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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Datadog Third Quarter 2019 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to your speaker today, AJ Ljubich, Director of IR and FP&A. Thank you. Please go ahead.

AJ Ljubich *- Datadog, Inc. - Director of IR and FP&A*

Thank you, John. Good afternoon, and thank you for joining us today to review Datadog's third quarter 2019 financial results, which we announced in our press release issued after the close of market today. Joining me on the call today are Olivier Pomel, Datadog's co-Founder and CEO; and David Obstler, Datadog's CFO.

During this call, we will make statements related to our business that are forward-looking under federal securities laws and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, including statements related to our future financial performance, including our outlook for the fourth quarter and for the full year of 2019, our strategy, benefits of our products, the potential contribution of customers with ARR of $100,000 or greater, R&D and go-to-market investments, expected capital expenditures and the size of our market opportunity. The words anticipate, believe, continue, estimate, expect, intend, will and similar expressions are intended to identify forward-looking statements or similar indications of future expectations. These statements reflect our views only as of today and not as of any subsequent date. These statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations. For a discussion of material risks and other important factors that could affect our actual results, please refer to our prospectus filed with the SEC pursuant to Rule 424(b) dated September 19, 2019, which is available in the Investor Relations section of our website.

A replay of this call will be available there for a limited time.

Additional information will be made available in our quarterly report on Form 10-Q for the quarter ended September 30, 2019, and other filings and reports that we may file from time to time with the SEC.

Additionally, non-GAAP financial measures will be discussed on this conference call. Please refer to the tables in our earnings release, which you can find on the Investor Relations portion of our website for a reconciliation of those measures to their most directly comparable GAAP financial measures.

With that, I'd like to turn the call over to Olivier.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Thank you, AJ, and thank you all for joining us today for our Q3 earnings call, which is our first as a public company. My co-founder Alexis and I started Datadog about 9 years ago with a mission to break down silos between developers and IT operations teams. Today, we are the monitoring analytics platform for DevOps and business users. We provide clarity and actionable insights into software applications and IT infrastructure, all in real time. We exist so that our customers can understand everything that happens in their technology stack, enabling them to deliver greater innovation, provide an exceptional user experience and achieve faster resolution of performance issues. While we are very proud of the company we have built, we're even more excited for the future and the tremendous opportunity ahead of us. I would like to start with a quick review of our business and financial results.

For the third quarter, revenue was $95.9 million, an 88% increase year-over-year. Non-GAAP operating income was $638,000 or a margin of 0.7%. We ended the quarter with 727 customers with annual run-rate revenue or ARR of $100,000 or more, which is a 93% increase from a year ago. We achieved this while maintaining an efficient tax payback.

As in past quarters, our dollar-based net retention rate was over 130% as customers increase their usage and adopted our newer products. And we also continued to be capital-efficient as our cash provided by operating activities in Q3 was $3.8 million and year-to-date, $6.8 million.

Since this is our first call as a public company, I would like to spend a few minutes providing an overview of our market opportunity, our product and our go-to market before I review our third quarter highlights. As we all know, the massive IT platforming is underway. Companies are moving from static on-premise IT architecture to public and private cloud, as well as other terminal technologies like containers, microservices and serverless computing. These newer technologies allow for increased agility and innovation but also compound complexity in IT's role. Meanwhile, historically separate developers and IT operations teams must come together in order to manage its scales and better collaborate around a shared view of the IT stack. As businesses are becoming more and more digital, these challenges are affecting companies across all industries, geographies and sizes.

We believe we are at the very early stages of a substantial market opportunity, which we estimate to be approximately $35 million based on our bottom-up calculation.

From a product perspective, Datadog was founded in 2010 as a real-time data integration platform that turns the chaos on diversified sources into digestible and actionable insights. Our vision was a single platform that will provide Dev and ops users with a common view across sources, teams and technologies. In 2012, we launched our initial use case, infrastructure monitoring. Starting with infrastructure give us broad deployment across Dev environment and ubiquity across Dev and ops users. In other words, we were deployed everywhere and used by everyone.

Since initial launch, we have continued to innovate across more environments, including containers and serverless as well as on-premise hybrid private and multi-cloud environments. Because problems rarely stop at the boundary between infrastructure and applications, we saw a need for full stack observability, and we launched Datadog Application Performance Management or APM in 2017. We quickly added Datadog Log Management in 2018, thus completing what we like to call the 3 pillars of observability. Earlier this year, we also launched Datadog Synthetics to extend into user experience monitoring, by letting our customers simulate user journeys on their web applications and API endpoints.

