition of nearly 800 customers from the acquisition o Clearbit. This brings our total customer count to over 215,000 and growing 22% year-over-year, fueled by our continued strong starter customer additions.

Average subscription revenue per customer was $11,400, flat in constant currency and up 1% year-over-year on an as-reported basis. We continue to see a positive impact on ASPs from multi-hub adoption of our professional and enterprise customers, offsetting the impact of large new cohorts of low ASP starter customers in recent periods. In addition, Clearbit added approximately a 1 point benefit to ASP in Q1. As I shared in February, we expect to maintain net customer additions around $10,000 per quarter throughout 2024 with ASRPC down low single digits in constant currency.

Gross retention held in the high 80s in Q1, and net revenue retention was 101% or 102% if you remove the impact of Clearbit in the quarter. While we have seen a stabilization in downgrade rates over the last couple of quarters, customer upgrade rates were more challenged in Q1. We expect similar trends to continue in the near term with net revenue retention holding around current levels throughout 2024. Calculated billings were $641 million in Q1, growing 22% year-over-year in constant currency and 20% as reported. The remainder of my comments will refer to non-GAAP measures.

Q1 operating margin was 15%, up 1 point compared to the year ago period. We continue to see solid progress towards our intermediate operating margin targets across the business. Net income was $89 million in Q1 or $1.68 per fully diluted share. Free cash flow was $104 million in Q1 or 17% of revenue. Finally, our cash and marketable securities totaled $1.8 billion at the end of March.

In connection with the quarter close, we discovered an error in our calculation of cost of goods sold related to how we calculate a credit in our holding agreement with AWS. As a result, we overstated our subscription cost of goods sold by a total of $14 million since Q4 of 2021. Calculating this correctly resulted in a $2 million pickup to operating income in each of Q1 2024, in Q1 2023. As you update your models, you should assume a positive $6 million contribution to operating income for the remainder of the year, which is included in our guidance. This had no impact on revenue, ARR, operating cash flow and free cash flow in the current or prior periods. We have concluded it was not material to prior periods and we'll be correcting the relevant financial statements for comparative purposes in our upcoming 10-Q, which we expect to file on Friday, May 10.

Before we dive into guidance, I wanted to touch quickly on the macro environment. As Yamini shared, we continue to operate in a challenging external environment and the buyer urgency we saw in December did not carry over into Q1. Customer decision-making is measured and budgets remain tight. Our guidance assumes that these weak conditions persist through 2024.

Now let's review our guidance for the second quarter and full year of 2024. For the second quarter, total as reported revenue is expected to be in the range of $617 million to $619 million, up 17% year-over-year at the midpoint. We expect foreign exchange to be a 1 point headwind to as-reported revenue growth in the quarter. Non-GAAP operating profit is expected to be between $92 million and $93 million. Non-GAAP diluted net income per share is expected to be between $1.62 and $1.64. This assumes 53.3 million fully diluted shares outstanding. And for the full year of 2024, total as reported revenue is expected to be in the range of $2.55 billion to $2.56 billion, up 18% year-over-year at the midpoint and consistent with our prior guidance. We now expect foreign exchange to be roughly a 1 point headwind to as-reported revenue growth for the full year. Non-GAAP operating profit is now expected to be between $426 million and $430 million. Non-GAAP diluted net income per share is now expected to be between $7.30 and $7.38. This assumes 53.5 million fully diluted shares outstanding.

As you adjust your models, please keep in mind the following. We still expect CapEx as a percentage of revenue to be roughly 4% and free cash flow to be about $365 million for the full year of 2024, with seasonally stronger free cash flow in Q4.

And with that, I will hand things back over to Yamini for her closing remarks.

Yamini Rangan

CEO, President & Director

Thank you so much, Kate. I want to close by sharing what keeps us grounded and excited about the future. We plan ourselves on not what is changing today but what will not change for our customers. Our customers will need easy-to-use solutions that can help them grow. Our customers will need us to drive innovation so that they can compete with bigger companies in the age of AI. This is exactly what we are focused on. Our customer platform is gaining momentum with more front doors like Sales Hub and multi-hub, and they remain focused on a massive opportunity to help millions of organizations grow.

