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Presentation

Operator

Good afternoon. My name is Audra, and I will be your conference operator today. At this time, I would like to welcome everyone to the Smartsheet Fourth Quarter Fiscal 2024 Earnings Conference Call. Today's conference is being recorded. [Operator Instructions]

At this time, I would like to turn the conference over to Aaron Turner, Head of Investor Relations. Please go ahead.

Aaron Turner
VP of Investor Relations & Treasurer

Thank you, Audra. Good afternoon, and welcome, everyone, to Smartsheet's Fourth Quarter of Fiscal Year 2024 Earnings Call. We will be discussing the results announced in our press release issued after the market closed today. With me today are Smartsheet's CEO, Mark Mader; and our CFO, Pete Godbole.

Today's call is being webcast and will also be available for replay on our Investor Relations website at investors.smartsheet.com. There is a slide presentation that accompanies Pete's prepared remarks, which can be viewed in the Events section of our Investor Relations website.

During this call, we will make forward-looking statements within the meaning of the federal securities laws. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends. These forward-looking statements are subject to a number of risks and other factors, including, but not limited to, those described in our SEC filings available on our Investor Relations website and on the SEC website at www.sec.gov. Although we believe that the expectations reflected in the forward-looking statements are reasonable, our actual results may differ materially and/or adversely. All forward-looking statements made during this call are based on information available to us as of today, and we do not assume any obligation to update these statements as a result of new information or future events, except as required by law.

In addition to the U.S. GAAP financials, we will discuss certain non-GAAP financial measures. Reconciliation to the most directly comparable U.S. GAAP measures is available in the presentation that accompanies this call, which can also be found on our Investor Relations website.

With that, let me turn the call over to Mark.

Mark P. Mader
President, CEO & Director

Thank you, Aaron, and good afternoon, everyone. Welcome to our fourth quarter earnings call for fiscal year 2024. Q4 was the culmination of a year where we demonstrated our ability to grow in challenging macro conditions while making considerable progress on our profitability and free cash flow. We crossed the $1 billion ARR threshold in Q4, within the original time frame we set at our first Analyst Day back in 2018. And we achieved this milestone while also expanding operating margins by over 1,500 basis points and achieving Rule of 40 for the second consecutive year.

Our performance in Q4 was highlighted by our continued strength in the enterprise, coupled with strong progress on our key growth opportunities. In Q4, 98 customers expanded their Smartsheet ARR by more than $100,000. We now have 65 customers with ARR over $1 million, up from 45 a year ago. And we ended the quarter with annualized recurring revenue with $1.031 billion and more than 14.3 million Smartsheet users.

In Q4, we expanded with customers such as Nutanix, University of Southern California, Genesis Motor America, the city of San Jose and Dairy Queen, among others. This past quarter, we saw significant expansion with a multinational information technology company. Smartsheet has been used within the marketing and sales departments at the company for a number of years. After a detailed RFP process for an organization-wide collaborative work management solution, Smartsheet was selected over competitors for enterprise-grade scale and world-class security.

Adoption has been high with a growing demand for licenses and implementation across marketing operations, M&A and more. These units have been leveraging the full breadth of premium capabilities of Smartsheet to replace manual processes, increase efficiency and improve collaboration. We had an expansion deal with a European-based leading global science and technology company. Their need for enterprise-grade security and governance was key to our expansion deal that included an upgrade to Advance Gold. The company's IT group underwent an extensive evaluation to consolidate their project management needs under one solution across their 3 main business divisions of life sciences, electronics and health care. The company selected Smartsheet and has consolidated their thousands of users under a one Smartsheet program and a transformation of our partnership with them. Going forward, the company will extend the use of its Smartsheet use to other units in their drive towards efficiency and optimization.

We saw significant expansion with a leading global entertainment and ticketing company. Previously, the team relied on very manual processes to market the high-profile and high-budget tours they manage all around the world. After engaging with our customer outcomes journey team, the customer discovered how Smartsheet could drive greater value by automating repeatable work, efficiently adapting to changes and improving communication. Now the company is using a tailored solution to manage all marketing operations in regards to their concert tours and artists and benefiting from an integration with their Salesforce-based system of record. Going forward, the company has planned additional phases of implementation to expand the transformation and efficiency already realized with the marketing and tour management solution to other parts of the organization.

The ability to rapidly scale was a key element to a recent international expansion at an APJ-based multinational corporation that provides digital transformation consulting to enterprises. The unit focused on their Middle East delivery region needed a scalable solution for reporting on financials across their portfolio of projects, which involved multimillion-dollar contracts with their customers. We worked with a key channel partner to deliver solution leveraging the Smartsheet platform. This initial solution will support one regional delivery team with a plan to scale to all their global delivery teams.

FY '24 was a big year for our platform. In the area of gen AI, our first 2 AI features became generally available to customers on our enterprise plan at the beginning of last month. The first capability allows our customers to create tailored formulas from their input, speeding up data-driven decisions. The second interprets customer data for clearer text summaries and translations. The customer response and usage of free AI has been strong. And since the beginning of February, more than 1/3 of our enterprise customers have leveraged these new tools.

Also in FY '24, we launched our free plan and the self-discovery of our capabilities. Both continue to perform well. And while contribution to our Q4 results was small, we are encouraged by the compounding growth rates we're seeing from these initiatives. Our free plan, which launched at the beginning of FY '24, is seeing steady growth. Through the fiscal year, our free plan has grown across thousands of domains. And in January, we added 500 paying new customers via the free plan, a new monthly record.

In Q4, over $2 million of capability bookings were the result of self-discovery trials. This is up from less than $1 million in Q3, and this motion continues to drive exposure of our capabilities to more and more customers. Nearly half of our Q4 self-discovery sales were with customers who purchased the capability for the first time. Given the success, we will apply this approach to additional capabilities in FY '25.

