ServiceNow, Inc. (NYSE:NOW)

Earnings Call Transcript

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Call Participants

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Presentation

Operator
Good day, ladies and gentlemen, and welcome to the Second Quarter 2012 ServiceNow Earnings Conference Call. My name is Deanna, and I'll be the operator for today. [Operator Instructions] As a reminder, today's conference is being recorded for replay purposes. I would now like to turn the conference over to your host for today, Mr. Robert Specker [ph], General Counsel. Please proceed.

Unknown Executive
Good afternoon, and thank you for joining us on today's conference call. The call is also being broadcast live over the web and can be accessed through the Investor Relations section of the ServiceNow website at investors.servicenow.com for the next 30 days. With me on today's call are Frank Slootman, Chief Executive Officer; and Michael Scarpelli, Chief Financial Officer.

After the market closed today, ServiceNow issued a press release with results for its second quarter ended June 30, 2012. If you like a copy of the release, you can access it online at our website. We would like to remind you that statements made on this conference call that are not historical fact may be forward-looking statements within the meaning of Section 27-A of the Securities Act of 1933, and Section 21-E of the Securities Exchange Act of 1934.

These forward-looking statements include among other things, information concerning our possible or assumed future results of operations, business strategies, financing plans, operating model, competitive position, industry environment, potential growth opportunities, potential market opportunities and the effects of competition. Words such as may, will, expects, intends, plans, believes, targets, estimates and variations of these words are intended to identify forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause our results to differ materially from those expressed or implied by such forward-looking statements. The risks and uncertainties include: Any weakening of general economic and market conditions and customers budgets for information technology spending, our ability to react to trends and challenges in our business and the markets in which we operate, our ability to anticipate market needs or develop new or enhanced products to meet those needs, our ability to scale our sales channels, our ability to recruit and retain personnel, our ability to compete in our industry and other risk and uncertainties described more fully in our documents filed with or furnished to the Securities and Exchange Commission.

All forward-looking statements are based on information available today, and we assume no obligation to update these forward-looking statements. Any future product feature or related specifications that may be referenced in today's call are for information purposes only, and are not commitments to deliver any technology or enhancement. ServiceNow reserves the right to modify future product plans at any time.

In addition, we will reference non-GAAP financial measures on this conference call. The company reports non-GAAP results for gross margins, operating margins, net income or basic -- net income or loss, basic and diluted income or loss per share, free cash flow and billings in addition to, and not as a substitute for or superior to, financial measures calculated in accordance with GAAP. Management believes that this supplemental non-GAAP information is useful to investors in analyzing and assessing the company's past and future operating performance. To see the reconciliation between these non-GAAP results and GAAP results, please refer to our press release filed earlier today.

I would now like to turn the call over to ServiceNow CEO, Frank Slootman.

Frank Slootman
Chief Executive Officer, President and Director
Thanks, Rob. Good afternoon, and thank you for joining us on today's call. I will start by summarizing the operating results for the second quarter. And since today's earnings call is our first as a public company, I'd like to run through a brief overview of ServiceNow, what we do, why customers choose us and how we gauge and progress. I'll recap some highlights of the quarter, and then turn it over to Mike Scarpelli, our Chief Financial Officer, for a more detailed look at the numbers and the outlook.

We were quite pleased with the company's performance in the quarter. We saw accelerating growth across many of our metrics, including revenue, which grew 93% year-over-year to $56.8 million, continuing a trend, with quarterly revenue growing by more than 80% year-over-year for the past 5 years. We're also pleased to report strong performance in both Billings and Deferred revenue, with total Billings for the quarter at $72.1 million, up 23% sequentially and ending the quarter with a Deferred revenue balance of $131.1 million, a 13% increase over the prior year quarter.

We're often asked, what does ServiceNow do? In basic terms, ServiceNow delivers a cloud software platform for implementing service-oriented applications. The applications that we built on this platform address the needs of IT

operations, management and infrastructure. On the operations side, we provide applications to automate the workflow of what IT people call "Incident, problem and change." It's a sequence of processes that deals with something that is broken, analyzing the underlying problem responsible for the incident, and then the change that is going to mitigate the problem.

On the Managerial side, we provide applications that are geared to IT executives that need analysis, dash boarding, and reporting of what's going on in operations.