Okay. I want to thank our customers, partners and investors for their continued support. And a huge thank you to all HubSpotters around the world for staying focused on solving for our customers every single day. With that, operator, let's please open up the call for questions.

Question and Answer

Operator

[Operator Instructions] And our first question is from the line of Samad Samana of Jefferies.

Samad Saleem Samana
Jefferies LLC, Research Division

it's great to see the healthy growth for HubSpot. A lot of other SMB software vendors have struggled and Hubs has been able to maintain that durable 20% plus growth. So it's good to see that. Can you help us understand how much of that is more traction with larger customers offsetting SMB weakness? And if that's the case, as we think through the rest of 2024, can market share gains in that 500 to 5,000 employee segment of the market keep powering this durable growth?

Yamini Rangan
CEO, President & Director

Samad, thank you so much for the question. Look, I think we're still operating in a very cautious buying environment. And we continue to see that caution across all of the segments within our customer base. Having said that, within the environment, customers are consolidating on fewer platforms, and we are the platform of choice for customers within this environment. That's why we have continuously leaned in on lower total cost of ownership, higher value, faster time to value, and that's been our playbook throughout kind of the soft period from a macro perspective. Now you asked kind of what we see in the 500 to 2,000 segment versus the lower environment, we're seeing kind of cautious strength in both, right? In the lower environment, we are removing friction. We are lowering the price and we are increasing the value. And if you look at the entire customer platform that we deliver for a starter suite customer, it is an exceptionally compelling value proposition, which is why we continue to see the net adds gain strength there.
And more importantly, what we really look for is when people buy HubSpot, they stay with HubSpot, which we see in that high 80s customer dollar retention. In terms of upper end of the segment, it is time to value. The number of conversations that I have with upmarket customers where they care about getting up and running and getting their teams using a customer platform in a few weeks instead of waiting for 8 months, 10 months, which is what happens with other legacy platforms, that is the reason we win. And we are doubling down in product innovation, but also doubling down in delivering the fast time to value. So it continues to be a environment, but we think it's -- in terms of durable growth, we are doing all of the right things in terms of going from app to suite to a platform. We're focused across all of the segments, and we are continuously focused on innovation with AI and embedding it into the platform.

Operator

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

Mark Ronald Murphy
JPMorgan Chase & Co, Research Division

So I'm curious if you have any sense of the underlying driver of the buyer urgency having picked up in December and then weakening during Q1, it seems like a bit of a quick oscillation there. And just in terms of the buyer behavior year-to-date, how does it feel if you compare it to 1 year ago when we were a little closer to the trend line changes for interest rates and inflation?

Yamini Rangan
CEO, President & Director

Mark, this is Yamini. Thank you for the question. Let me share kind of what we saw and maybe provide some contrast across the different periods that you mentioned. We saw choppiness in the environment in Q1. And very specifically, we saw tight budgets, more decision-makers, more meetings, more demos. And even for the first time, more proof of concepts before customers got ready to make purchase decisions. And as I mentioned before, this was different than what we saw in December, even accounting for the seasonality differences between Q4 and Q1, December felt more like an anomaly and it felt like in Q1 we are back to a very cautious buying environment. Now it certainly could be what you mentioned, which is just caution in terms of interest rates in the environment. So it felt more like what we saw throughout 2023, and December felt like an anomaly. So look, we know that month-to-month, quarter-to-quarter, the environment might look different, that's why we have consistently leaned on the same playbook, which is, in our case, the playbook is communicating business value, communicating the value of consolidating and lowering the TCO and driving a product road map, which is built in with innovation, so we continue to deliver the needs for the customers across these segments.

Operator

Our next question today is from the line of Alex Zukin of Wolfe Research.

Aleksandr J. Zukin
Wolfe Research, LLC

I guess I wanted to maybe dig in a little bit on parsing macro versus micro, if you think about buying urgency, sales cycles, demos, POCs and you separate that by SMB versus maybe upper market. Are you -- did you feel like the pricing change maybe elongated sales cycles at all? And then just a clarifying question for Kate. Any idea of Clearbit contributions to revenue and billings in the quarter?