As I mentioned earlier, we surpassed $1 billion in ARR in Q4. We got to this point by focusing on our customers and building an enterprise-grade platform that can scale to their most demanding needs. I'd like to call out our Chief Revenue Officer, Mike Arntz, who is retiring today. When Mike joined Smartsheet over 7 years ago, our ARR was under $100 million, and our average customer contributed less than $1,000 per year. During Mike's tenure, our ARR and contributions per customers has grown by 10x. I'm grateful for his service and wish him all the best in retirement. Mike will remain on as a consultant through mid-May to support the transition to his successor.

As we enter the post-$1 billion ARR growth phase of the company, the strategy that underpins our go-to-market and product and innovation will be refined and expanded. Executing this strategy will be a leadership team consisting of proven executives, each motivated for the next tier of growth and customer success. Today, we announced that Max Long has joined Smartsheet to serve as President of Go-to-Market. Max has over 3 decades of experience leading commercial teams for global tech companies with diversified offerings, including Microsoft and Adobe and most recently, NetApp, where he served as Chief Commercial Officer. We will be unifying go-to-market operations under Max and unifying product and innovation under Praerit Garg, newly appointed President of Product & Innovation.

Prior to joining Smartsheet in 2019, Praerit served in leadership roles at Microsoft and Amazon. And under his product leadership at Smartsheet, our platform has been recognized as the leading enterprise platform in work management, serving the largest number of sophisticated scale deployments in the category. We're setting the foundation for the next era of profitable growth with proven, more efficient go-to-market motions paired with enterprise-grade product innovation informed by decades of data, work patterns and customer use cases. We see a significant opportunity to win additional market share by delivering AI-enhanced, collaborative workflow solutions for customers. I see it as a tremendous opportunity representing multiple vectors of growth.

In the enterprise segment, productized and scalable no-code workflow solutions are undercutting more expensive, slower to deploy alternatives. Regardless of the macro environment, significant demand exists for more efficient solutions to power critical workflows. Smartsheet is well positioned to capture this opportunity due to our category-leading scalability, no-code platform and enterprise-grade security.

In an effort to drive performance, particularly in the SMB segment, we will deploy our simplified design, pricing and onboarding experiencing during the course of the year. We are on a mission to remove friction and maximize self-directed experiences for our customers to enable faster time to value. We are taking the right steps to execute our strategy and to bring our enterprise-grade work management platform to organizations of all sizes all around the world. We are well positioned for our next phase of growth to $2 billion and beyond.

Now let me turn the call over to Pete.

Pete Godbole
CFO & Treasurer

Thank you, Mark. Our performance in FY '24 demonstrated our ability to drive durable growth with improving profitability despite a challenging business environment. We outperformed our guidance in Q4. However, similar to prior quarters, we continue to see tighter domestic spending tied to the current macro environment negatively impact expansion, particularly in the SMB segment of our business. This served as a headwind to our overall growth rate. The macro impact on our SMB segment in Q4 was worse than Q3, and we are expecting this segment of our business to continue to be under pressure in FY '25.

In FY '24, we took steps to reduce our use of stock and compensation structure. This resulted in our stock-based compensation as a percentage of revenue to decline in FY '24 from the previous year. We expect our SBC as a percent of revenue to continue to decrease in FY '25 and beyond.

Additionally, in response to investor feedback, going forward, we will be disclosing and guiding annualized recurring revenue, or ARR, rather than billings. ARR provides a better reflection of our quarterly net bookings performance. One additional callout. In the past, we have used ARR and ACV interchangeably in our nonfinancial metrics. Starting this call, we will be standardizing on ARR.

I will now go through our financial results for the fourth quarter and the full year. Unless otherwise stated, all references to our expenses and operating results are on a non-GAAP basis and are reconciled to our GAAP results in the earnings release and presentation that was posted before the call.

For the full fiscal year '24, we ended with total revenue of $958.3 million, up 25% year-over-year, and billings of $1.069 billion, up 20% year-over-year. Non-GAAP operating income was $100.9 million, representing an operating margin of 11%, and free cash flow was $144.5 million, representing a free cash flow margin of 15%.

Turning now to our quarterly results. Fourth quarter revenue came in at $256.9 million, up 21% year-over-year. Subscription revenue was $244 million, representing year-over-year growth of 23%. Services revenue was $12.9 million. Revenue from capabilities made up 34% of subscription revenue.

Turning to billings. Fourth quarter billings came in at $341.9 million, representing year-over-year growth of 19%. Approximately 95% of our subscription billings were annual with about 2% monthly. Quarterly and semiannual represented approximately 3% of the total. Annualized recurring revenue, or ARR, grew 21% in the fourth quarter to $1.031 billion.

Moving on to our reported metrics. The number of customers with ARR over $50,000 grew 22% year-over-year to 3,924, and the number of customers with ARR over $100,000 grew 28% year-over-year to 1,904. These customer segments now represent 66% and 53%, respectively, of total ARR. The percentage of our ARR coming from customers with ARR over $5,000 is at 91%. Next, our domain average ARR grew 15% year-over-year to $9,672. We ended the quarter with a dollar-based net retention rate, inclusive of all our customers, of 116%. The full churn rate was 4%.

Now turning back to the financials. Our total gross margin was 85%. Our Q4 subscription gross margin was 88%. Overall, operating income in the quarter was $39.6 million or 15% of revenue. Free cash flow in the quarter was $56.3 million, a new quarterly record for our company.

Now let me move on to guidance. We are electing to remain conservative with respect to our FY '25 guidance, given changes in our sales leadership, the timing of our initiatives aimed at driving incremental growth and the ongoing macro influencing spending constraints.