All our products, features and functionalities are offered within the same tightly integrated platform. Our customers can frictionlessly add up new products, all from the same user interface and powered by a common data model. We believe we win in the market for a few reasons. One, we are a truly integrated platform, allowing us to solve our customers' end-to-end problems and innovate rapidly. Two, we were built for the modern dynamic stack offering end-to-end visibility. Three, we are simple but not simplistic, easy to install with no professional services. And four, we are designed for use in collaboration across development, operations and business team.

From a business model perspective, we have an efficient operating model, which has enabled us to achieve best-in-class growth and very modest cash burn. Despite significant and ongoing investment in R&D and sales and marketing, we have only burned approximately $30 million in cash since we began and we have a very strong CAC payback. This allowed us to continue to invest in our product and solve more problems for our customers. With that background in mind, let's review our third quarter performance.

Overall, we are very pleased with our results. Strength was broad based, driven by both robust new logo additions as well as continued growth of existing customers. Our platform strategy is clearly resonating, including strong initial uptake of our Synthetics product in the quarter.

From the R&D perspective, we continue to invest in our product suite. And we announced over 15 new products, features and functionalities this July at Dash, our annual user conference. One of the products we announced was Network Performance Monitoring to allow customers to visualize the flow of network traffic in both cloud-based and hybrid environment it is an extremely lightweight solution that is compatible with all major cloud providers and on-premise servers, giving customers the flexibility to monitor network traffic without sacrificing performance.

Another new product was Real User Monitoring, which complements Synthetics for user experience monitoring. It allows customers to analyze the performance of applications as directly experienced by the end users.

We also continue to iterate on our existing solutions. For instance, Log Rehydration allows our customers to reload our catalogs into the Datadog platform to enable full indexing and analysis. And as a reminder, our model allows us to charge for data indexing separate from ingestion. We added certain level of service level objectives to our platform, allowing customers to easily track SLOs, which are relevant to both engineers and business users. And additionally, we announced enhancements to our machine learning and AI capabilities. Watchdog, our always-on detection engine now automatically surfaces anomalies within the infrastructure and APM portable platform.

Metric Correlation is another new feature that will analyze any metric exhibiting an unusual trend and actively search for others that are displaying a similar pattern, and Trace Outliers will automatically analyze all incoming APM traffic allowing our customers to easily spot meaningful outliers.

Last but not least, another exciting development we announced in October is that Datadog is currently in process for FedRAMP certification, and we're very excited by the potential to expand our addressable market to U.S. federal departments and agencies.

As a quick note, the products announced at Dash are in beta, and we are not yet charging our customers for them.

Now switching gears to talk about products we already charge for. In Q3, we began charging for Synthetics, which has gotten off to a very strong start. This is in line with our track record of new product introductions as our unified SaaS platform allows customers to adopt new products without any friction. In Q3, we saw strong adoption of our newer products from both new and existing customers. As evidence of our strong platform adoption, approximately 50% of our customers were using 2 or more products at the end of Q3, which is up from 40% last quarter and 15% a year ago. And we'll point out that our newer products are no more than about 2.5 years old.

As mentioned before, we have continued to invest in R&D. For the year-to-date period through Q3, non-GAAP R&D expense was 30% of revenue, which is an increase from 27% in the year-ago period. Given our platform strategy and our proven track record of efficiently developing and selling newer products, we plan to continue to invest meaningfully in R&D. That's it for product. Onto the go-to-market side.

In the third quarter, we saw strong new logo additions as well as expansion from existing customers. As of the end of the third quarter, we had approximately 9,500 customers, up from 7,100 a year ago. We ended with 727 customers with an ARR of $100,000 or more, up 93% from a year ago. That's an increase of more than 130 in the quarter alone. Given that more than 70% of our ARR is generated from customers over $100,000, we expect this cohort of customers to be a large driver of our future growth.