Yamini Rangan
CEO, President & Director

Yes. I'll take that first question, Alex, in terms of parsing macro and pricing. So we talked about the seat change. We launched the seats change in March. And what we specifically saw was a faster adoption by customers of the seat-driving model. And compared to what we saw in ANZ and compared to what we saw in our pilot, we saw faster adoption. And that actually led to a faster decline in ASP, and we're beginning to see the velocity kind of like pick up to be able to offset that ASP decrease. And that is slightly different than the macro changes that we saw from the macro changes, you said it exactly right where the buying environment is cautious. The environment requires more meetings, more calls and more conversations before we get to the decision. And so I think it's very, very hard to kind of parse these out, but they both had slightly different impacts within the quarter. Kate, for the second part of the question.

Kathryn A. Bueker
CFO & Treasurer

Yes, sure. Alex, Clearbit drove about 1.5 points to revenue growth and billings growth in the first quarter, and we still expect that Clearbit will provide about a point of growth for the full year.

Operator

Our next question today is from the line of Carolyn Valenti of Goldman Sachs.

Gabriela Borges
Goldman Sachs Group, Inc., Research Division

This is Gabriela. I wanted to ask on how to think about the full year guidance and the impact of macro. So if guidance for revenue is the same, it sounds like the macro environment got a little bit worse through the quarter. So is there a company-specific dynamics to the positive that? Or have you always assume a little bit of room for macro degradation as we think about the full year?

Kathryn A. Bueker
CFO & Treasurer

Yes, Gabriela, thanks for the question. We are holding our full year guidance, and there are a few things that are leaving us to do that. The first one that you heard from both Yamini and I in the script as well as in some of Yamini's early comments on this call. Customers are still cautious about their sense, right? Deal cycles are longer, budgets are tighter and our foundational assumption and guidance is that this behavior will continue throughout 2024. There's also about $10 million of incremental FX headwinds from the strengthening of the U.S. dollar from this period over when we set guidance last time. And then the combination of the seat pricing model timing and the Q1 macro pressure is causing another $10 million or so of headwind in the quarter-over-quarter expectations. That said, there are some great things that we're seeing. Gross retention remains strong in the quarter. There are some marginal improvements in downgrade activity that we're seeing, particularly for seats and contacts. Our guidance philosophy hasn't changed. We want to have a high degree of confidence in the guidance that we share and we think we achieved that in what we put forward today.

Operator

Our next question today is from the line of Keith Bachman of BMO..

Keith Frances Bachman
BMO Capital Markets Equity Research

Yes. I apologize for the background noise at the outset. I wanted to come back to that for a second, and the last question and really focus on seats and pricing. And so you mentioned that, Kate, that the transition was maybe a $10 million headwind quarter-over-quarter. But how does that reflect as you think of the full year? Does the seat-based pricing actually turn into a tailwind because there's greater adoption as we get through the year, but maybe just talk about what happened during the quarter, but how do you see that transitioning as we get to exit run rate for the year?

Yamini Rangan
CEO, President & Director

Keith, this is Yamini. Let me maybe start with explaining what the changes and what we expect, and then Kate can take the second part of how this impacts our guidance for 2024. So just to step back, why did we make this change? We lowered the price of starter to make it easy for customers to get started with HubSpot. We removed seat minimums to make it easy for customers to upgrade to pro and enterprise. But the real benefit of the model. This is why we like it so much is it leads to fewer downgrades and more upgrades over a period of time. So in a nutshell, this pricing change allows us to acquire more customers who can start with exactly what they want and can buy more when they need it. And that is good for customers because it leads to healthier customer cohorts, it's really good for HubSpot. Now as we mentioned in the prepared remarks, what surprised us is that we saw a higher percent of customers adopt seats in month 1 compared to what we saw in the pilot. So we expected the ASP to go down, volumes to go up and offset each other immediately. But because more customers are adopting the model, we're seeing a sharper decline in ASPs, and it's going to take a couple of months for the volume of customer additions to catch up and offset that ASP decline. So there is a short-term trade-off, but we are very convinced that this is the right thing for customers. This is the right thing for HubSpot, and therefore, it's the right thing for all of you as investors. Having said that, Kate, I'll let you talk about the guidance point.