For the first quarter of FY '25, we expect revenue to be in the range of $257 million to $259 million and non-GAAP operating income to be in the range of $32 million to $34 million. We expect non-GAAP net income per share to be $0.26 to $0.27 based on diluted weighted average shares outstanding of 141 million. For the full fiscal year '25, we expect revenue of $1.113 billion to $1.118, representing growth of 16% to 17%. We expect services to be around 5% of total revenue.

We expect our non-GAAP operating income to be in the range of $135 million to $145 million, representing an operating margin of 12% to 13% and non-GAAP net income per share to be $1.06 to $1.13 for the year based on 142.2 million diluted weighted average shares outstanding.

We expect our FY '25 ARR growth to be 14%. Regarding seasonality, we expect quarterly ARR growth rates to follow a similar trend as last year with higher growth rates at the beginning of the year. Based on the relationship between dollar-based net retention rate and ARR, we expect our net retention rate to follow a similar trajectory as ARR through the course of the year.

We also expect our FY '25 free cash flow to be $200 million.

To conclude, in FY '24, we made significant progress on our profitability and free cash flow while navigating a difficult economic climate. Moving into FY '25, we're laser focused on growing our enterprise leadership position and further expanding profit margins. This next phase of growth will be driven by an energized team committed to streamlining our go-to-market efforts and compelling product innovation. Now let me turn the call over to the operator. Operator?

Question and Answer

Operator

[Operator Instructions] We'll take our first question from Terry Tillman at Truist Securities.

Robert William Dee
Truist Securities, Inc., Research Division

This is Bobby Dee on for Terry. First one for me, would love to get an update on the road map for new and upcoming scalability/infrastructure enhancements this year, particularly the 5 million cell per sheet enhancement. Related to that, are there some potential near-term expansion opportunities with larger customers that could come out of those improvements? And then I have one follow-up.

Mark P. Mader
President, CEO & Director

Yes. We've had -- this is Mark, multiple milestones achieved in the past year. We're well on our way to hitting those. The team has actually done a really nice job of setting commitments with prospects and customers that they've been able to fulfill. And I would say that was reflected in some of the big enterprise expansions we've had in the past year. The good news is on some of those upper bounds that we set for ourselves, we're actually going beyond those. We're really getting to a point where the changes that we're doing today are sort of decade-long impact changes.

So we're really getting to a model where those upper bound constraints are really getting to a point where you're talking about well north of 10x capacity of what we have today. And when you look at the largest companies in these industries that we serve, it's always remarkable to see how far they want to push it. And I think it's really a combination of both scale but also scale as it relates to administration and the ability to govern. So it's not always in the context of cell links and sheet counts and dashboard supported. It's also can we manage these huge engaged populations within these environments. So kudos to the team for both building the feature set and also the tooling required to administer these.

Robert William Dee
Truist Securities, Inc., Research Division

That's great. Appreciate the color. And then nice to see the strong cash flow guide for FY '25. Curious how you all are thinking about capital allocation moving forward and even potential M&A. Any platform areas where buyback still could be attractive?

Pete Godbole
CFO & Treasurer

So we've got a fairly thoughtful what I call capital allocation strategy, and we start with sort of where we want to deploy capital. Obviously, a buyback remains in our strategic consideration set. But we're focusing our balance sheet right now on adding to the strength of it since we deal with the largest companies in the world. I think we will consider potential -- we want to have some flexibility to drive potential M&A that may be adjacent to where we are, that will be a part of the consideration set.

Operator

We'll take our next question from Ryan MacWilliams at Barclays.

Pete Newton
Barclays Bank PLC, Research Division

This is Pete Newton on for Ryan MacWilliams. Just sort of looking at your implied trajectory and guidance throughout the year despite the slight slowdown [throughout] FY '25. So if you can just add some color on what you're seeing on the macro and what your guidance implies for how the year looks in terms of SMB, enterprise demand. Just any color we can get there would be helpful.

Pete Godbole
CFO & Treasurer

I think you were cutting out a little bit, but I think your question is about the composite of our guide and how we're thinking about the world. I think I'll start there. So the guide is a composite. So it starts with what we experienced in Q4. So when you think of what we experienced in Q4, our enterprise NDRR growth rates were strong, over 120%. The SMB did worsen in Q4. And as you think of that NDRR worsening, it was close to 0. So we expect this trend to continue in FY '25. So that's kind of the first part of it.

And as we see this trend progressing through, essentially, we're thinking about the enterprise business. We -- obviously, it's a very back-end loaded business and the visibility grows as we go through the year, so being sort of prudent with our initial guide. And the last part of it is we're focused on -- we've looked at embedding some level of incremental conservatism given the new sales leadership that Mark just talked about.

Pete Newton
Barclays Bank PLC, Research Division

That makes sense. And then just a follow-up. Really pleased to hear some of the AI commentary. I think that's pretty positive here, and especially in terms of when you think about upturning customers. So maybe, Mark, what are you seeing on the AI front? What are customers looking to utilize Smartsheet's AI products for? Just how you're feeling about AI going through this year?

Mark P. Mader
President, CEO & Director

Yes. It's really on 2 primary dimensions. One is on being able to configure logic into the Smartsheet solutions, so how quickly and simply can someone do that. And a big part of our value prop is velocity. So the AI that we've enabled that I spoke to in our formulas, that is part of how you configure workflows and automations and logic into these solutions.

On the second side, it's about the analysis. How can I derive insights from the things that I'm tracking? The resonance -- seeing 1/3 of our enterprise customers within weeks of its announcement using it or release using it, I was really pleased to see that. I would say what you'll see with the AI skills coming forward, you'll see that we will continue to shift and release features that I would say are in higher use, high-frequency use experiences. So when we released the AI skill on the dashboarding and the insights, which is a really popular area for our application, I expect the count of interactions to go up materially. So it's all about enabling and improving the experiences that they're very familiar with today.