Now let's review some of our key wins in the quarter. First, one of our new customers is a multinational telecom provider out of Europe. This customer adopted Datadog to support their e-commerce site ahead of the new iPhone launch. Our platform enabled them to have a successful launch without any major performance issues, while other carriers in the country experienced website outages because of traffic surges. This initial 6-figure land includes all 3 pillars: infrastructure, APM and logs as well as Synthetics. Second, an established Fortune 500 retailer had a 6-figure upsell. This customer adopted infrastructure monitoring in 2017, followed by both APM and Log in 2018 and more recently, Synthetics. Over 100 of their internal teams are using Datadog as they adopt Microsoft Azure and container technologies. This customer's spend with us has grown more than 5x since our initial deal, and we believe there is still a lot more room for growth. Next, one of our largest Q3 deals was a 7-figure, 3 pillars, new logo from a higher education software and services company. This mid-market customer with fewer than 5,000 employees demonstrates the spending power of even midsized companies as they come to Datadog as a strategic partner to support their digital businesses. Finally, a large Europe-based shipping and logistics company with origins dating back over 100 years, had a 6-figure upsell in the quarter. This company was previously using built-in cloud provider monitoring tools, which lack the ability to correlate front- and back-end issue. And this is a powerful example of how Datadog enables companies in all regions and industries who are in the middle of their digital transformation.

As we said during the IPO, we'll continue to invest in our go-to-market. This includes growing quota-carrying reps by 70% year-over-year as of the end of Q3. We do experienced high returns on our sales and marketing investments, benefiting from our very efficient business model and driven by our land and expand go-to-market. As evidence of our business model efficiency, our CAC payback continues to be approximately 1 year. And we intend to continue investing meaningfully in our 7 marketing efforts globally.

With that, I would like to turn the call over to our Chief Financial Officer; David Obstler. David?

David M. Obstler - *Datadog, Inc. - CFO*

Thanks, Olivier. As mentioned, we are very pleased with our strong third quarter results. Since this is our first earnings call, I would like to begin with a brief overview of our financial model. I will then review our Q3 performance and provide our guidance for the fourth quarter and full year.

We generate revenue from the sale of subscriptions to our SaaS platform. Customers have the option to purchase multiple products, including infrastructure monitoring, APM and Logs as well as additional SKUs, such as containers, custom metric packages and anomaly detection. Our revenue is all subscription as professional services are not required to implement our products. Customer contracts typically have either annual or monthly commitments. Additionally, customers are built for on-demand usage in excess of their committed amount, typically monthly in arrears. Given the mix of annual and monthly invoicing and the variability in billing, we do not believe that calculated billings is the most useful metric for investors to evaluate our business performance. As in any one period, billings growth can vary substantially from revenue growth.

Turning to Q3 results. Revenue was $95.9 million, up 88% year-over-year. As Olivier mentioned, the quarter's strength was broad based, driven by new and existing customers as well as strong platform adoption and initial uptake of Synthetics. To provide you with some more context. First, in Q3, we saw strong new logo additions across both sales channels and regions. This is particularly notable in what is typically a seasonally challenging third quarter involving the summer. Additionally, we saw strong continued expansion of existing customers. In the third quarter, our dollar-based net retention rate was above 130% for the 9th consecutive quarter. Our robust retention rate is driven by increased usage of existing products as well as cross-selling of newer products, including the inclusion of Synthetics for the first time. Once our customers are on the Datadog platform, they can frictionlessly expand with us through increase use of the platform. The cross-selling of newer products is a more recent driver of our net retention rate. Lastly, we note strength internationally, specifically a strong sales quarter in EMEA. This is particularly impressive, given many of the teams in the region are still ramping.

Calculated billings, defined as revenue plus the sequential change in deferred revenue, was $112 million, up 132% year-over-year. As mentioned, we do not believe calculated billings to be a focused metric for our business due to the mix of monthly and annual billing terms among our customers and because billings growth can vary substantially from revenue growth in any one period. Nor do we plan to comment on it on a regular basis going forward. But to give you an example of the variance between billings and revenue growth, we want to add a few comments.

First, we had a multimillion dollar deal which was renewed and billed in Q3 '19. This customer was not billed in Q3 last year. In addition, we had one large 2-year prepaid deal in Q3 '17, which was, thus, not billed in Q3 '18, but was billed again in Q3 '19. Adjusting for these two customers, normalized calculated billings growth would have been approximately 100%, still very strong and generally reflective of our strong Q3 sales.

Now let's review the income statement in more detail. As a reminder, unless otherwise noted, all metrics are non-GAAP. We have provided a reconciliation of GAAP to non-GAAP financials in our press release. Gross profit in the quarter was $72.9 million, representing a gross margin of 76%. This compares to a gross margin of 77% a year ago and 75% last quarter. As we have discussed previously, we are in the middle of an accelerated innovation cycle of delivering new products as well as the build-out of cloud data centers in newer geographies. We will, over time, balance investment and optimization to manage our gross margin. R&D expense was $26.8 million or 28% of revenue in the Q3, up slightly from 27% a year ago. We continue to benefit from product-led adoption and have made extensive investments in our platform. This is evidenced by the launch of Synthetics earlier in the year and the 15-plus product announcements made at Dash. We continue to see a meaningful opportunity to further our innovation and expand our platform and therefore, plan to continue to make meaningful investments in R&D going forward.