Kathryn A. Bueker
CFO & Treasurer

Yes. Let me add a couple of specifics to the overall story that Yamini shared. We expected to see customer ASPs fall as part of the seat model change. Because of the pace, it happened quickly in March. And we saw ASPs fall by 20% to 25%. This is very consistent with what we saw in the pilot that we ran in ANZ. In the pilot, we also saw an increase in deal velocity that roughly offset the lower ASPs. And so the end result there was that new customer ARR was basically neutral. And because of the sort of sharp pace of adoption, we did not see the velocity in March step-up enough to offset the lower ASP. Now April was better but not enough to make up the new customer ARR to be neutral. And April short-cycle deals, which are kind of a leading indicator to what we would see, actually look very similar to the pilot, which is highly encouraging. The other piece of good news is that the upgrade rate for customers that are on the new seats model is healthier and very similar to what we saw in the pilot in ANZ. It's about a 6- to 8-point improvement in net revenue retention depending on the addition. So the motion is accretive. It's just going to take a little bit longer than we initially thought for that to play out. And as a result, what we now expect is that the seat model change is going to be neutral to overall ARR for 2024.

Operator

Our next question is from the line of Rishi Jaluria of RBC.

Rishi Nitya Jaluria
RBC Capital Markets, Research Division

I apologize for any background noise. I wanted to dive a little bit deeper into Clearbit. Can you give us a sense for how traction with the product and the integration is going? And maybe how all the data that you're getting from Clearbit can play into your broader AI strategy?

Yamini Rangan
CEO, President & Director

Rishi, thanks a lot for the question. It's early days with Clearbit, but it's going really well. It's been 1.5 quarters since the team got integrated into HubSpot. Now if we take a step back, the vision that we have is really to bring that type of enrich data and powerful AI tools so that can drive insights into our entire customer platform. We think that this is a way for us to accelerate our overall customer platform vision. And we are seeing that play out. So Phase 1 of integration was really to bring the Clearbit product into the hands of our installed base customers. And that is going well. It's again early days. But really, the thing that we are excited about is natively bringing the company enrichment data, the instance data and the contact enrichment data natively into HubSpot, so it can power all use cases. And this is the way we see the world operating. When you start thinking about a campaign, you already have the information about the companies that look like your customers and then you can apply AI tools on top of that so that your campaigns can be supercharged. So the combination of enrich data, AI and a unified customer platform is really powerful, and we feel very good about where we are going in terms of that vision.

Operator

Our next question today is from the line of Elizabeth Porter of Morgan Stanley.

Elizabeth Porter

I wanted to ask again a question on the pricing change. It was great to see the faster pickup of seats by existing customers, but I wanted to double click on the volume of -- from the new customer side. What were some of the gating factors you think in attracting some of the new logos to the seat model? Is it just about education and the availability of the new model or just any willingness -- less willingness to pick up maybe new solutions? And then any go-to-market changes to kind of address that new customer side?

Kathryn A. Bueker
CFO & Treasurer

Why don't I just start, Elizabeth is a bit of a clarification. The -- we moved to the seats model pricing for new customers only at the beginning of March. The existing customers will begin being migrated over to the seats model in the back half of 2024. That's going to take some time. As we talked about last quarter, we're going to migrate customers at the same ARR at which they are currently on our platform. And then we will cap any increase on their subscription at 5% when they renew their -- the following time.

Yamini Rangan
CEO, President & Director

And look, I think in terms of your -- is there a resistance or is there something else that we need to be doing. Customers like the model, and they're adopting the model. But if you step back and think about it, it is a big change in terms of the actual go-to-market motion. Our reps need to drive even faster velocity. They need to be able to say which ones are starter customers with 1 or 2 seats versus Pro customers with more seats. And it takes us a minute to kind of like get that motion settled. Having said that, we have driven a ton of enablement of our entire go-to-market motion. We have provided clarity in terms of how this needs to get approached by partners as well as their reps. So I think it's going to take a minute for the model to settle in, but we're seeing the most important thing, which is customer adoption.