On the Infrastructure side, we provide applications that are seen as foundational to IT and test the IT infrastructure itself. We provide a configuration management database that records all hardware and software assets and their relationships. It is seen as the single source of truth for the IT infrastructure, and it is essential for IT to function.

We also have the Discovery technology that populates and maintains the configuration management database. Runbook automation is our data center automation product that enables software automation of operational tasks.

All these applications have been developed from a common stem, a powerful underlying software foundation referred to as the platform. They all share 1 code base, 1 database, 1 set of user profiles. Because of that, we have addressed what has been the bane of the software professional's existence, namely the maintenance, poor function, and integration of a patchwork of software components provided by a myriad of vendors.

The single software foundation starts to answer the question, why so many enterprises are betting their IT management everyday on ServiceNow.

The platform makes applications in order of magnitude more flexible, extensible, consistent, scalable and supportable, compared to the legacy alternative our customers have had to contend with.

As of the end of the quarter, we are pleased to announce that ServiceNow has more than 1,200 customers, and we added more than 120 customers in the quarter. Our customer base is diverse in terms of revenue concentration, vertical industry and geography. We've also seen solid traction with very large enterprises and have established a footprint in approximately 11% of the Global 2000 enterprises as ranked by Forbes Magazine.

Our growth formula, consist of winning new customers, renewing current customer relationships, and expanding our presence in existing customer accounts. All in all, we are pleased with the growth we're seeing, especially considering the amount of revenue the company has already achieved. I'd like to spend a few minutes focusing on highlights of the quarter.

In May, we held our annual users conference called Knowledge, almost 2,000 attendees converged on New Orleans to share best practices and to discover how ServiceNow can bring additional value to the business. This record number is up from the almost 1,000 that attended last year's Knowledge conference. We believe Knowledge has established itself as the preeminent industry event focused on the use of cloud service automation, by enterprise IT. The event is not only an opportunity to share the ServiceNow story, it is a great forum for us to stay connected with our customer base. Our customers expect the best from our cloud service, and we are constantly improving the availability and security of our data centers.

During the quarter, we made significant progress in migrating customers from our Generation 1 data centers, which are in a managed service model, that gives us limited control over the infrastructure, to our Generation 2 data centers where we directly control our cloud infrastructure and its operations. We believe this will improve the reliability, security and scalability of our platform.

Additionally, we introduced what we call Advanced High Availability in our primary data centers. With Advanced High Availability, customer production data will be replicated in near real-time to a geographically remote data center. In the event of a service disruption, customer instances can be configured to fail over to an alternate data center. We believe ServiceNow Advanced High Availability is setting a new standard for cloud service availability and resiliency.

We believe a strong partner ecosystem enables customer satisfaction and growth of our business. During the quarter, we brought on KPMG as a global partner for implementation services, process design, process integration and IT organizational change consulting for ServiceNow customers. By establishing relationships with global system integrators, we gained deeper and broader reach into the yet-to-be-penetrated ranks of Global 2000 enterprises.

Without the great people of ServiceNow, we clearly wouldn't be where we are today. During the quarter, we continue to attract new talent, increasing headcount by 154 employees, and ending the quarter with 882 employees, a sequential increase of 21% and a year-on-year increase of 135%. We added employees in all functional areas with the majority landing in sales, research and development, and cloud infrastructure, which are focus areas for investment this year.

On a year-on-year basis, we've added 170 employees within our sales and marketing team, 108 in research and development, and 47 in cloud infrastructure. As we entered the second half of 2012, we could not be more excited about the opportunities ahead of that.

With that, I will now turn it over to Mike Scarpelli, our CFO, to take you through the numbers.

Michael P. Scarpelli
Chief Financial Officer and Principal Accounting Officer
Thank you, Frank. As Frank highlighted, we had a terrific second quarter. Let me take you through some of the numbers.

Our growth formula consists of winning new customers, renewing current customers and expanding our presence in existing accounts. During the quarter, we added 127 net new customers for a total customer count of 1,201 customers as of June 30, 2012. We had a renewal rate of 95%, and 36% of our total annual contract value signed came from upsells in our existing customer base.

In the future, as our customer base grows, we expect the mix of bookings from existing customers to increase as a percentage of total annual contract value signed as we further penetrate our customer base. We expect this metric will be lumpy as it can be swayed by a handful of large deals.

