ABHEY LAMBA, VP Investor Relations

Thanks operator and good afternoon. Thank you for joining our conference call to discuss the results of our second quarter of fiscal 20. On the line is Andrew Anagnost, our CEO, and Scott Herren, our CFO.

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

During the course of this conference call, we may make forward-looking statements about our outlook, future results and strategies. These statements reflect our best judgment based on factors currently known to us. Actual events or results could differ materially. Please refer to our SEC filings for important risks and other factors that may cause our actual results to differ from those in our forward-looking statements.

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

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

And now I would like to turn the call over to Andrew.

ANDREW ANAGNOST, CEO

Thanks, Abhey.

Our great momentum from the first quarter carried into the second quarter, resulting in strong performance, with revenue, billings, earnings and free cash flow coming in ahead of expectations. We also crossed the $3 billion mark on ARR for the first time, which was driven by solid performance across all regions and products. Our last twelve months free cash flow of $731 million is the highest amount of free cash flow we have ever generated in a four-quarter period in the company's history. We performed well in the first half of the year, demonstrating focused execution and the strength of our recurring revenue model.

Although we continue to execute well and are not materially impacted by current trade tensions and macro conditions, we are aware of the current business and geopolitical environment that is causing uncertainty in the market. As we look across the next six months, we are taking a prudent approach to our outlook for the remainder of fiscal 20. However, we think the uncertainty caused by macro related events is only a short-term issue. We remain confident in our ability to achieve the fiscal 23 goals we have laid out for you. Our confidence is grounded in the value delivered by our products, their ability to help our customers differentiate via innovation and digitization, focused execution delivered by our partners and sales teams, and the significant strides we are making to capture the non-paying user community. I would also like to point out that although there are headlines of some impact from the current environment on a few industry verticals like Manufacturing, we outgrew competitors and gained share in the space. The Construction industry is also holding steady and continues to invest in innovative solutions, and we saw ongoing strength in Construction this quarter.

Before I offer you more color on strategic highlights during the quarter, let me first turn it over to Scott to give you more details on our second quarter results as well as details of our updated fiscal 20 guidance. I'll then return with further insights on the key drivers of our business, including Construction, Manufacturing and Digital Transformation before we open it up for Q&A.

SCOTT HERREN, CFO

Thanks, Andrew.

As Andrew mentioned, revenue, billings, earnings and free cash flow all performed ahead of expectations during the second quarter. Overall demand in our end markets was solid during the quarter, as indicated by our strong billings and revenue growth. Growth was driven by both volume and pricing, which is a result of the strong uptake of our products by new users as well as increased usage with existing customers. Sales volume of AutoCAD LT also remained strong. This has historically been a leading indicator of a potential demand slowdown. And as you can see, revenue from our AutoCAD and AutoCAD LT products grew 31 percent in the second quarter. AEC and Manufacturing revenue rose 37 percent and 20 percent, respectively.

Geographically, we saw broad-based strength across all regions. Revenue grew 32 percent in the Americas, 27 percent in EMEA and 33 percent in APAC, with strength across almost all countries.

We also saw strength in direct revenue, which rose 38 percent versus last year and represented 30 percent of our total sales, up from 28 percent in the second quarter of last year.

Before I comment on ARR, I want to remind you how we define ARR. ARR is the annualized value of our actual recurring revenue for the quarter, or said another way, it is the reported recurring revenue for the quarter multiplied by four. Total ARR of $3.1 billion continued to grow steadily and was up 31 percent. Adjusting for our fourth quarter acquisitions, total ARR was up 27 percent.

Within Core ARR, growth was roughly in line with total organic growth and was driven by the strength in product subscriptions. In Cloud, ARR grew 175 percent, propelled by our strong performance in Construction. Excluding $98 million of ARR from our fourth quarter acquisitions, growth in organic Cloud ARR, which is primarily made up of BIM 360 and Fusion 360, increased from 43 percent in the first quarter to 45 percent, which is a record for that product set.