The next phase that you'll see is really around how we can get people to understand how to exploit new use cases on the platform. So how can I, with an initial intent, state my case, state my objective and be presented with a composite solution of dashboards and forms and automation. That is the second phase. But what we're really doing right now is enrolling people into the capabilities alongside things they understand. And we think that's a strategy that's served us pretty well so far.

Operator

Our next question comes from John DiFucci at Guggenheim.

John Stephen DiFucci
Guggenheim Securities, LLC, Research Division

So when I look here, and there's a lot of changes here, right? And Mike Arntz has been with the company since before the IPO and has led a lot of the changes needed as you scaled. So Mark, I guess, what do you anticipate are some of the areas that Max may address to accommodate your next phase of growth?

Mark P. Mader
President, CEO & Director

John, I think a few of the traits that I was looking for was somebody who had deep experience with international, understood partner ecosystems very well, was super fluent in a multiproduct catalog and how you cross-sell. When we think about the rise of capabilities in our world with less than -- fewer than 10% of our customers buying something from us other than a seat, it is a huge portion of our growth strategy. So really trying to find someone who has that experience base.

And also, it's pretty -- when you think of who we serve, John, right, we serve everybody from the SMB all the way up to the largest companies in the world. Finding somebody who has comfort and an informed point of view on how to go to market on both dimensions, that is a really important thing I was looking for. And I think Max's experiences across Microsoft, Adobe and NetApp is a pretty good collection of past experiences that he's going to bring to bear.

John Stephen DiFucci
Guggenheim Securities, LLC, Research Division

And that makes a lot of sense, especially the opportunity, well, across everything, but like you led with international, which just seems like such a big opportunity here. I guess if I could just ask a follow-up for Pete. Listen, Pete, if NRR is going to follow similar trends as ARR through the year, that implies it continues to decline. Can you talk a little bit more about this? Because the way I understand the NRR metric, it's a next 12-month metric, and you could actually see on a quarterly basis an inflection point where things tend to get a little better near the end of the year, and you wouldn't necessarily see that metric right away. I guess I'm just trying to sense what this -- the guide is because I think that's the thing that our people are -- the 14% growth in ARR is the thing that people are sort of questioning right now. Do you think it just gets -- continues to get worse throughout the year? Is that what you're sort of implying? I know you gave all the reasons why you're being "prudent", I'm glad you said that. But do you think it actually could get better throughout the year at some point? Or does it -- or even stabilize or that it's going to get -- just get worse through the year?

Pete Godbole
CFO & Treasurer

Yes. So the -- if you think of the -- you're absolutely right, John, in terms of the net dollar retention rate conversation, it's a look back for a full year. But remember, the underlying underpinnings of that are what's happening in the enterprise and what's happening in SMB. I called out in SMB that we don't expect it to stay stable. We expect it to continue to worsen. So that's going to be a drag on that -- on the net dollar retention rate, and it will build into the composite. Now could it get better? I think we're doing many things ourselves, which are things we've launched in the water. But we always guide based on what we can see and what we have visibility to. And that's what we're consistent about. So that's what we're doing sort of here as well.

Operator

Our next question comes from George Iwanyc at Oppenheimer.

George Michael Iwanyc
Oppenheimer & Co. Inc., Research Division

Mark, maybe could you give us more color on the traction you're seeing with self-discovery? And as you start to roll out new capabilities, how should we think about the pace of that this fiscal year?

Mark P. Mader
President, CEO & Director

Yes. Self-discovery, we have -- there are 2 aspects of it. One is the ability to -- for someone to experience a feature in the product without having to engage with someone from our team to actually utilize it. The second part of that, actually fulfilling it from a booking standpoint, is the other portion. So what we have done to date is we have enabled thousands of -- tens of thousands of companies to be able to utilize these tools, and we're seeing really good progression quarter-on-quarter around people exploring those and trialing those.

The second chapter of this is actually marrying a self-discovery motion with a transaction motion. So we are skating to a place where those lower-value SMB, small starting customers can not only see them but also transact on those. We have not yet set markers in terms of in which quarter that we will convert to that commerce element, but we are focused on getting elements within our content realm, our people realm, which is our resource management realm, and our work realm exposed to market.

So a few weeks ago, we released our advanced resource management capability. Prior to releasing that, a prospect or a customer would have to engage with our customer success or sales team to enable that. That is now fully automated, zero setup required. And the weeks in performance we've seen have been extraordinarily positive in terms of the number of people who have been able to engage with that and to utilize it. So we are moving to a place where we want almost the entire portfolio available for someone to see without it being gated by a human being on our side.

And when I think about driving long-term efficiency into our go-to-market, I think it's built on the back of this and how do you get more of your people and your success and your journey teams focusing on your mature, growing, super large customers and letting your early-stage growing customers move as quickly in a self-directed way as possible. So it's -- you will see releases this year in self-directed features across our existing capabilities. You will see our digital asset management come into a self-directed motion in the later -- in the first half of this year. And as I said, the people dimension on resource management was released to market in a self-directed way just a few weeks ago.

George Michael Iwanyc
Oppenheimer & Co. Inc., Research Division

And Pete, one question for you. Could you give us some perspective on how you're prioritizing the investment this year? Is it leaning more towards sales and marketing? Or is it really balanced across R&D and S&M?

Pete Godbole
CFO & Treasurer

I think our investments are pretty balanced. We're not making large investments in field capacity. We were fortunate to have an experienced and sort of what I call highly savvy field already in place. We've complemented that with things, which Mark talked about to help take our most experienced customers to the next level. So we've made some targeted investments there. And on the R&D side, we've focused on kind of getting a series of new and massively modernized core application experiences out there. And we've sort of invested in taking these self-directed capabilities and extending them to other products. So short answer, balanced across both sales and marketing as well as R&D.

Operator

We'll move next to Jake Roberge at William Blair.