As Frank already mentioned, total revenues for the second quarter were $56.8 million, representing 93% year-over-year growth, and 20% sequential growth over first quarter revenues of $47.4 million.

Subscription revenues for the quarter were $46.8 million, representing 89% year-over-year growth and 18% sequential growth. As a reminder, we defer subscription revenue at the time of billing and recognize it ratably over the term of the contract. As a result of our recognition policy and back-end loaded bookings within each quarter, our quarterly subscription revenues are not significantly impacted by bookings within the quarter.

Professional services and other revenues were $10 million for the quarter, more than doubling from the same period last year, and growing 26% sequentially. Professional services and other revenues are generated primarily from fees related to the implementation and configuration of our subscription service, as well as training fees. Additionally, in the second quarter, it includes $2 million in registration and sponsorship revenue from Knowledge, our annual user conference. We generally recognize professional services revenue over the period in which the services are delivered unless there are acceptance clauses. As a reminder, $2.2 million of professional services revenues recognized during the first quarter were associated with engagements that required us to defer revenue until the project was completed and accepted by the customer. In the second quarter, we recognize Professional Services revenues of $0.8 million, associated with the acceptance of services. Most new contracts we are entering today for Professional Services do not have acceptance terms that would affect the timing of revenue recognition.

Total revenues, based on geography, were $40.7 million in North America, $14.0 million in EMEA, and $2.1 million in the rest of the world, representing 72%, 25% and 3% of total revenues respectively.

As Frank mentioned earlier, our total billings were $72.1 million for the second quarter compared to $58.6 million last quarter, representing 23% growth, which include the impact of Knowledge12. Additionally, approximately 16% of our billings in the quarter were for periods greater than 1 year.

Before we turn to expenses, I'd like to point out that we ended the quarter with 882 employees, an increase of 507 employees from the same period in the prior year, and an increase of 154 employees for -- from the prior quarter.

Our non-GAAP subscription gross profit, which excludes stock-based compensation expense was $33.3 million. Our non-GAAP subscription gross margin was 71%, which, as we had planned, is down compared to 81% in the same period last year and 73% from the prior quarter. The decrease is primarily attributable to the investments we are pursuing to support our growth for continuing to improve reliability. Namely, the migration of customers from Generation 1 to our Generation 2 data centers, and investments in our cloud infrastructure personnel.

During the migration, which we expect to be completed by the end of 2012, we are incurring double rent and accelerated depreciation for certain assets. In addition to the migrations, our cloud infrastructure team grew 162% year-over-year, including the addition of several key members in senior management. We believe building a strong cloud infrastructure team is critical to the reliability and scalability of our data centers.

As a result of these expenses, we expect subscription gross margins to continue to be down relative to historical run rate for the balance of 2012.

Starting in 2013, we expect gross margins to improve as we will no longer be absorbing the cost associated with our Generation 1 data centers.

Starting in 2013, we also expect gross margins to gradually improve due to improving economies of scale in our cloud infrastructure organization, also driven by the investments we have been making in automation.

Our non-GAAP professional services and other gross profit was $1.6 million, representing a gross margin of 16%, compared to 1% in the prior year, it is important to note that professional services and other revenues includes $2 million from our Knowledge event with all expenses related the event running through sales and marketing providing a boost to gross margin that we will see once a year in the quarter we hold the event.

Excluding Knowledge, our non-GAAP professional services margins were negative 6% compared to negative 27% in the prior quarter. This margin improvement was driven by a more robust focus on scoping projects and resource utilization, along with the transition to time and material contracts compared to our historical fixed fee contracts. As we continue this transition, we expect to see continued improvement in professional services margins.

Our total non-GAAP gross profit was $34.9 million, representing a non-GAAP gross margin of 61% compared to 69% from the prior year. Excluding the $2 million in revenue from our Knowledge event, non-GAAP gross margin was 60% compared to 57% in the prior quarter.

Moving to non-GAAP operating expenses for the second quarter. Sales and marketing expenses were $24.4 million or 43% of revenue compared to $11.8 million or 40% of revenues in the second quarter of 2011, and $17.8 million or 38% of revenues in the prior quarter. Increased expenses in sales and marketing were mostly attributable to aggressive investment and the expansion of our sales capacity. Sales and marketing expenses also included $3.6 million related to our Knowledge event, an expense we expect to only incur in the second quarter of each year.