We continue to make progress with our maintenance to subscription, or M2S, program. The M2S conversion rate of the maintenance renewal opportunities migrating to product subscriptions was in the high 30 percent range in Q2, which is higher than our historical rate. This uptick in the conversion rate was in line with expectations as our maintenance renewal prices went up by 20 percent in the second quarter, which made it significantly more advantageous for customers to move to subscription. Of those that migrated, upgrade rates among eligible subscriptions remained within the historical range of 25 to 35 percent.

Now moving to net revenue retention rate, during Q2, the rate continued to be within the range of approximately 110-120 percent and we expect it to be in this range for the remainder of fiscal 20. As a reminder, the net revenue retention rate measures the year-over-year change in ARR for the population of customers that existed one year ago, or base customers. It is calculated by dividing the current period ARR related to those base customers by the total ARR from those customers one year ago.

Moving to billings, we had $893 million of billings during the quarter, up 48 percent. The growth in billings was driven by strength in new customer billings, and strong renewals with continued momentum in our core products. And as we have said in prior quarters and in line with our plans, billings are also benefiting from a return to more normalized levels of multi-year agreements.

Remaining performance obligations, or RPO, which in the past we had referred to as total deferred revenue, is the sum of both billed and unbilled deferred revenue, rose 28 percent versus last year and 3 percent sequentially to $2.8 billion. Current RPO, which represents the future revenues under contract expected to be recognized over the next 12 months, was a little over $2 billion, an increase of 23 percent.

On the margin front, we realized significant operating leverage as we continue to execute in the growth phase of our journey. Non-GAAP gross margins of 92 percent were up 2 percentage points versus last year. Our disciplined approach to expense management combined with revenue growth enabled us to expand our non-GAAP operating margin by 14 percentage points to 23 percent while absorbing two meaningful acquisitions. We realized significant leverage from our investments in sales and marketing and R&D initiatives during the quarter and are on track to deliver significant margin expansion in fiscal 20 and further expand non-GAAP operating margin to approximately 40 percent in fiscal 23.

Moving to free cash flow, we generated $205 million in Q2. Over the last twelve months, we have generated a record $731 million of free cash flow, driven by growing net income and strong billings.

Lastly, we continue to repurchase shares with our excess cash, which is consistent with our capital allocation strategy. During the second quarter, we repurchased 253 thousand shares for $40 million at an average price of $159.54 per share. Almost all of our repurchase activity during the quarter was through our 10b5-1 plan, which we entered into before the most recent market volatility.

Now I'll turn the discussion to our outlook. I'll start by saying that our view of global economic conditions and their impact on our business has been updated to reflect the current state of various trade disputes and the geopolitical environment and their potential impact on our customers. While we have not seen any material impacts to our business, we are taking a prudent stance regarding customer spending environments in the UK due to Brexit, central Europe due to a slowdown in the Manufacturing industry there, and China due to trade tensions. These items individually are not material headwinds, but in the aggregate are responsible for our guidance adjustment, which now reflects our current views based on what we know about the environment today. Our pipeline remains strong globally, including in these regions, but we began noticing some changes in demand environments in these areas towards the end of July. As such, for these affected areas, we feel it is appropriate to adjust our expectations for the rest of the year. As you will soon hear from Andrew, customers continue to increase their spending on our products even in these areas and our renewal rates are fairly steady. Additionally, we are now assuming more billings will occur later in the quarter for the remainder of the year.