Sales and marketing expense was $37.3 million or 39% of revenues, down from 48% in the year-ago period. The change in Q3 was more pronounced than usual due to both the outperformance of revenues and the timing of trade show events between 2019 versus 2018. We note that for the 9 months ended September 2019, sales and marketing expense as a percentage of revenue was 41%, down from 43% in the year-ago period, showing the development of some leverage in sales and marketing. We continue to see strong returns from our sales and marketing investments and plan to continue to invest to expand our go-to-market globally.

G&A expense was $8.2 million or 9% of revenue, slightly higher than 8% a year ago, given some IPO-related expenses. Operating income was a positive $638,000 or 0.7% operating margin compared to an operating loss of $3.2 million or negative 6% in the year-ago period.

Net income for the quarter was $695,000 or breakeven per share based on 285 million weighted average diluted shares outstanding. We have a highly efficient business model and experience a high return on our investments in sales and marketing and R&D. While we have operated around breakeven and outperformed on profitability in Q3, we see ample opportunities to continue to invest in the larger -- in the large market opportunity ahead of us.

Turning to the balance sheet and cash flow. We ended the quarter with $771 million in cash, cash equivalents and restricted cash. This includes approximately $709 million net IPO proceeds. Cash flow from operations was a positive $3.8 million for the quarter and a positive $6.8 million year-to-date. After taking into consideration capital expenditures and capitalized software, free cash flow was a negative $3.7 million for the quarter and a negative $10.1 million year-to-date. Our capital expenditures consist primarily of real estate build-outs and was slightly elevated due to projects in our New York and Paris offices. The timing of some of the payments for New York and Paris build-outs shifted to Q4, and we, therefore, expect another quarter of slightly elevated CapEx. Given we are hosted entirely in the cloud, our hosting costs flow through the P&L, not CapEx.

I would now like to turn to our outlook for the fourth quarter and the full year 2019. Beginning with the fourth quarter. We expect revenue to be in the range of $101 million to $103 million, which represents a year-over-year growth of 65.5% at the midpoint. Non-GAAP operating loss from operations is expected to be in the range of negative $6 million to negative $8 million. Non-GAAP net loss per share is expected to be in the range of negative $0.01 to $0.02 per share based on approximately 297 million weighted average shares outstanding.

A few things to take into account in our guidance. First, in the third quarter, we saw a meaningful growth of existing accounts and billed for Synthetics for the first time. While we have seen meaningful and sustained growth of existing accounts over time and have a history of launching new products, this can be more challenging to predict over short periods. Second, on profitability. In Q4, we will have the first full quarter of public company costs, particularly D&O insurance as well as some sizable trade show expenses.

For the full year 2019, revenue is expected to be in the range of $350 million to $352 million, which represents 77% year-over-year growth at the midpoint. Non-GAAP loss from operations is expected to be in the range of negative $18 million to negative $20 million. Non-GAAP net loss per share is expected to be in the range of negative $0.11 to negative $0.12 per share based on approximately 140 million weighted average shares outstanding.

To summarize, we are very pleased with the business performance in the third quarter. We have built the leading monitoring and analytics platform for the cloud age and are generating growth at scales that few companies can match. We are making continued investments for growth in the foreseeable future. We believe we are at the early stages of a multibillion-dollar market opportunity, and we feel very good about our ability to build a very large and successful company over time.

With that, we will now open the call for questions. Operating -- operator, let's begin the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Sanjit Singh from Morgan Stanley.

Sanjit Kumar Singh - *Morgan Stanley, Research Division - VP*

Congrats to the team on a successful IPO and your first earnings call and a very strong set of results, so congrats on all fronts there. Olivier, maybe to start off the Q&A, I wanted to ask about the quarterly performance this quarter. Did you see strength coming from competitive displacements? Are you seeing displacing competitors? Or you're continuing to see a lot of the growth coming just from greenfield expansions? And then I had a follow-up.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So the business is still mostly greenfield and it's mostly net new, and it's mostly cloud environments, which by definition are new for our customers. They always have other solutions, especially when you talk about large customers and large enterprise customers. They have lot -- they have existing solutions for their legacy environment, but they make new decision for the cloud environment. We do see also a few competitive displacement, but that's not the majority of what we do.