Non-GAAP research and development expenses were $7 million or 12% of revenue compared to $2.2 million or 8% of revenue in the second quarter of 2011, and $6.1 million or 13% of revenues in the prior quarter. In addition to a $1.5 million adjustment for stock-based compensation, non-GAAP research and development excludes a $0.7 million charge to write off internally-developed software that was capitalized in the first quarter. This write off had no effect on our GAAP results of operations or cash flows for the 6 months ended June 30, 2012. We did not capitalize research and development expenses in the second quarter, and we do not expect to do so going forward. We expect the research and development expenses to increase in future quarters as we continue to make significant investments in our services.

Non-GAAP general and administrative expenses were $5.4 million or 9% of revenues compared to $2.8 million or 10% of revenues in the second quarter of 2011, and $5.4 million or 11% of revenues in the prior quarter. We expect general and administrative expenses will continue to increase. Our non-GAAP operating loss in the second quarter was $1.9 million compared to non-GAAP operating income of $3.3 million in the second quarter of 2011, and a non-GAAP operating loss of $2.4 million in the prior quarter. This equates to a non-GAAP operating margin of negative 3.4% compared to a positive 11.4% margin in the second quarter of 2011, and an operating margin of negative 5.1% in the prior quarter.

During the quarter, we reported a non-GAAP tax expense of $1.2 million. We expect net operating losses for the year to offset taxable income.

Non-GAAP net loss for the second quarter was $3.1 million or a net loss of $0.12 per basic and diluted share compared to non-GAAP net income of $2.9 million or net income of $0.05 per diluted share in the second quarter of 2011, and a non-GAAP net loss of $3.1 million or a net loss of $0.13 per basic and diluted share in the prior quarter.

During the second quarter, we generated $6.9 million in cash flows from operations. We used approximately $11.7 million for capital expenditures, resulting in negative $4.7 million in free cash flow. This compares to $9.8 million of free cash flow in the second quarter of last year.

The year-over-year decrease in free cash flow is mainly attributable to the significant investments we're making in the business to ensure we are well-positioned to execute on a growth opportunities we foresee in the future.

We ended the quarter with approximately $88.3 million in cash and short-term investments, which does not include the $173.3 million received on July 5, 2012, from the sale of our stock in our initial public offering.

In our IPO, we sold 10,350,000 shares of ServiceNow common stock at a price to the public of $18 per share, including 1,350,000 shares upon exercise of the underwriters over allotment option.

We incurred approximately $3.3 million in cost associated with the IPO, which will offset the gross proceeds received by the company from the IPO.

Our total deferred revenue balance was $131.1 million at the end of the second quarter, up 13% over the $115.8 million reported at the end of the prior quarter. Overall, we are very pleased by our performance in the second quarter.

Before we discuss specific guidance for the third quarter and in 2012, I'd like to discuss the financial impact of a lease for a new corporate headquarters in San Diego. In February, we secured a lease that enabled us to meet our long-term expansion needs in San Diego. We expect to transition to the new facility in the third quarter of 2012, and expect to record a one-time charge of approximately $3.5 million related to exit from our existing lease which runs through January of 2019.

Let us turn to guidance for the third quarter and full year of 2012. Please note that our margin and EPS guidance is on a non-GAAP basis, which excludes stock-based compensation and related tax impact.

For the third quarter of 2012, we expect total revenues between $61 million and $63 million, representing year-over-year growth between 78% and 84%. Revenues are expected to consist of subscription revenues between $53 million and $54 million, and professional services and other revenues between $8 million and $9 million. We expect subscription gross margin between 66% and 67%, professional services and other gross margin between negative 14% and negative 19%, and overall gross margins between 55% and 56%. We expect an operating margin between negative 17% and negative 19%, and a net loss per basic and diluted share between $0.10 and $0.11, with weighted average shares outstanding of approximately 121 million.

For the full year 2012, we expect the revenues to fall within the range of $233 million to $237 million representing year-over-year growth between 82% and 85%.

Our total annual revenues estimates consist of subscription revenues between $198 million and $200 million and professional services and other revenues between 35% and 37%.