At the mid-point of our updated guidance, we are calling for revenue and ARR growth to be approximately 27 percent and 26 percent, respectively, which speaks to the resiliency of our model versus prior cycles. The wider than normal range of our full year guidance is a result of the greater uncertainty we are expecting over the second half of the year. Additionally, currency now offers a headwind of about $10 million to our full year revenues versus being neutral at the beginning of the year. As such, the low end of our updated constant currency guidance is in line with the low end of the initial outlook we shared with you at the beginning of the year and it also reflects the potential for a slight deterioration of the environment from the current level. While our billings guidance has come down by about $50 million, billings are still expected to grow approximately 50 percent, or 40 percent after adjusting for the adoption of the ASC 606 standard last year. This supports our view of strong demand for our products even in uncertain environments. Regarding free cash flow, the $50 million adjustment to $1.3 billion is primarily a result of our updated view of billings and their timing. We expect to achieve our original target of $1.35 billion trailing twelve months free cash flow during the first quarter of fiscal 21. While it is too early to give you detailed color on fiscal 21, we expect to continue growing billings, revenues, and free cash flows while expanding our margins. This is supported by what we are seeing in North America, especially in AEC, where our pipeline remains strong and we have more visibility into our business than in Central Europe and China. Construction is also performing very well, as we continue to increase the value we are bringing to our customers. And we continue to make strides with capturing revenue from non-paying users.

Looking at our guidance for the third quarter, we expect total revenue to be in the range of $820 to $830 million, and we expect non-GAAP EPS of $0.70 to $0.74. Third quarter free cash flow is expected to be modestly above the second quarter. The earnings slide deck on the investor relations section of our website has more details as well as modeling assumptions for fiscal 20.

In summary, I want to remind everyone that since our business model shift, we have moved to a much more resilient business model that generates a very steady stream of revenue that is less exposed to macro swings than when we were selling perpetual licenses. So while we are adjusting our fiscal 20 guidance slightly, we are still expecting revenue growth of 27 percent for the year, margin expansion of about 12 percentage points, and we are confident in delivering on our fiscal 23 targets.

Now, I’d like to turn it back to Andrew.

ANDREW ANAGNOST

Thanks, Scott.

As you heard, we delivered very strong performance in the first half of the year, and despite negative headlines from Europe and Manufacturing, we are still seeing strong demand for our solutions.

For example, a large European automobile company recently signed a new three-year enterprise business agreement, or EBA, despite a more challenging macro backdrop for their industry. They see the new agreement as an investment in design, as they know innovation is needed to stay ahead of the competition. They view Autodesk as a market leader in this area and count on us to provide new, innovative design solutions such as generative design. The EBA also offers them the flexibility to access our entire product portfolio, including products ranging from manufacturing and AEC collections to Alias, 3ds Max, Maya and Vault, while at the same time representing a more than 130 percent increase in annual contract value for us. We will continue to partner with them to ensure they get maximum value out of our products and remain a leader in an industry that is undergoing significant change.

Our customers know that at the end of every downturn is an upturn, and if they don't continue to innovate and use the latest technology tools throughout the cycle, they will be at a distinct disadvantage when growth returns. This underscores the importance of our products regardless of the macro environment as well as our customers' commitment to investing in technology to stay ahead of competitors.

Now, let me give you an update on some of key strategic growth initiatives we are focused on, specifically our continued traction within Construction, gains in Manufacturing and leveraging our Digital Transformation to capture the opportunity within our non-paying user base. These initiatives are key drivers of both our near- and long-term business.

In Construction, BIM 360 was the primary driver of our organic growth in Cloud, led by BIM 360 Design and Build. Our customers are continually finding value in this offering. And the PlanGrid team continues to see strong momentum. For example, Tutor Perini, one of the largest general contractors in the U.S., selected PlanGrid, over competitor offerings, for two $500 million key projects. The team wanted to provide real-time, up to date documentation and plans to the field. Senior management for these projects had used PlanGrid before at a different firm and this relationship provided an opportunity to demonstrate PlanGrid's capabilities for these two projects. PlanGrid set up the projects by processing the drawings and pulling out title block information, categorizing the drawings with tags, and hyperlinking detail call outs for 2,000 drawings in under an hour. This was an immediate time savings for Tutor Perini. Additionally, the field teams have access to new drawings, changes, RFIs, and submittals right away in an easy to use interface. Going forward, we continue to look for opportunities to partner with Tutor Perini across all their products and subsidiaries.