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

I understand we're still in a bit of an uncertain macro, especially on that SMB side of the house, and you're obviously going through the go-to-market transition this year. But if you take a step back, what do you think are some of the factors that could help stabilize NRR later this year and potentially reaccelerate the growth in the business heading out over the longer term?

Pete Godbole
CFO & Treasurer

So the factors that could stabilize NRR, in my mind, are some of the initiatives that Mark mentioned and those gaining traction. So we talked about -- these are -- we are launching them. We're launching a totally modernized core application experience. That's coming through. We have launched the first part of it this quarter, but that's the early start to it. The lift that comes from that experience could be large, but it's going to take a while to sort of assess that out.

The second thing we would -- I would think of is think of our largest customers then taking the enterprise-grade features that we can sort of get these customers to deploy. The portfolio is really rich. If I can get our most experienced median customer to our top quartile customer, that's an opportunity. And that's where I think the leadership for Max to bring his experiences to bear will be helpful. So those are some of the upside elements out there. The one I'd be remiss not to mention is AI. That's in early stages, if you will. But as I said, it's a little bit of a wildcard on how that plays out.

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

Okay. Helpful. And then I know they're a good portion of revenue, but with capabilities still being less than 10% penetrated in the entire base, what do you think the unlock will be to get those solutions deeper into the customer base? Is that all going to be self-discovery driving that? Or is there anything differently you can do on the direct go-to-market side that could help drive more traction with those solutions?

Mark P. Mader
President, CEO & Director

Yes. I love the question. It is -- you're absolutely right. It's much more than just self-discovery. One of the things that we're working on from a packaging standpoint is how do we enable the median customer to get into a paid state with us on a premium capability in a ramped fashion. And what I mean by that is to date, many of our capabilities sales have come in the context of fairly substantive solutions. Like we go in, we work with a midsize or a large customer and we discuss a high-value solution that's delivered. We see a huge opportunity within the tens of thousands of organizations we serve, which start actually small.

So how can I consume a capability at sub-$5,000, sub-$1,000? And it's I think planting a bunch of seeds is how we built this business over 19 years. And we had our capabilities really married to an assisted sales motion. So when we think of packaging, how do you get that same PLG motion that we have with our seats introduced on a capability. And you should expect from us this year to release mechanisms for allowing people to step into capabilities much more quickly. So I would see the penetration rate of capabilities to go up significantly and then put us in a position to be able to build on that as they consume more and more of those.

So again, one is building them, having them; the other is making them available and discoverable; the third is how do you have a monetization strategy, which caters to the people who are starting out with them and those who are using them at massive scale.

Operator

We'll take our next question from Michael Berg at Wells Fargo Securities.

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

I want to follow up on the capabilities discussion here. It's growing nicely, if my calculations are correct, and it's still 30%. That seems down pretty meaningfully from the rest of the year. Maybe is there anything under the hood? What's going on there? Is there incremental budget constraints? Because I kind of think of those as being more enterprise-type solutions. And how do you think about those potentially reaccelerating, just building off of the last question?

Pete Godbole
CFO & Treasurer

I would say that we were pretty satisfied with the performance of capabilities. And I think that the draft you're seeing in year-on-year growth rates is just a sign of the macro that customers have experienced. It's just as simple as a conversation around people wanting a capability, but do they buy a composite set in a package in advance or do they buy them à la carte. So that affects the dollars that we -- that push through, if you will. But I think in general, the demand for capabilities continues to be robust and continues to grow. So I'd say I'd leave it there.

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

Helpful. And then a quick follow-up on that same topic. As you think about this large opportunity set at hand, is it reasonable to conclude that capabilities will at some point be the majority of the revenue, just given the value proposition tied there? It seems like that's an underappreciated part of the -- not only the products, but the overall story.

Pete Godbole
CFO & Treasurer

So I think my belief is, and Mark and I share this, I think we're going to see both growth. So it's sort of like this race where as you start with seats and then you're adding capabilities on top of it, but it continues in that way. So I think we've got a huge sort of what I call potential in the low end of the market with these modernized core application experiences. So think of that as the piece that builds the seat part of the portfolio. Now that doesn't mean it's only seats. You get the self-discover capabilities as well. So I think that percentage, I wouldn't view it as being lopsided towards capabilities. I view it as being balanced and growing over time. I do think capabilities will be an increasingly growing part of the mix.

Operator

We'll go next to Pinjalim Bora at JPMorgan.

Pinjalim Bora
JPMorgan Chase & Co, Research Division

Pete, can you talk about kind of the demand trends going into Q1, February, March so far? Are you seeing the SMB weakness kind of deteriorate? Has it been similar to Q4? And any way to understand kind of the headwind to ARR for the full year FY '24 from the SMB softness?

Pete Godbole
CFO & Treasurer

So I'll give you my texture on February. So February was -- we continue to see the pressure on SMBs in the month of February. So that pressure actually continued. So we've seen that in play. And that's what informed our guide. If you think of Q4, we saw that worse than Q3. We saw that pressure continue to further worsen in February. So we're extrapolating that to say that's what continues all through the year. And that's the headwind to the other part of the business, which is pretty strong, which is the enterprise business, which had another good quarter in Q4 and will sort of continue in that vein. So that's the assumption going in.

To the second part of your question, what's the size of each one, I think it's hard to call out. Remember, just to give you an order of magnitude size, SMBs are roughly 1/4 of our business. And as I mentioned earlier, if you looked at the net dollar retention rate, which is a measure of our expansion, it was down to close to 0 in Q4. So you can see the pressure in that segment playing forward.

Pinjalim Bora
JPMorgan Chase & Co, Research Division

Understood. Helpful. One for Mark. Mark, we had heard from some of your customers that your AI capabilities like summary generator could help reduce the reliance on power users, kind of allowing average users to do more complex tasks. Do you think that could accelerate the adoption of paid seats within your existing enterprise tier accounts as it frees up the time for power users, one, and maybe makes the average user much more productive and engaged?