Before opening up the line for questions, I want to reiterate our long-term target financial model. We ultimately aim to reach a non-GAAP gross margin between 68% and 70%, sales and marketing of 29% and 31% as a percent of revenues, research and development of 11% to 13% as a percent of revenues, general and administrative of 4% to 6% as a percentage of revenues, and an operating margin of approximately 20%.

With that, operator, you could now open up the line for questions.

Question and Answer

Operator
[Operator Instructions] First question will come from the line of Adam Holt, Morgan Stanley.

Adam H. Holt
Morgan Stanley, Research Division
My question, it may sound like a silly one given the growth rates, which were obviously eye-popping. But we had certain companies throughout the earnings release and talk about different geographies in different verticals as being a little bit tighter in June and they saw a few months ago, could you talk about how you think your business trends currently relative to the broader macro indicators that we might look at -- is the secular demand strong enough that you're not really impacted by the macro?

Frank Slootman
Chief Executive Officer, President and Director
This is Frank, Adam. We -- the scale of our company is such that we're not going to hide behind the macro in one geography or another because as you sort of indicated, our business is really impacted by the specific circumstances of our markets and our opportunity. There are always headwinds, and there's linearity, there's seasonality, all these kinds of things. But the momentum we have in our business, we should be able to plow through that. On the whole -- the whole sentiment, the marketplace is solid, it's sober, certainly there's no euphoria out there. And Europe has its own unique set of circumstances, but we believe that we can execute in those markets without the macro being an overhang to our performance.

Adam H. Holt
Morgan Stanley, Research Division
Okay. If you look at the win rates in the quarter, and the market share that you took, are there any commonalities in terms of who were beating and where the customs are coming from or what they look like?

Frank Slootman
Chief Executive Officer, President and Director

We're pretty much a ratable replacer of the legacy install base. In other words, those guys were the biggest market shares. Those are most prominent in terms of the companies that we replace that would be BMC and HP. They represent 50% or 60% of what we replaced, and then it becomes a longer list, IBM, CA and then a range of smaller vendors. There's no real concentration that we're sure more prone to replace one vendor or another. It's really by market share.

Adam H. Holt
Morgan Stanley, Research Division
And just last question for me. You obviously had significant headcount growth. Could you talk a little bit about how your sales productivity is tracking relative to what is obviously significant headcount for us?

Frank Slootman
Chief Executive Officer, President and Director
Our sales productivity, I mean this is something that we actually watch very carefully because when you're hiring as fast we are, you're always sort of watching that hairy edge where you start thrashing and it's unproductive to add more headcounts. But we have continued to consistently increase the productivity per sales head quarter-on-quarter. And that's really what we want to see, as long as we see that happening, we will continue to invest headcounts.

Operator
The next question comes from the line of Walter Pritchard, Citigroup.

Walter H. Pritchard
Citigroup Inc, Research Division
I wonder if you could talk about the platform and what you saw in terms of that is trashing with existing customers and if that's entering in at all to the decision that you're seeing around new customers coming to ServiceNow?

Frank Slootman
Chief Executive Officer, President and Director
Yes, the platform is quite strong in our business. We've done some incremental research since we launched our roadshow, which indicates that about 85% of all our production instances are using custom objects. In other words, that's an indicator for us that the customer is actually doing custom development on our platform, and not just using the standard applications that we provide. And that we've historically always said that we think it was sort of half and half, but that's mostly because we add so many new customers. A lot of them really haven't got into production yet. So you really can't count those. SO if you really look at production instances only, it's as high as 85% of customers that are actually doing custom application development on our platform, which we think is very significant. So we're investing very hard in our platform to further prioritize our documentation, community, all infrastructure that we have to build around it, to further sort of further smooth the adoption and the customer base. We have this Trojan horse strategy where our platform comes in the door with our application portfolio and customers discover the platform is a byproduct of deploying and implementing our applications.

Walter H. Pritchard
Citigroup Inc, Research Division
Got it. And then just, Mike, a question for you on the year -- I think you had kind of a 6-month year, you're running here with the transition of fiscal years and if I'm not mistaken, could just give us a sense of how that impacted the quarter, and as we go forward, should we expect the Q3 seasonality or the Q2 seasonality to be like you saw this quarter, it was obviously really strong?