Operator

Our next question today is from the line of Kirk Materne of Evercore ISI.

Kirk Materne
Evercore ISI Institutional Equities, Research Division

Yamini, in terms of your partners, I mean, there definitely seems to be a lot of interest around AI more broadly. Is there any chance that proof of concepts can move into production and that can help upgrade rates by the end of the year? Or is it a longer-term dynamic? I know it's a bit of a guessing game, but I was just kind of curious about how you see the functionality you're bringing to bear with AI. You playing out over the course of the year. I realize it's a multiyear journey, but just kind of curious on how that dynamic is going thus far.

Yamini Rangan
CEO, President & Director

Yes, it's a great question. And so maybe two parts to the dynamic. One part of your question is like AI usage and adoption. And the other part is proof of concept. I would say the proof of concept is just a function of where we are from a cautious buying cycle perspective. Customers are looking at consolidating on our platform. They want to be very, very sure. And so there's like some additional proof of concepts there. In terms of AI, though, we have -- it's been about a year, right? Last year about this time is when we launched our first set of products. And most of the products are now in GA. In fact, in April, as part of our new spotlight, we launched about 70 additional AI features. And what we are seeing in terms of adoption is there are customers who are leading with AI. They're looking at like every single department within the go-to-market function saying, how can I leverage AI? And those customers are moving fast. And we can see that in terms of content use case adoption, we can see that in terms of service summarization as well as deflection of call adoption, and we can see that in terms of Sales Hub adoption of AI features. But then there are a whole set of customers who are either just getting out of experimenting or figuring out the first set of use cases and then getting value, and that is going to take time. So our focus this year is all about driving repeat usage. From a product perspective, we are focused on driving repeat usage. From a go-to-market perspective, we are focused on educating customers how their data is being used where they can drive productivity benefits as well as growth benefits. And so it's going to take a little while for the AI usage, but we are really happy with the level of innovation as well as leading customer adoption.

Operator

Our next question today is from the line of Parker Lane of Stifel.

Jeffrey Parker Lane
Stifel, Nicolaus & Company, Incorporated, Research Division

Yamini, addressing the top of funnel. You said you saw a lead flow shift away from high-quality INBOUND to partner source leads. With partner source leads to lower quality rep source leads, how would you characterize that lower quality rep source lead? Is that a particular type of customer that's showing up there? Is it those with worse retention characteristics, more characteristics or a combination of all of that?

Yamini Rangan
CEO, President & Director

Parker, great question. Thank you for asking you this question. Maybe I'll take a minute to explain what I meant. So what we saw in Q1 was a mix shift from INBOUND and partner source leads to more rep source leads. Now INBOUND leads are when customers come in, raise their hands and say that we have a need and we want to kind of move quickly. Partner source leads are and partners have had conversations with our prospects and bring us a qualified lead. These two lead types tend to be more qualified and more ready to purchase. Now in the beginning of the year, we saw a mix shift down from those two sources, and we compensated that by rep source leads. Our reps talking to customers, calling customers. Now the only difference is that the rep source leads takes more time to progress in the sales pipeline. It's not an immediate interest and ready to purchase customer that's coming into the pipeline. It takes more calls and more demand. So the characteristic is that it takes longer, especially to progress like larger deals. And so we saw that dynamic. But in terms of retention characteristics, it's pretty much the same, right? Once customers are part of HubSpot, they get onboarded and they get activated and we focus on kind of the usage. So hopefully, that explains that mix shift comment I made. Thank you, Parker, for the question.

Operator

Our next question today is from the line of Brad Sills of Bank of America Merrill Lynch.

Bradley Hartwell Sills
BofA Securities, Research Division

I wanted to ask a question around the AI road map here. Obviously, a lot of innovation that you've highlighted here that's going into the base product. I think in the past, you've said that you're kind of looking at some of the features that could go into premium-only versions. I'd just be curious if you're finding some use cases that you think are interesting that could do that? And what are your thoughts on just that being a catalyst? I know it's further out, but could that be a catalyst for premium mix and ASP growth? Just any of those dynamics, I think, would be great.