Mark P. Mader
President, CEO & Director

I do. That's part of the thesis. And some of the things that we're able to see as leading indicators of that is we looked at our enterprise segment, the number of inquiries we had to our support desk in these areas, and we're already seeing a step down in that usage up, inquiry down, good dynamic. So I do think that, that is something that will exist. I think as we get the AI introduced to other elements that are super commonly used by analysts who are doing dashboard building, trying to derive insights from data sets, I think that word will start to spread within organizations.

And I think a lot of times, the way folks work within these companies, they want to see a data point. They want to see an example from someone in a neighboring group achieve success. Again, we are weeks into this being available. I would expect, as we get a couple of months under our belt, to start seeing this pattern emerge.

Operator

We'll move next to Alex Zukin at Wolfe Research.

Ethan Bruck
Wolfe Research, LLC

This is Ethan Bruck on for Alex Zukin. I guess maybe a bit more of a high level maybe for Mark. Just as we think about the percent of customers that are using capabilities, is that number kind of inches up from single digits continuing to 20% over time? Like as you embed generative AI and self-discovery as that accelerant, what does success look like for you over the next few years? Like where the -- those amount of customers using your capability can go? And then as you think about monetizing that more improved functionality, I mean, where do you need to see adoption to go for all those ROI investments for R&D to pay off basically?

Mark P. Mader
President, CEO & Director

I think the R&D is paying off well today. I think what I'd like to see us reach is a much broader penetration. I think on an earnings call 1 or 2 times ago, someone asked, so Mark, what's your expectation? And I very quickly snapped back, 50%. My expectation is the median customer at Smartsheet should be able to derive value from multiple products that we sell. So again, back to why I chose to partner with Max on go-to-market. When you look at the largest software companies in the world, they're not one-trick ponies. They offer value to their customers on multiple dimensions. And what our job is, is to make that is accessible to as many companies as possible and their users. And I think part of that is what you offer them. And then the other part of that is how you make it available to them through a pricing and packaging standpoint. So a big driver will be how we judge the percent penetration of our portfolio into those organizations.

The other important part is what's the contribution per organization. But I think right now, we're not confused on our remit, which is make these things available, get them into the hands of many people and organizations as possible. When you look at the retention dynamics of the companies that are deeply embedded with multiple products, good things from an NDRR standpoint happen when people are connected on multiple fronts. So again, this is -- and it's not simply done by hiring more people. This is about letting the product pull for you. And it's one of the reasons R&D is working so hard on making this happen.

Ethan Bruck
Wolfe Research, LLC

Yes. No, it's incredibly good thing. That makes perfect sense. And just maybe for Pete, as you think, and I know we talked about the different layers of conservatism embedded to the guide. But if you would stack rank where you would see some of the biggest areas of outperformance, how do you think about that between just a better macro, assuming this go-to-market execution above expectations? Just anything there?

Pete Godbole
CFO & Treasurer

So I think as you think about what -- how I might stack the upside of the different drivers, I'm most excited about the product portfolio that we're launching in the -- through the year. We started with the launch in the modernized core application experiences this quarter. And I'm sort of bullish on that. I'm bullish on the next one, which is the leadership that Max brings in bringing efficiency in our sales and marketing theaters that allow us to go -- making our median rep operate like our top rep and getting that forward.

And the third one I would describe is the wildcard, which is all these self-directed experiences, as we open them up to more products, how is that going to play out in terms of the upside of producers. So those are my top 3. The macro is a wildcard, which none of us can actually quite exactly predict. And putting a weight on it -- it's always the biggest one. Could it make a change? It could. But I look at the parts and -- the parts of the puzzle and the pieces we can drive and control.

Operator

Next, we'll move to Josh Baer at Morgan Stanley.

Joshua Phillip Baer
Morgan Stanley, Research Division

I wanted to dig in a little bit as we talk about macro and SMB and what exactly is going on. It looks like from customer counts and full churn disclosures, like we're not talking about logo churn. I just want to confirm that. And then can I dig in between -- is it just seat contraction or less expansion? And like what are the actual behaviors of these SMB customers?

Pete Godbole
CFO & Treasurer

Yes. So the -- I'll describe it to you in terms of rank orders, you can sort of stack it up. The #1 driver is gross expansions with these customers, like the amount of propensity they have to buy in their current environment they're operating in. The lesser one after that is we are seeing reductions tick up, but that's not the major driver. That is a contributor to it, but not in the scale of the first one I mentioned.

Joshua Phillip Baer
Morgan Stanley, Research Division

Okay. That's helpful. And then, I guess, with both of those in mind, like what is -- are those users within an organization using other tools? Like I know there might not be a direct competitive replacement perspective, but like when faced with tougher budgets and having less gross expansion or some reductions, like what are those users using?

Pete Godbole
CFO & Treasurer

So I would describe it as being -- remember, the biggest driver is people buying and gross expansion. So that's just companies deciding there isn't a budget in small companies and saying, I'm not adding another seat. Things that used to happen, we call our transactional business. People would pop in and say, I need another seat. Everything in these smaller enterprises and expansion is going through a more detailed review process. And frankly, that's the part of the business that's suffering.

Now what happens where there's a reduction? I think in some ways, people are leveraging the model to make decisions around, can I convert somebody from being a creator to a collaborator? Can I look at people in the platform and say, who actually absolutely needs it? That's a smaller driver in this equation, but that's what generally happens. It is not a switch to a different product most of the times. It's a, can I do without this person on the platform?

Operator

We'll go next to Taylor McGinnis at UBS.