Michael P. Scarpelli
Chief Financial Officer and Principal Accounting Officer
Yes. So for those, so I'll just reiterate to people when we changed our year-end our Historical comp plan was based upon a June year end. And as a result, there were a number of reps that were into accelerators. But as I mentioned, most of that does not have an impact on the quarter because of the back-end loaded nature of how deals are booked, and because the ratable recognition, most of that impact happened this quarter. We are not expecting that big of a change in 2013, but we'll be discussing our 2013 guidance on our January Q4 2012 call.

Operator
Your next question comes from the line of Tom Ernst, Deutsche Bank.

Thomas Ernst
Deutsche Bank AG, Research Division
First question I've got for you. I think we all established fairly easily your market pretty clear market leadership in this space with customer diligence. Help us reconcile what BMC said yesterday, if you would. Obviously you're growing

incredibly rapidly. So what BMC said, I'm sure you saw it, they said, up to 370 SaaS customers growing 225%. What do you interpret that, and how you're competing against them specifically please in the SaaS space?

Frank Slootman
Chief Executive Officer, President and Director
Yes, this is Frank, Tom. I think it relates to a segment of the market where we, for the most part do not operate. We said very high in the market, very large enterprises and we think that the SaaS portion of EMC's business is really geared towards a much smaller customers. That explains that scenario in terms of customer accounts growing for them. So we're sort of holding different approaches to the marketplace, this is where our focus is at. That's how I would explain it. We are certainly -- they are certainly the main brand that we're replacing at the enterprise level.

Thomas Ernst
Deutsche Bank AG, Research Division
Okay. And specifically, no shift in win rates or presence you're seeing them in your target market when you're competing?

Frank Slootman
Chief Executive Officer, President and Director
No, our win rates are as high as they've ever been.

Thomas Ernst
Deutsche Bank AG, Research Division
Fantastic. Mike, one quick question for you. I noticed that the deferred commissions as a percentage of revenue is a kind of a recent all-time high, is there anything from an accounting standpoint or is this just representative of the momentum in the business? How would you interpret the trend?

Michael P. Scarpelli
Chief Financial Officer and Principal Accounting Officer
I would interpret that trend as, I have explained them before, our accounting, the way we set up deferred commissions is when a sales rep books a deal, we pay the commission the following month, but we set that commission up, we set the liability and the asset up immediately. And that asset is deferred over the life of the contract. Given that -- you'll always see the biggest increase from the, in this case, historically, it's been March to June because June is the quarter that everyone is in accelerators, and there's a big increase because of the accelerators for our sales reps. Going forward, historically, you'll see that big change in the December quarter because December will be the quarter with the big annual accelerators kicking in.

Operator
Your next question comes from the line of Raimo Lenschow, Barclays Capital.

Raimo Lenschow
Barclays Capital, Research Division
Quick one on the sales mix that you have in the quarter. I mean, if we talked to investors a lot and people still think of you as an IT services desk company and you're placing remedy there. Can you maybe take our talk a little bit about the mix of modules that you see coming through, especially your success rate in terms of going deeper into the IT ops with kind of asset management and other module care? I don't know if you want to provide that in the future, but that's something that kind of came up a lot in discussions.

Frank Slootman
Chief Executive Officer, President and Director
Yes. It's a good question. I mean, there's no doubt that the systems that we are replacing, our legacy helpdesk management systems, typically of the client server variety that was sort of popular the early to mid -- in the late '90s. But what people are aiming for is to transition off that kind of a service model to much more of an online presence, and back end automation. Lights out and no hands. Very, very efficient, optimized automation of service management processes. That said, the applications that we sell have the highest degree of penetration is obviously incident management, because that's sort of the direct color relative to the legacy helpdesk management process that we replaced. But after that, it's actually request management service catalog, those are really the applications that allow people to create the online presence for IT. And change management. Change management is very heavily IT operations-oriented. Other applications that have incredibly high -- and by the way these applications have more than 50% penetration in our customer base. And then the other area where we have very high penetrations on configuration management. So the adoption of our configuration management database, the use of our discovery technology and these are all things that are indicative of us really taking root in the infrastructure. Incident change and the request on config management, these are all processes that hang together very, very tightly.