Sanjit Kumar Singh - *Morgan Stanley, Research Division - VP*

Understood. And then as a follow-up, it seems like you're seeing some strong momentum with new products. It seems like Synthetics has some really good early signs of traction there, and you had some additional opportunities in international. And also, it looks like, you said, to be an opportunity for you. So maybe if you could sort of stack rank some of the opportunities in terms of what are the biggest opportunities that you see over the next 1 to 2 years. And what are some of the more near-term opportunities that you think can drive growth more than near term or whether it's network performance monitoring, when that comes off of beta? Or is it just continued traction with Synthetic? So sort of a stack ranking of the near-term and the medium-term opportunities.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Well, near term, we have -- our core product or core infrastructure product is still growing very, very fast. And is what we -- no, most of our customers use in conjunction with other products, and they still grow a lot with that product. In addition to that, our APM and Log Management products are also very recent, and they're both in hyper growth. And so they drive a lot of our short-term and near-term success. Newer products, like Synthetic are a nice add, but their -- they don't represent the bulk of the outperformance within this quarter. So right now, it's still the basic, still the 3 pillars, the products we have in the market and we've been developing over the past few years that are getting us the bulk of our growth.

As we mentioned in the call, we've been very happily surprised by the performance of Synthetics right out of the gate. It's a great sign. It's a great sign, in particular, when we think of all the new products, we're having the wins that we haven't started charging for. But again, that's -- it will be more material in the quarters or in years to come.

Operator

Next question comes from the line of Sterling Auty from JPMorgan.

Sterling Auty - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I wanted to better understand, in terms of the customers that are going with multiple products, both new and existing, how would you characterize how much of that success is coming out of the mid-market versus large enterprise?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

It's about the same. We see the same behavior in the -- in all parts of the market when it comes to that. In fact, if -- the places where we'll see customers not using necessarily us for everything they do is companies that have been earlier into the cloud and that have used other products for a while and then have everything set up that will wait. That's where we don't have any initial opportunity to displace everything at once. When customers are newer to the cloud and they're starting their migration, which is the case of most of the enterprise customers as well as the higher end of the mid-market, there's an immediate opportunity to land on 2 or 3 or 4 of our products at once.

Sterling Auty - *JP Morgan Chase & Co, Research Division - Senior Analyst*

That makes sense. And then one follow-up question. The market has seen your pricing that you're using for logging as very disruptive. And I think we're starting to see some of the competition make changes to their pricing. Wondering what you're seeing in the competitive dynamics with all of those changes.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

We don't see any change in the competitive dynamics yet. I think we've seen some pricing from some other vendors. And -- but ultimately, it hasn't changed the fundamental dynamics for their customers and in the conversation we've had so far.

Operator

Next question comes from the line of Chris Merwin from Goldman Sachs.

Christopher David Merwin - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. Maybe can you just talk a bit about how the ongoing shift to containers is changing the competitive landscape for you at all? Is it, I guess, increasingly important in terms of your ability to monitor these workloads? Is that an increasingly important factor in determining why you win with customers?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So it's definitely -- when you think of what makes the old guard of tooling and approaches just not work at all, like containers as one big part of that. And we've been monitoring containers at scale for many years now. We've had -- we've seen our customers run containers in production since -- before it was advisable to do it. And that's been a big part of our infrastructure monitoring product for many years now. We don't have numbers to share on the volumes we see, but I can tell you that we already see several times the numbers of containers at any point in time as we do the number of traditional instances of VMs.

Christopher David Merwin - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. Great. And then as you continue to invest in R&D, maybe can you just talk a bit about some of the main projects there. I mean it look, obviously, you have a very strong and comprehensive suite in the market already, but with the incremental R&D investment, are you looking to go broader in terms of product from here? Or is it just maybe more focused on deeper in terms of the functionality with some of your existing products maybe to help with even further traction in the enterprise?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Well, it's a bit of both, right? So we have, as I mentioned earlier, our infrastructure product is still growing very fast. And there's a lot of ground. We can still cover to make life easier for our customers there. So we are heavily investing in our infrastructure product. Our Log Management and APM products are in hyper growth, and we're very rapidly innovating there. So we're investing heavily. We have a few more products we've announced at Dash that we have to fully bring to market. As I mentioned earlier, most of these products are in beta, and we haven't started charging for them yet. And that's something that you'll see in the next few quarters. And then there's a few larger categories we talked about in the IPO road show that we think we can enter in the future, but that's, I would say, mid- to long-term plan.

Operator

Thank you. Next question comes from the line of Brad Zelnick from Crédit Suisse.