BuildingConnected and Assemble also performed well as we continue to focus on integrating these offerings. During the quarter, we integrated BuildingConnected's bid management solutions with PlanGrid technology, enabling the seamless transfer of data from preconstruction to the building process. The integration allows construction project managers to automatically push design and preconstruction files from BuildingConnected to PlanGrid, saving time, reducing errors and further enhancing the cost savings associated with using both platforms. And as you recall, we integrated Revit with PlanGrid with the launch of PlanGrid BIM last quarter and have received tremendously positive feedback from customers regarding the update. In the first quarter after its release, the product is also being used in over 650 projects by more than 300 customers. These integrations are steady steps towards providing Autodesk construction customers with integrated workflows that connect the office, trailer and field.

We are also continuing to see outstanding cross-selling with our recent construction acquisitions. For example, during the quarter, Chick-Fil-A, an existing Autodesk customer, expanded its relationship by adding BuildingConnected and Assemble solutions to reduce the time to open new locations and downtime due to construction updates in existing locations.

And as a reminder, infrastructure is an area that we have seen in the past perform well during macro related slowdowns and we continue to focus efforts in this area. This quarter, we secured a new Enterprise Business Agreement with Gannett Fleming. Gannett Fleming is a leading, global engineering and architecture firm, ranked #35 on the ENR Top 500 Design List. The Gannett Fleming executive team considers a strategic partnership with Autodesk to be a distinct competitive advantage. With the EBA, Gannett Fleming now has direct access not only to the full portfolio of Autodesk technology, but also to a wide range of Autodesk services and expertise that will help them achieve their corporate growth and market expansion goals.

On the manufacturing front, revenue grew 20 percent in the second quarter despite a more challenging manufacturing environment in Europe. Customers are seeing the benefits of our differentiated solution, and we continue to gain market share while displacing competitive offerings in the space. For example, during the second quarter, a leading Swiss watchmaker selected Autodesk's Design and Manufacturing Collection to replace Solidworks given the flexibility offered by our solutions. In addition, our investments in generative design and Fusion 360 have resulted in competitive displacements not only in the CAD market, but also in the computer aided manufacturing or CAM space where there are lower barriers to switching vendors. As a result, we see displacements of competitors like MasterCAM. Once we're embedded in those customers' downstream processes, we are increasingly penetrating design activities within those same accounts. Customers pick Fusion over competitive offerings due to its integrated CAD-CAM functionality, compatibility with other CAD tools, ease of use and the attractive pricing model.

Now, let's talk about progress with our digital transformation. Many of you recall that a key part of this transformation will increase the insight we have on our non-compliant user base. One of the initiatives we undertook to accomplish this started last year and has given us the ability to analyze usage patterns of our non-compliant users. Since last year, we have analyzed significant amounts of data on these users, including how long they use the software and how their journey traverses across non-compliant usage to downloading free trials or using student editions. With this data, we can test different ways to convert them, including in-product messaging and leveraging our inside sales team. While still early in the conversion process, we have an increasing amount of data that allows us to take necessary actions to convert this large pool of potential customers. In the quarter, we expanded our pilot cases for in-product messaging to many international regions and enhanced our license compliance initiatives using our sales team as well as via email campaigns. These conversations resulted in multiple deals, including two over a million dollars, one of which was in China. Our billings from license compliance initiatives were up by approximately 65 percent versus last year, although on a small base.

So, as you've heard, we made great progress this quarter that enabled us to finish the first half of the year strong. We continue to execute well in Construction where IT spending remains strong. We are making competitive inroads in Manufacturing with our innovative solutions and are making strides in converting the current 14 million non-paying users into subscribers. We are highly confident in Autodesk's ability to capitalize on our large market opportunity and are committed to delivering on our fiscal 23 goals.

With that, Operator, we'd now like to open the call up for questions.