Operator
Your next question comes from the line of Phil Winslow, Credit Suisse.

Philip Winslow
Crédit Suisse AG, Research Division
I just wanted to get a sense of some of your newer products in the Runbook automation, the discovery tools as well. Just sort of what traction you're seeing in the customer base with those.

Frank Slootman
Chief Executive Officer, President and Director
Sorry, the configuration management and discovery asset management. We've had really strong uptake on those technologies for the reasons that I mentioned, because there are so closely related to the core workflow in the cadence of IT organization in terms of the managing incident, problem and change. Runbook automation is still a relatively fresh and new entry for us. I would argue that it is somewhat immature and we are still in the process of maturing the technology itself, and figuring out where to focus the technology, because it's been used in lots of different places for provisioning virtual machines and things of that sort to upgrading desktops and the applicability, the technology is pretty much endless. So we have a long ways to go to, the penetration is less than 10% for Runbook automation. But it is an important area of focus and investment for us. Customers typically start out with the consolidation of their service management processes, and automation is always downstream in terms of the priorities that people have in terms of setting up the system. So first, they do the front ends, the consolidation of systems, then the back ends, followed behind that. Sort of naturally follows the other applications.

Operator
And your next question comes from the line of Brent Thill, UBS.

Brent Thill
UBS Investment Bank, Research Division
Frank, if you could just give update us on the evolution of the platform and how you think about the pricing? And then Mike, I have a quick follow-up for you.

Frank Slootman
Chief Executive Officer, President and Director
The important observation I want to make there on the platform is we have started the process of licensing and pricing the platform separately from the applications. That is something that we have historically not done. So new customers that are signing up with us, and you heard, we added about 127 of them. We explicitly singled that out, something that the people have to purchase and be licensed for in order to use. When it comes to renewals, we that same conversation. In other words, we got a new contract and the platform is now separate from a pricing and a licensing standpoint. Sort of a Step 1 for us to be able to A, get better measurability of the impact that the platform is having, as well as the better opportunity to monetize it. We know that we have generated revenue off the platform in the past, but the kind of information that we have about this is more anecdotal than it is systemic and that obviously it has to change. So we're doing a lot of things to make the platform, just to be really standout as a separate offering for us and that customers really appreciate it as a development environment for service-oriented applications.

Brent Thill
UBS Investment Bank, Research Division
Okay, and Mike, just given your outperformance on the revenue side. Have you changed your trajectory at all and your sales hiring for the year, is that unchanged or have you increased your trajectory and if you could just remind us in terms of the metrics that you're going to give out around quota-carrying reps going forward, that'll be helpful.

Michael P. Scarpelli
Chief Financial Officer and Principal Accounting Officer
Okay, no, we really haven't change our outlook in terms of the number of people we're going be adding into our sales and marketing organization. We've added so many new people. We added 170 people year-over-year in our sales and marketing organization. We really want to -- we're going to continue at a same absolute number, but as a percentage it's going to be a lower percentage that we're adding because really want to focus on ensuring these people get integrated, trained and productive. In terms of metrics, we will not be disclosing quota-carrying reps, nor will we be disclosing quotas. All we will be disclosing is the number of people in the sales and marketing organization.

Operator
Your next question comes from the line of Rob Owens, Pacific Crest.

Rob D. Owens

Pacific Crest Securities, Inc., Research Division
I had a question around CapEx. Given the data center changes that came in a little later than we were expecting this quarter. So maybe what happened in Q2 and what your plans are for Q3?

Frank Slootman
Chief Executive Officer, President and Director
Yes, so there was about $5 million in CapEx that slipped from this quarter to this quarter. And a lot of that was because -- quite frankly, our IPO happened later in the quarter and we kind of pushed out some of those things. I expect that, that's going to flow into Q3 and with the numbers we disclosed before, that will be a net add to those numbers for Q3.

Rob D. Owens
Pacific Crest Securities, Inc., Research Division
Okay, great. You talked about launching your Advanced High Availability capabilities in May. How many of your customers have migrated? How smooth has that transition been just maybe a little color around that?

Frank Slootman
Chief Executive Officer, President and Director
We have migrated during the quarter from our Generation 1 data center architecture to Generation 2, about 259 customers. I think we are now pushing 70% of our customer base migrated to Generation 2. That said, not everybody in the Gen 2 data centers is already on the Advanced High Availability Architecture. So a lot of new customers that need to be -- can be set up that way right away when we instantiate then, others follow on a different process.