Brad Alan Zelnick - *Crédit Suisse AG, Research Division - MD*

Great. Congrats on a very strong start as a public company. My first question is for Olivier. Olivier, I wanted to ask a question about open telemetry as we head towards the official convergence of open census and open tracing. And obviously, you've supported the project up until now. But looking forward, to the extent the project is successful in standardizing instrumentation for metrics and traces, what sort of impact would you expect it to have on your business model, if any, at all?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

It's all good for us. I think we've always thought that the data collection on the customer side was not going to be the long-term differentiator. And that's why we've actually open-sourced all of our technology that leads on the customer side, our agents our libraries, or APIs, everything is open-sourced. Supporting open telemetry is another step in that direction. At the end of the day, what matters is to make the product as easy to deploy as possible as easy to get information in and out of as possible. And that's where we invest heavily on the back end of our product.

Brad Alan Zelnick - *Crédit Suisse AG, Research Division - MD*

That makes perfect sense. And David, can you update us on how we should expect gross margins to scale as you continue to see strength internationally and need to ramp compute capacity overseas?

David M. Obstler - *Datadog, Inc. - CFO*

I think we gave, in our long-term model, a slight improvement over time. We said that we're in investment mode. So right now, we're balancing the investment versus optimization. You see we've been in the range of 75%, 76%. We said we will -- as we get to 75%, start to try to balance a little more. So that's our approach to that. But we're still in investment mode, and we'll still expand geographically.

Operator

Next question comes from the line of Raimo Lenschow from Barclays.

Raimo Lenschow - *Barclays Bank PLC, Research Division - MD & Analyst*

Congrats from me as well. Olivier, like -- if I understand you correctly, like, people come to you when they move over to the cloud because the old tools, the on-premise tools, don't work anymore. And there, my first question is more a big-picture question. Where are we in that cloud migration? It feels very, very early, which basically means that even on infrastructure monitoring, there should be huge opportunity of initial workloads coming over, but then more and more workloads coming over. I just want to hear your big picture thinking there?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So look, nobody knows exactly where we are. Like, it's hard to wrap your arms around the whole thing. But depending on the various people you can ask, the various folks who have tried to estimate that, it's either single-digit percent or it's in the low teens, basically, of the workload that have moved from legacy IT to public and private cloud. So with that in mind, we have basically 95% or so, or 90% of the end market that is -- that hasn't been attributed yet, which is why we think, even for infrastructure, which was our first product, there is a tremendous amount of runway ahead of us. This is also compounded by the fact that as companies transform and become digital businesses, the overall impact and footprint of their application and software is going to grow. So the end state, we're not just looking at the transition from whatever we had before data center into something that's more cloudy, but of equal size. We see that end state is going to be a lot larger. Again, it's hard to quantify. I know you can lead -- read a lot of Gartner reports and things like that, but we're confident that this is a very large opportunity, and we are at a very, very, very beginning of it.

Raimo Lenschow - *Barclays Bank PLC, Research Division - MD & Analyst*

Okay. Perfect. And then the follow-up was like, as you launch a new product, like, what's your thinking around just marketing or selling this as a platform versus the individual products?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

So the way we do this is we may [schedule] around the platform, but we approach customers with the infrastructure first. And the infrastructure is the immediate pain that customer feel that needs to be remediated that we get our foot in the door with, so to speak. But we always mix that with the platform.

Raimo Lenschow - *Barclays Bank PLC, Research Division - MD & Analyst*

So it's a bit of both?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes.

Operator

The next question comes from the line of Matt Hedberg from RBC Capital Markets.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

Guys, I'll offer my congrats as well. Olivier, my question was on APM, and it's sort of a follow-up to Raimo's. When we talk to folks out there in the industry, a lot of people think that maybe only 5% of apps are being monitored. I'm curious, I guess, why is that? And 5 years from now, where do you think we could be at as an industry?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So -- and that's a product mostly used in conjunction with legacy APM. So the APM that was used in a traditional data center app. And the reason for this slow instrumentation rate is that these APMs are very, very, very heavy weight, and they're very expensive. So it's very hard actually to deploy them and get value out of them. And it ends up being limited to a small set of extremely high-value applications for which you can be convinced to make an investment and get some ROI out of it. When you think of the world we're going into, the world of the cloud, the world of companies that are becoming increasingly software companies, they are going to have many, many, many more apps. And the solutions we're providing to them are a lot easier to deploy. And it's actually a lot more affordable for each unit of compute they have to deploy our solutions. So we're going to end up with a market that is significantly larger. And there's going to be a lot less investment needed to get to -- to see returns. So that's the big difference between the -- this world of the 5% of the apps being monitored with APM to the world of the future where companies operate mostly digitally, and they will end up instrumenting most of the applications.