Taylor Anne McGinnis

UBS Investment Bank, Research Division

So can you comment or quantify what you're seeing so far in quarterly DBNR at the start of this year? I know you said enterprise was strong, but just curious if that means stable or what that exactly means. And then as a follow-up, it seems like in order to get to ARR growth of 14% for the year, you'd have to assume a pretty significant deterioration in DBNR. So is the assumption that SMB and enterprise quarterly DBNR continue to worsen throughout the year?

Pete Godbole
CFO & Treasurer

Yes. So Taylor, I'll answer your question in piece parts as you went through it. The first one is our enterprise dollar-based net retention rate for Q4 is over 120%. So we were pleased by how that played out. That's the first part of it. The second part of it is our assumption is -- what we're making is the SMB portion of that. Remember, I told you the SMB DBNR was close to 0. So it wasn't significantly over 100. We've assumed that, that continues to worsen as we go through the year. What we're doing is essentially taking a more conservative approach to the way the macro might roll out and how the trends might evolve as one part of it. And we're also dealing with an element of as we think of the enterprise portion of it. Enterprise sales cycles are back-end loaded as is the total bookings. We're early in the year, so being a little more thoughtful and prudent as we make those determinations on how big those enterprise bookings and DBNRs could be.

Taylor Anne McGinnis
UBS Investment Bank, Research Division

Got it. And then just as a quick follow-up. I think you mentioned earlier that there might be some initiatives in place to potentially prevent some of the weakness that you're seeing or help curb some of the weakness that you're seeing in the SMB segment. Can you just walk us through what some of those initiatives might be?

Mark P. Mader
President, CEO & Director

Yes. There are 3 things that we're doing. One is at the leading edge, which is about lowering friction on the sign-up and getting started. So that's widening the funnel. I would say the other pieces that have been in flight for a number of quarters now, the first of which is being released later this quarter, is we've gotten a lot of feedback from both the sell-side, buy-side as well as customers on, we really like the power of your platform, but boy, could we modernize it a little bit, please?

And one of the big new views that we've been working on has been actually in evaluation with over 1,000 of our large customers for -- coming up on 5 months now, I believe. That is going to ship this quarter. It's a new view. It's beautiful. It's fast. People love it. It helps on understanding your data and Smartsheet better. That drops this quarter. That's available to every single business plan, every single enterprise plan.

When we think about stabilization and we think about resonating with the SMB buyer, they want new stuff. They want beautiful stuff. They want it packaged in a way that's accessible. So as we look at our guide, one of the conservative things is the new view hasn't released yet. The massively modernized existing views we have, which ship this year, haven't launched yet. Do I think those are going to pull harder than what we've had? Yes, I do.

And until I see a quarter where I see the reaction to those things, both in terms of initial conversion rate, engagement of existing users, which drives the -- and IT administrator's ability to continue to grant them that license or revoke the license, these are all things that I view as potential tailwinds. What I can say is we've been überdisciplined on shipping those things when they're ready. So that first view that launches later this quarter, that thing will be ready, and I know customers love it. And again, what part of our job will be is to report out to you on a quarterly basis now, when they drop, what happens in terms of engagement.

We're doing that on AI right now. We'll report out on views. And I would expect because of the vastness of the lead flow we get from that SMB lower end of the market, it will be really interesting to see how those new experiences drive conversion. The conversion one is sort of a hero metric, but I think the retention piece is the more nuanced one. And I think these can play as big a role in retention as they do in initial conversion. So those are the ones that I'm really keying off of in terms of improved performance.

Pete Godbole
CFO & Treasurer

And one of the things I'll add to what Mark said is the fact that, remember, our guidance philosophy is based on things we can see we have experience on. So the part that Mark mentioned are not included in our guide because we need to see the experience as the full set of these features come to bear in market.

Operator

Our next question comes from Steve Enders at Citi.

Steven Lester Enders
Citigroup Inc., Research Division

I guess when you're talking about trying to bake in more conservatism with new sales leadership coming in, I guess, what does that mean mechanically to the model? And I guess, how much kind of flexibility are you kind of building in for incremental spend or incremental marketing initiatives to help support that change there?

Pete Godbole
CFO & Treasurer

So Steve, we've -- as a part of our plan, irrespective of a new leader arriving, we always have dollars set aside to explore opportunities where we think there are good solid returns. That's a part of the thinking playbook we go through. That's already built into our plan today. It's not incremental conservatism on the margin side that's different. So that's what we've guided to.

And then as far as it relates to sort of how we've built in conservatism for the transition in sales leadership, I'd say it's not one item has a certain value, but all the items I described have a cumulative effect that's built into the guide we've provided.

Steven Lester Enders
Citigroup Inc., Research Division

Okay. That's helpful. And then I think in the prior comment about what the change means, I think there's more focus on international and partners. And I guess, how are you thinking about potentially increasing the investment in those areas and what potentially could be built out more fully with this change?

Pete Godbole
CFO & Treasurer

So as you think about the areas which Mark talked about, which are important to the company and Max brings into the picture, if you will, we're making investments in those areas already. We're making important investments. For example, on the international side of things, we're launching a data center in Australia by the end of the year. We're building out a market in Japan. So all of those investments are progressing with sort of the same mindset. So that's already built into the plan.

What we would incrementally look at if things came out are opportunities that come from those same investments that Max would have a perspective on and the team would have a perspective on. Mark, anything to add on that one?

Mark P. Mader
President, CEO & Director

Yes. I think the area of investment, as we look at shifting some capital from a direct sales team into the partner-enabled channel, I think there's some real return opportunity there. One of the examples I gave in terms of customer success on this call on my prepared remarks was a large global services firm. That deal would not have happened without the partner. The partner was essential based on their industry expertise, their know-how on our platform. We are going to be doubling the capacity of people who are enabling our channel. And that is a -- when we think about our international markets, we have some where we team up with partners. Those are the areas where we have our existing sales teams and success teams.