Yamini Rangan
CEO, President & Director

Brad, thanks a lot for that question in terms of like AI and how we're thinking about it. Maybe just to step back, our vision is to embed AI in all Hubs and through our entire platform. And that's exactly what we're doing. We are moving very quickly to build a robust roadmap of AI features and spring spotlight that we just launched and announced was full of those kinds of features. And if you think about our monetization strategy, it is threefold. When we embed AI across all Hubs and across our entire CRM, it drives adoption. We're seeing more people actually start with the full platform. They get exposed to AI, and we're beginning to see that lift in terms of overall adoption. The second thing, and you're absolutely right, we have talked about more features being at the pro and enterprise tiers. And in fact, we said that nearly 65% of the features that are becoming generally available in the first half of 2024, will be in the pro and enterprise tiers. And that's also where we are beginning to see more adoption. In the prepared remarks, I talked about 50% of enterprise customers experimenting and leveraging AI features and 25% of Pro customers are using AI features. And when you look at that, it falls into the bucket of content use cases, service use cases as well as guided selling use cases. So all of that shows that we are on the right path. And when we do that, we're going to see kind of the upgrade rates in terms of Pro as well as enterprise. It's still early days. And so our focus is usage, it's repeat usage and making it super easy for our customers to adopt and innovate with AI.

Dharmesh Shah
Co-Founder, CTO & Director

Just one quick note. This is Dharmesh. So if you think through last year, 2023 was the year of that ChatGPT and chatbot, and we were early to game with our chatbot product. This year is going to be the year of AgentAI, where we have AI software that can move to a higher level of abstraction take on higher order goals. And we -- that's what we're kind of marching towards, and we think that's even higher value functionality that we can add to the platform.

Operator

Our next question today is from the line of Michael Turrin of Wells Fargo.

Michael H. Berg
Wells Fargo Securities, LLC, Research Division

You got Michael Berg on for Michael Turrin here. I just wanted to ask on AI in the realm of competitive landscape in moving upmarket. It seems like you guys are moving at a very fast clip and kind of differentiated approach to AI. Has this helped any meaningful capacity in the competitive landscape, particularly upmarket?

Yamini Rangan
CEO, President & Director

So let me take that. Thank you for the question. Look, we have a very different approach for AI. And our approach, if you go back to 2014, we said everybody needs to have a great CRM. And if you look at like 2023 last year at INBOUND, we said everybody has to have a great AI-powered CRM. And so our approach has been embed all of the features into Hubs, embed all the features into the platform and make it super easy for our customers to start with AI features and continue to grow with AI features. I think it's a very differentiated strategy, one that leans into our strength of easy to use, fast time to value. And that's very different from a lot of the competitors that are on the path of charging for AI features or getting started with a services engagement. And one of the things that we have recognized about AI is this, go-to-market teams are -- they've had the same age old problems over multiple decades. They spend too much time looking at information. They spend too much time collecting and gathering instead of being in front of customers. They spend too much time capturing information that can then be part of handoff. AI creates a new approach to solving age old go-to-market problems. And we want to do it in a way where it is fundamentally easy for our customers to adopt. And so I do think that our approach is differentiated and our approach is going to help our customers adopt it faster. I don't know if Dharmesh, you have more to add there.

Dharmesh Shah
Co-Founder, CTO & Director

Yes. Just one quick note. So HubSpot, one of our core differentiators for a long time has been our unified customer platform. We have all the data in one place. And this makes it very differentiated from other players in the space where kind of step one in order to get value out of AI, you got to first figure out how to get all your data together and make sure everything sort of makes sense. From the get-go, HubSpot is already together, it's already unified. And so that's what makes it possible for us to kind of embed AI across the entire platform, make it available to hundred thousands of companies and learn from that feedback because we get adoption and usage very, very quickly. So I think we have a a very kind of HubSpot-specific take on democratizing AI, making it accessible and then learning really fast based on the usage and leveraging our customer data platform.

Operator

Our next question today is from the line of Ken Wong of Oppenheimer.