Matthew George Hedberg - *RBC Capital Markets, Research Division - Analyst*

That's super helpful. And then maybe as a follow-up. Congrats on the early success of Synthetics. I imagine a lot of that's greenfield wins. But could you talk a little bit more about the competitive landscape for Synthetics?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So there's a few different aspects to it. And the first one is a number of the APM vendors have Synthetics capability on top of their APM product. So that's, I would say, the first set of competitors. And then there are a number of companies that offer pure-player Synthetics testing. Some of them, I would say, fairly low end. So some cheap products that you can very easily adopt. And then there's another part of the industry that is more into QR replacement in a high-end software testing. So that's the overall landscape. Our initial focus was not really to try and compete with any of those specifically. It was to fill a gap we saw in the way our customers could understand and maintain the performance of the applications. So we didn't drive it from an intent to compete head-to-head with those companies. We drove it from what we think the future is going to look like in terms of an integrated platform that covers everything, including simulating user traffic.

Operator

The next question comes from the line of Brent Thill with Jefferies.

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Brent John Thill - *Jefferies LLC, Research Division - Equity Analyst*

Yes, just a quick follow-up in Synthetics. When you mentioned the strong uptake, I was just curious if you could dive a little deeper into that comment in terms of what you're seeing and perhaps what you think the incremental revenue uplift you're seeing?

And the second part is as you continue to expand this product portfolio, which is obviously very robust. Is there an easier way that you can go-to-market with an enterprise license agreement or some type of suite pricing that will make it easier for the sales force to go to customers and engage as you roll out more and more features? Are you seeing a desire from customers for that? Or is it still too early?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes, on the first part. So let me -- yes, we're very impressed by what we saw right out of the gate with Synthetics. I think it's -- we can say that it's a couple of percent of the overall growth rate that comes from Synthetics, which is more than we had expected. I will say, though, that this includes a few months of pent-up demand as we on boarded customers during the beta. We also didn't start charging for the product right away after the product went GA. So when we started charging in Q3, we already had some build up usage, basically.

We -- over time, that product, we expect it to grow. We don't know if we'll see the same impact next quarter as we had this quarter, again, because we had some pent-up demand when we started charging for it. But we're bullish.

On the pricing and the way to sell multiple products. We already do that, in a way. We let customers commit to a certain amount of spending on Datadog with a rate card, basically that lets them buy any of the products and combine them in any way they see fit without having to commit to specific level of use for any of the product. And that's something our products -- our customers love because it lets them just negotiate a rate for everything ahead of time and not have to worry about what their teams are going to use or not use. And today, it hasn't been a problem for the sales force to sell that to customers. And that's, in great part, because the buyers are the same for everything we sell today.

Operator

Next question comes from the line of Brad Reback from Stifel.

Brad Robert Reback - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD & Senior Equity Research Analyst*

Great. If we compare the first 9 months of this year to last year, have you seen any difference in customer drawdown rates on existing contracts?

David M. Obstler - *Datadog, Inc. - CFO*

We continue to see the same effect, which is customers are drawing down in both periods more quickly than the pro rata. So they're consuming the products, both from the usage of infrastructure as well as additional products. So we continue to have the same muscle, which is that customers are finding they're using more quickly and sort of come back for more reserved instances, some more fixed capacity. That happened last year, and that's continuing this year.

Operator

Next question is coming from the line of Michael Turits with Raymond James.

Michael Turits - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Infrastructure Software Analyst*

Congrats on the IPO and on a great first quarter out of the gate. You guys have pioneered so much in terms of monitoring and looking at this from a multi-solid approach. There have been some competitive responses from a couple of companies in the APM space and a lot of the space. Do you see any change in sales cycles or decision cycles in response to that broadening of the market and people following your lead?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

No, we don't see any changes. And again, I mean we did it -- we do expect that as -- with our approach of combining the silos and solving the end-to-end problem for our customers is obviously successful. We do expect that it's not lost on our competitors, who we have in high regard. So that's -- we see that as validation of our approach. But today, we haven't seen any changes in the competitive dynamics.

David M. Obstler - *Datadog, Inc. - CFO*

And I think as we said, the -- in Q3, we had a very strong new logo. You can see that in the customer count, so -- even over the summer months. And then we also have maintained the retention rates with increased usage as well as, as we talked about earlier, increased adoption of the platform. So all of those things are continuing in that quarter.