And then we're also formalizing our partner-first regions, where we are really bolstering the enablement capabilities, the lead allocation to those regions. And that is something which is really going to become -- come online in those regions for the first time in the company's history. Now are those going to be a massive meaningful contributor on bookings this year? I doubt it. But we're planting a lot of seeds. We have those markets identified. We have a number of partners already secured and enabled. And we will -- as I look at the shifting of our people to those higher value, higher leverage positions, whether it be enterprise or partner channel, I think it's one of the things that we've done pretty well as we enter this year.

Operator

We'll go next to Brent Thill at Jefferies.

Brent John Thill
Jefferies LLC, Research Division

Mark, the magnitude of the rev decel is -- I think everyone's kind of scratching their head a bit, why you won't show a little more margin improvement this year. And I'm curious if you could just comment why we shouldn't see more leverage, given the growth rate is falling pretty conservatively? And then I had a quick follow-up for Pete.

Mark P. Mader
President, CEO & Director

On the margin side, what was the reference there? Sorry, I missed that part of the question.

Brent John Thill
Jefferies LLC, Research Division

The revenue deceleration is not offset by the increase in margin. Your margin improvement is obviously very modest. Why not give more margin improvement given the massive deceleration of growth?

Pete Godbole
CFO & Treasurer

I'll answer that one. As you look at the guide we've provided at the start of the year, it's always a balance. So when you think of where we started last year, we sort of started the year with a set of things we think we can do well. And we go through the year and continue to optimize as we sort of deliver and go through the operational rigor of what we need to do. So our initial guide is 12% to 13% op margin. It's probably a reasonable starting point for this journey. So we've entered the year with a Rule of 40 for FY '24. If you look at where we started in FY '24, we started at about 34%, 35% rate, and this through the year to where we needed to get to.

Mark P. Mader
President, CEO & Director

Yes. I think the other thing that I would add to that, in terms of how we plan for the year, we set our budgets, we set our plan. And we also have certain stage gates that we expect our teams to deliver against. So as we go through Q1, we have certain opportunities that we're looking to drive on AI, some of these new capabilities we're launching to market. We expect performance to come on the back of that. And if those stage gates are met, then we continue to invest per our plan. And Pete has the right to inform us of a pullback in a couple of those areas to add more margin if those stage gates aren't hit. So I like the fact that we still have this mindset of investment. And I do think some of the investments we have an opportunity to demonstrate a contribution beyond what we have in our plan today.

Brent John Thill
Jefferies LLC, Research Division

Okay. And then just a real quick follow-up on SMB. One of the theories of why maybe you're seeing the weakness that you're seeing is that you are spending a lot more time going upmarket. And many question, is this more execution and more of a competitive issue rather than blaming SMBs for not spending?

Mark P. Mader
President, CEO & Director

Yes. I think part of the things that we're looking to do, one of the reasons we're trying to get the lowering of friction, getting people to discover things in a self-directed way, it's like, you don't want to spend a lot of human capital getting those thousands and thousands and thousands of trialers to a point where they want to buy. I think a really good indicator of continued progress is we had, of our 500 companies, new organizations who moved from the free plan to a paid state in January, one month, those are very self-directed motions. Those are not like heavy enterprise selling. And we're trying to get -- they open the aperture of getting that lead flow bigger and then positioning our offerings in a way where people can connect and purchase. Part of that is features. Part of that is pricing and packaging. Part of that is the instantiation of the free plan a year ago.

And when I look at the performance of new logos coming in at that leading edge, it remains very healthy. We have tens of thousands of orgs who do not pay us today engaged on the free platform today and the conversions coming out of that. Now we launched that free plan a year ago. So could you say, well, some of that demand is -- didn't convert, rests in free and there's a bit of an air gap now, we're waiting for that demand to build? Yes, you absolutely can -- you can draw up that model and convince yourself of that.

I think the NDRR though -- sorry, the conversion rate on new on those SMB customers is heavily influenced by what you serve up to them. And one of the reasons we're making these investments is because we think there's an opportunity to dramatically improve that. And we're doing that alongside of the enterprise focus. It's not like we're moving student body, right, saying it's all about enterprise. It's enterprise-grade offerings that should work for both the leading edge SMB as well as a really large company out there. And it's -- again, we look forward to reporting on improvement on this.

Pete Godbole
CFO & Treasurer

And you mentioned the competitive element, if you will, that was your follow-up. If you just looked at it, we talked about sort of what SMB -- what I call NDRRs are doing. If you look at our -- any of the competitive in-peer NDRRs, they're thinking our NDRR is probably the strongest on that peer set. So when you look at it, the business has to go somewhere with an expansion. Nobody's seeing it. So I would describe it as being it's more of a function of the buyer in that market and how they're sort of prosecuting incremental adds in what they want to do. That's as simple as it is.

Operator

We'll move next to Scott Berg at Needham & Company.

Robert Michael Morelli
Needham & Company, LLC, Research Division

This is Rob Morelli on for Scott. Just a high-level one here. With budget scrutinization continuing, can you just provide any insight on how consolidation trends impacted the quarter, particularly on the enterprise side, whether it continues to be a net benefit or a headwind and then maybe how you anticipate it plays a role into 2025?

Mark P. Mader

President, CEO & Director

I think consolidation remains more present in enterprise settings where people have hundreds of thousands of dollars of investment. We haven't really seen a dramatic change, though, in rate or frequency. A couple of customer examples that I said in my prepared remarks did become via a review by an IT organization that is trying to standardize. But when you look at the grand scheme of transactions in the quarter, it's still a very, very small percentage.

Operator

And that does conclude our question-and-answer session. At this time, I would like to turn the conference over to Aaron Turner for closing remarks.

Aaron Turner
VP of Investor Relations & Treasurer

Great. Thank you all for joining us this quarter, and we'll chat with you again next quarter.

Operator
And this concludes today's conference call. Thank you for your participation. You may now disconnect.