Hoi-Fung Wong
Oppenheimer & Co. Inc., Research Division

I wanted to dive in on NRR. With strong retention, downgrade stable, I guess, is it fair to assume that the potential pressure that's embedded is just purely a byproduct of upgrade? And then kind of secondarily, any reason to think that there was any hesitation from customers ahead of seat licensing rolling out to the base in the second half. I might have maybe kind of caused some pause on upgrade behavior?

Kathryn A. Bueker
CFO & Treasurer

Yes. Why don't I take that one? Net revenue retention in the quarter was 1.02 for the organic business. And when you add in the impact of Clearbit, it was 101. A couple of positive trends there. We've consistently seen that customer dollar retention has held for us really strongly in the high 80s, and we saw that again in Q1. The other thing that we've been seeing over the last couple of quarters is a stabilization in downgrades, particularly in seats and contacts. That said, and I think that we are not the only ones that you've been hearing this from, upgrade rates were particularly challenging in the quarter. Even with some of the early positive signs that we saw in seat expansion with the new pricing model, we did still see significant pressure in upgrade rates.

Operator

Our next question is from the line of Terry Tillman of Truist.

Unknown Analyst

This is Bobby Deon for Terry. Curious to learn more about the evolution of the customer success or following several promotions announced in early April. What was the thought process on leaving the Chief Customer Officer role on Could there be opportunities to drive more alignment between customer success, sales and marketing as a result?

Yamini Rangan
CEO, President & Director

Bobby, thank you so much for the question. Yes, we announced that our Chief Customer Officer, Rob, left early April. And you're absolutely right. We decided that we were going to flatten the organization and have marketing sales and customer success report directly into me. Maybe to step back a few years ago, we needed the Chief Customer Officer role, and we needed the role to bring together marketing, sales, customer success and set of their unified strategy. And you probably remember that 4.5 years ago, I joined, that was the first time that I took that role. And I'd say that, that strategy setting for the organization and more importantly, bringing marketing sales customer success together has been working really well at HubSpot. Now it's the time for speed and execution, and I'm really thrilled that we have a very deep bench of leaders with significant go-to-market as well as HubSpot experience who are stepping up to lead there. And as we mentioned in our press release earlier in April, we have Kip Bodner, who has been our CMO for a very long time, 9-plus years. And he is a leading voice within AI. He is stepping up and directly into the executive lead. And the same thing goes for Christian Kanneer, who's been with us for a very long time, has global perspective, used to lead our international sales and a couple of years ago to on the Chief Sales Officer. He's stepping up in to lead sales. And then John Dick, who has been an amazing leader at HubSpot for about 8-plus years in the marketing organization is stepping up to lead our customer success team, and he is deeply passionate about the full customer journey. So we're really fortunate to have a deep bench of leaders, and we decided that this is the right time for each of those leaders to step up directly. And we have that full clarity in terms of where we are going in terms of the strategy. So pretty excited and looking forward to each of their contributions.

Operator

Our next question is from the line of Tyler Radke of Citigroup.

Tyler Maverick Radke
Citigroup Inc., Research Division

Yes. Maybe I'll direct this at Kate. So obviously, just the color on the FX assumptions impacting the full year guide. But despite holding the full year guide constant, you were able to raise operating income guidance. So could you just talk about some of the incremental savings that you saw there? And whether there's any incremental FX impact on that, too?

Kathryn A. Bueker
CFO & Treasurer

Yes, Tyler, thanks for the question. I think you've heard this from me before, but we always try to really strike a balance between growth and profitability, and we continue to show progress against our profitability targets. We remain comfortable that we're going to be in a good position to hit the 18% to 20% target by 2026 and then our longer-term target of 20% to 25% profitability. But coming back to 2024, this is a year where we're going to return to a more normal hiring cadence throughout the year. We expect to end the year at about 10% growth from a headcount perspective. And we are investing disproportionately in R&D. We want to do that to drive innovation and to really plan -- continue to plant the seeds for long-term growth. You saw some of the the fruits there in the recent Spring Spotlight. And we're funding this through driving continued leverage in our go-to-market organization, particularly across CS marketing and our Partner Commission, in addition to just continued optimization of our real estate footprint. And so we expect that we'll be able to deliver more than 1 point of leverage concentrated this year in the back half.