Michael Turits - *Raymond James & Associates, Inc., Research Division - MD of Equity Research & Infrastructure Software Analyst*

And then a follow-up for David, there's a great feed on EBIT and a nice guide on EBIT for next quarter. But if I -- as I model it quickly, it looks like the OpEx that's implied is less than we had originally modeling. Is there any push out of spending into -- or slowly out either into next quarter or into next year?

David M. Obstler - *Datadog, Inc. - CFO*

Not at all. We're continuing to grow the sales team and the R&D team and invest. Similarly, I think you saw revenues has outperformed. And with our gross margins, that's dropped to the bottom line. But we're continuing with the same investment pace that we had when we met during the road show.

Operator

Next question coming from the line of Pat Walravens with JMP Securities.

Patrick D. Walravens - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

Great. And let me add my congratulations. So one for each of you. Olivier, I'd love to hear your thoughts on where customers are in their journey toward the DevOps maturity? And maybe how you see it differ by geography or by industry or by size of company?

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So it's interesting because we see -- so if you think of the transition to DevOps and more broadly to the cloud, the markets in EMEA and in APAC are about 2 or 3 years behind what we've seen in the U.S. So when we've seen, in particular, large enterprises in the U.S., start going to public and private cloud at scale 2 to 3 years ago, it's something that is just starting to happen in other parts of the world today. So with that just the main comment I would have. Otherwise, we've seen the first company is to move to the cloud and to DevOps where the small companies, there is no tech-oriented companies. After that, you saw the larger enterprise companies that you need to modernize. And I think last are going to be the mid-market, more traditional companies that are trying to mobilize as well. So we see all those various parts of the market turn on in one after each other, basically.

Patrick D. Walravens - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

Yes. And is the, like, federal government even behind all those where we...

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Federal government is happening too, but it's-- I would say it's a bit of a different beast.

Patrick D. Walravens - *JMP Securities LLC, Research Division - MD, Director of Technology Research and Senior Research Analyst*

Yes. Okay. And then, David, congratulations on the 9th consecutive quarter. Just -- I would love if you could set our expectations a little bit in terms of the dollar-based net expansion rate and what we should expect as we think about it for the future.

David M. Obstler - *Datadog, Inc. - CFO*

Yes, I think we had set a time in the IPO that we would comment on that relative to 130%, and we're continuing to do that. We've seen no change in the environment relative to what we saw when went public relative to the drivers of that, increased usage and cross-sell.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. And we -- in our perspective, 130% is already best-in-class, and that's the number we're going to use moving forward.

Operator

Next question comes from the line of Jack Andrews with Needham.

Jon Philip Andrews - *Needham & Company, LLC, Research Division - Senior Analyst*

Congratulations on the results. I wanted to see if you could drill down a bit more on just trends in terms of the new logos, specifically that you've been landing. Are you seeing different, perhaps higher ASPs? Are you still predominantly landing with infrastructure or perhaps more multiproduct deals? Any more color on the new customer wins you're experiencing would be helpful.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Yes. So the trends are -- remains the same as what we've detailed during the IPO. If you still have some of the data in the S1 or in the road show, that all of that remains true, and some of that, you can extrapolate a little bit and you get a good idea of what is happening today. On the -- that's on the new logos. And on the ASPs, again, the trends remain the same.

David M. Obstler - *Datadog, Inc. - CFO*

I think we had -- they're similar. And I think we've said a couple of hundred thousand for enterprise and 150, 160 for mid-market continues to grow with the customers and continue to have a meaningful contribution. We talked about of customers landing with more than 1 logo -- with more than 1 pillar. And so it's very much what we said on the IPO road show continuing.

Operator

I'm showing no further questions at this time. I would now like to hand the -- over the call to Olivier Pomel, CEO, for any closing remarks.

Olivier Pomel - *Datadog, Inc. - Co-Founder, CEO & Director*

Thank you. Well, in closing, I'd like to repeat that we are incredibly proud of what we've built at Datadog. We believe we're in the early stages of a substantial re-platforming opportunity. We are very focused on executing on our growth strategies today, and we believe we have the potential to be a substantially larger and profitable company in the long term.

And I would like to thank all Datadog customers for their trust. And of course, all Datadog employees for their hard work and dedication. We have accomplished great things so far, and I believe the best is yet to come. So thank you.

David M. Obstler - *Datadog, Inc. - CFO*

Thank you, everybody.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may all disconnect.