Rob D. Owens
Pacific Crest Securities, Inc., Research Division
Great. And then lastly, Mike, around the long-term deferred revenue downticking sequentially. I know it happened last year, maybe just remind us of what the dynamics are that makes that occur and typically, what bookings look like, what the average length of a contract is?

Michael P. Scarpelli
Chief Financial Officer and Principal Accounting Officer
So the downtick and deferred revenue all depends upon the cash payments terms with customers. And it depends upon whether you have a down quarter or not with seasonality. We are not expecting there to be any in the foreseeable future, down quarter in terms of deferred revenue in our model. In terms of the dynamics of what we're seeing, roughly, as I mentioned on the script, this past quarter, 16% of our billings were for periods in excess of 1 year. From a forecasting standpoint, I expect that, that's going to normalize more at 10% of our billings is going to be for periods in excess of 1 year. And one of those reasons is, I believe I mentioned on the road a few times is, our historical comp plan, incented sales reps to get multiple year billings in advance. Given that I know, there's not much and we end up having to discount deals to get to that. We want to hold our discounting and whether I get the cash this year or next year for the year 2 and year 3, that's okay with us given where interest rates are. We do -- we have seen pretty consistent in terms of the average length of contract that we've been selling. This past quarter, it was roughly 33% with the average dollar -- or the average dollar -- weighted average dollar amount of our contracts we sold on an actual transaction level, I think, it was about 31 or 30 months is what the average new business was.

Operator
Your next question comes from the line of Jason Maynard, Wells Fargo.

Jason Maynard
Wells Fargo Securities, LLC, Research Division
I had a couple of questions. I just wanted to focus first on what you see is your biggest challenge. Right now, it looks like competitive and market acceptance are not really big issues for you so I'd be curious if you think it's really just managing the business? And then the second part, if I could get your comments around ramping the indirect partner channel, the KPMG relationship, how do you scale other relationships and also just the hiring climate since you're adding so many people?

Frank Slootman
Chief Executive Officer, President and Director
Yes, this is Frank. You already started to answer your own question there. I mean, our hardest challenge is really growing at this level of scale, is pretty uncomfortable because we have, as said, we have brought on 507 people into the company over the last year, literally tripling our headcount. That is an awful lot of people to absorb into an organization and make productive. So keeping the wheels on, it's sort of our daily mantra and really tightening the execution, the discipline, the repeatability, so that we can really continue to run at great speed as we have been,

but maybe with little bit less let vibrations to go along with it. So that's really a bit part of what we're focused on a day-to-day basis. In terms about the reseller channel that directly goes to the whole issue of sales productivity and sales ramp. I mean the better use that we can make of channels and relationships, the quicker we can make our sales people productive. We're very much focused on the Global 2000 enterprises in the world, and getting access to those enterprises, this is what partners like KPMG can be absolutely invaluable and there's a bunch of others out there like them that have tremendous access and relationship. So it's very important to us and we're quite excited about the relationship with KPMG, and the effect that we've already seen from that. So you can expect us to do a lot more of that. The whole message of IT transformation, that's really what these large global system integrators are into and so we fit with their focus and their initiatives extremely well.

Jason Maynard
Wells Fargo Securities, LLC, Research Division
And then just a follow-up on the hiring front. What you guys are seeing in terms of competition for both sales and development talent?

Frank Slootman
Chief Executive Officer, President and Director
Yes, talent acquisition, if you sort of aggregate everything to the top level, talent acquisition is the hardest thing for any business, but especially a business of hours, because, everybody is out there, competing for good resources. We don't want to settle, we have a voracious appetite for talent, so that's hard. One of the things that we've done, as you know, we're not just in San Diego anymore, which was very constrained in terms of talent, in terms of the sheer size and the diversity of the talent base. So we're now in Silicon Valley, where our presence has grown a lot, and we're up in Seattle where we're running our cloud infrastructure operations. So companies like ours have to go to where the talent these days. You cannot just be in one place and expect talent to come to you.

Operator
Thank you ladies and gentlemen for your question. This concludes today's conference. You may now disconnect, and have a great day.