

AI adoption accelerates, but weaker margins and cash conversion leave the financial inflection unproven

1 KEY RESULTS VS. CONSENSUS			
Metric	Reported	Consensus	vs. Cons.
Revenue	\$4.106 billion	\$4.10 billion	+0.15%
Diluted EPS (adjusted)	\$1.00	\$1.03	-2.9%
REVENUE BY LINE			
Subscription revenue	\$3.988 billion	\$3.98 billion	+0.2%
Professional Services & Other revenue	\$118 million	\$114.2 million	+3.3%

2 | GUIDANCE AND OUTLOOK

Full-year subscription revenue guidance was raised to \$15.78 billion to \$15.79 billion, from \$15.76 billion to \$15.78 billion; the \$15 million midpoint increase is \$12 million currency and \$3 million operating. Fourth quarter subscription revenue is guided at \$4.245 billion to \$4.255 billion, with current remaining performance obligation growth of 18.5% in constant currency, including about 175 basis points from Armis. Full-year subscription gross margin guidance stays at 81%, operating margin at 31.5%; the free cash flow margin target rose to 36% from 35% on lower capital expenditure.

3 | EARNINGS ANALYSIS

A MODEST REVENUE BEAT, A PROFITABILITY MISS. Total revenue of \$4.106 billion beat consensus by \$6 million, or 0.15%; subscription revenue beat by \$8 million and current remaining performance obligations by \$80 million. The profitability lines missed: adjusted EPS of \$1.00 was 2.9% below the \$1.03 estimate, adjusted gross profit fell about \$55 million short, and adjusted free cash flow missed by about 11%.

THE FULL-YEAR RAISE IS MOSTLY CURRENCY, WITH A DEPLOYMENT OFFSET. The \$15 million increase in the full-year subscription revenue midpoint comprises \$12 million of currency and \$3 million of non-currency change, because management is bundling deployment expertise into selected large contracts, allocating consideration from subscription revenue to professional services: about 25 basis points of subscription growth in Q3 and about 50 basis points in Q4.

MARGIN DETERIORATION IS THE CENTRAL FINANCIAL FACT. Subscription gross margin fell from 83% to 80% as adjusted subscription cost of revenue rose about 42% against 20.9% revenue growth, and adjusted services gross profit swung from a \$12 million profit to a \$23 million loss. The 32.5% adjusted operating margin exceeded management's 31% guidance but declined from 33.5% a year earlier. The 81% full-year subscription margin target implies a Q4 margin of roughly 81.6%.

CASH FLOW QUALITY: THE INCREASE IS CAPEX AND ADDBACKS. Adjusted free cash flow rose 38.9% to \$822 million, but operating cash flow rose only 3.2%; conventional free cash flow was \$748 million. Of the \$230 million increase, \$26 million came from operating cash flow and the rest from lower capital expenditure and larger addbacks. Year to date, operating cash flow fell 3.4% while adjusted free cash flow rose 19.9%.

AI ADOPTION IS REAL; ITS INCREMENTAL ECONOMICS ARE UNPROVEN. AI net-new annual contract value grew 65%, the year-end AI ACV target rose to \$1.7 billion from \$1.0 billion at the start of the year, and production consumption rose more than 13x. But ACV is not recognized revenue, and how much consumption is incremental paid usage is undisclosed. The quarter strengthened the company's strategic position; a financial inflection is not yet established.

4 | KEY READ-THROUGHS

SERVICENOW'S DOWNMARKET ENTRY CHALLENGES FRESHWORKS' DEPLOYMENT ADVANTAGE
Freshworks (FRSH) | Negative | Moderate near-term competitive and valuation risk, potentially high strategic significance for Freshservice over 12 to 24 months
ServiceNow introduced Flow, a conversational service desk for businesses not ready for formal ITSM, with self-service purchasing, consumption billing, and same-day deployment. That attacks the deployment simplicity differentiating Freshservice, narrowing the separation between the enterprise incumbent and the midmarket challenger. Freshworks' employee-experience ARR growth of 24% is counterevidence, but net dollar retention of 104% makes new-customer acquisition important.

FASTER CRM MIGRATIONS WEAKEN A KEY DEFENSE OF SALESFORCE'S INSTALLED BASE
Salesforce (CRM) | Negative | Moderate for service, operational CRM, and configure-price-quote opportunities; lower immediate impact on consolidated revenue
ServiceNow reported 28 CRM and industry-workflow transactions above \$1 million, up from 15 in Q2, with CRM AI net-new ACV tripling, and management described customers ripping and replacing rather than only adding alongside. Implementation periods of about 30 to 60 days, aided by the Sweep acquisition, reduce the switching costs protecting Salesforce's installed base. Salesforce's Agentforce ARR above \$1.5 billion is substantial counterevidence.

AUTONOMOUS RESOLUTION PUTS LABOR-BASED REVENUE MODELS UNDER GREATER PRESSURE
Concentrix (CNXC), Teleperformance (TEP) | Negative | Potentially high over multiple renewal cycles; moderate near-term valuation sensitivity
ServiceNow's level 1 service desk specialist resolves incidents 85% faster than human agents and operates autonomously in production. Under contracts priced by staffing, hours, or interactions, fewer human-handled requests translate into lower revenue and weaker renewal pricing. The offset is contract structure: outcome-based pricing lets an outsourcer that owns the automation keep part of the savings, as Concentrix's margin expansion on falling revenue shows.

CAPITAL-LIGHT APPLICATION AI CAN STILL SUPPORT HYPERSCALER DEMAND
Microsoft (MSFT), Alphabet (GOOGL), Amazon (AMZN) | Positive | Low consolidated financial impact from ServiceNow alone; meaningful validation of a broader industry mechanism
ServiceNow grew production agentic AI consumption more than 13x while raising its free cash flow margin target on lower capital expenditure, because application vendors can expand AI usage without owning all the infrastructure. Gemini Enterprise supplies a conversational front end into ServiceNow workflows, and AWS sits in the Control Tower Alliance. Capital efficiency at the application layer can coexist with growing cloud demand.