Operator

Our next question today is from the line of Arjun Bhatia of William Blair.

Unknown Executive

This is Chris on for Arjun. I wanted to return to some of the commentary you made about demand. It sounds like it's pretty consistent with what we've heard from some of in the space. It seems like there was some softening in front office demand during the first quarter that was at least somewhat unexpected. Are there any areas of conservatism or sources of confidence in guidance that you'd like to highlight if these conditions were to continue to worsen?

Kathryn A. Bueker
CFO & Treasurer

Yes. Why don't I just sort of talk about how we approach guidance. As always, we endeavor to put forward guidance that we have a high degree of confidence that we can meet. We have a rigorous forecasting process. We have a rigorous guidance process that we've been using consistently for a very long time. We do a lot of scenario analysis to try to land on the guidance that we feel confident in our ability to achieve. And frankly, that reflects all of the risks and upsides that we see.

Operator

Our next question today is from the line of Brian Peterson of Raymond James.

Unknown Analyst

This is Jonathan on for Brian today. So you mentioned the strength in sales and marketing, specifically at front doors this quarter. We heard a little bit last quarter of some of the increased traction in Service Hub as an on-ramp, and I've heard that from partners as well. So just curious if that's still a trend you're seeing for Service Hub you had the conversation in the last 90 days?

Yamini Rangan
CEO, President & Director

Yes, certainly. I think that we -- when we think about front doors, you see 3 front doors, marketing, Sales Hub and then multi-hub. And if you look at the most common combination in multi-hub, it is marketing help and service. So we're beginning to see our customers kind of adopt the full platform and start with multiple hubs. And specifically, in terms of Service Hub, we made excellent progress this quarter, right? We officially relaunched Service Hub as part of our spotlight, and it's been extremely well received. Kudos to product team for making excellent progress there. And last year was a big year for Service Hub Pro. We did a ton of work to make the Pro very powerful. And this year, the focus has been on making all tiers of Service Hub, very competitive and powerful. And if you look specifically at the spring spotlight, we launched advanced SLAs, more robust routing and support management tools, and all of these are really aimed at serving our upmarket customers. So that enterprise tier just got even better. And then we also, for the first time launched our customer success workspace. This is for CSM or customer success persona, and we want to provide unified workspace for them to be able to manage their entire book and also be a conduit for connecting the sales teams and the support teams together. So I think that's a huge another area. And as always, we've been thinking about how do we like leapfrog Service Hub with AI capabilities, and we certainly see our customers adopt our AI features within Service Hub. So overall, I'm very pleased with the momentum in Service Hub, both from a product perspective as well as from a customer adoption perspective and really happy with the traction we see there.

Operator

Our next question is from the line of Michael Vidovic of KeyCorp.

Unknown Analyst

This is Mike on for Jackson Just quickly on the partnerships and your channel partners. You talked about seeing fewer partner source deals this quarter and having to rely more on direct sales sourcing. But I guess what are you seeing in terms of the different dynamics between, call it, your direct sales measure and your channel sales motion as it relates to the pricing change?

Yamini Rangan
CEO, President & Director

Yes. I think on the pricing change, overall, nothing specific in terms of the change between partner as well as direct sales. Now in terms of what we made as a comment earlier for partner source sales, on the partner side, we've seen great success with our core selling motion. And what that means is partners as well as our direct reps work together, and that coal selling motion is up 65% year-over-year. Now on the flip side, when that core selling motion is really strong, then partners spend a little bit of time, less time in generating and sourcing their own deals. And so we always want to have the right balance between that core selling as well as partner sourcing, which is exactly what we are focused on right now. So we're rolled out partner enablement. We have rolled out a ton of resources to make sure that our partners and our direct teams work in a way where both the core selling as well as the partner sourcing is in balance, and we're certainly seeing that in Q2.

Operator

Thank you. And with no further time for any questions, this will conclude the HubSpot First Quarter 2024 Earnings Call. Thank you all for joining. You may now disconnect your lines.