Corrected Transcript

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Datadog First Quarter 2022 Financial Results Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please also note this event is being recorded.

And I would now like to turn the conference over to Yuka Broderick, Head Of Investor Relations. Please go ahead.

Yuka Broderick

Head-Investor Relations, Datadog, Inc.

Thank you, Tom. Good morning, everyone, and thank you for joining us to review Datadog's first quarter 2022 financial results, which we announced in our press release issued this morning. 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 forward-looking statements, including statements related to our future financial performance, our outlook for the second quarter and the fiscal year 2022, our gross margins and operating margins including from the impact of R&D, go-to market, CapEx and increased office activity in marketing, our strategy, our product capabilities, our ability to capitalize on market opportunities and the closing of acquisitions. 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 are subject to a variety of risks and uncertainties that could cause actual results to differ materially.

For a discussion of the material risks and other important factors that could affect our actual results, please refer to our Form 10-K for the year ended December 31, 2021. Additional information will be made available in our upcoming Form 10-Q for the quarter ended March 31, 2022 and other filings and reports that we may file with the SEC. These filings are available on the Investor Relations section of our website, along with a replay of this call.

We will also discuss non-GAAP financial measures, which are reconciled to their most directly comparable GAAP financial measures in the tables in our earnings release, which is available at investors.datadoghq.com.

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

Olivier Pomel

Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

Thanks, Yuka, and thank you all for joining us this morning. I'll start by saying that we are pleased with our execution in Q1, as we continued to drive high revenue growth along with strong profitability and strong cash generation.

To quickly summarize our Q1 financial performance, revenue was $363 million, an increase of 83% year-over-year and above the high-end of our guidance range. We had about 19,800 customers, up from about 15,200 in the year-ago quarter. We ended the quarter with about 2,250 customers with ARR of $100,000 or more, up from 1,406 in the year-ago quarter. These customers generated about 85% of our ARR. We are seeing strong efficiencies in our business model with free cash flow of $130 million and free cash flow margin of 36%. And our dollar-based net retention rate continued to be over 130%, as customers increased their usage and adopted our newer product.

At a high level, we saw positive business trends in Q1. Usage growth from existing customers was strong and consistent with historical trends, as customers continued on their cloud migration and digital transformation journey, and the Datadog platform continued to expand and deliver more value. New logo ARR was very robust and churn remained low and in line with historical rates. All these factors together led to another strong quarter of ARR added. It was, in fact, our second best quarter of ARR added aside from Q4 2021.

Next, our platform strategy continues to resonate in the market. As of the end of Q1, 81% of customers were using two or more products, up from 75% a year ago; 35% of customers were using four or more products, up from 25% a year ago; and 12% of our customers were using six or more products, up from 4% last year.

We saw strong growth across the products in our platform in Q1. For example, Infrastructure Monitoring continues to grow at a rapidly click and exceeded $0.75 billion in ARR in Q1. Our APM suite and log management product had a strong quarter and are in hyper growth mode. As a reminder, our APM suite includes core APM, Synthetics, Real User Monitoring and Continuous Profiler.

We're also very pleased with the growth of our user experience products, which are Synthetics and Real User Monitoring more specifically. These products together exceeded $100 million in ARR in Q1. And in security, we are seeing very rapid growth. It's still early days and we're growing off a smaller base, but we continue to see strong adoption with thousands of customers getting security coverage through the Datadog platform.

Now let's move on to production R&D, where our teams delivered another strong quarter of innovation. Just 12 months after we acquired Sqreen, we are pleased to announce the general availability of Application Security Monitoring last week. Some applications and APIs are some of the most common sources of data breaches, yet companies typically have no ways to effectively detect attacks, so [ph] there could be less than (00:05:36) for days or weeks. Some other approaches to application security aim to find vulnerability before code reaches production, but these solutions often slow down development cycles and overwhelm teams with false positives, with no easy way to prioritize their issues.

The Datadog Application Security Monitoring product leverages the full execution context of applications running e-production. This allows teams to focus on attacks that actually matter and provides an immediately actionable remediation path.

Application Security Monitoring is the 14th product in the Datadog platform and this is the fourth product within our Cloud Security Platform, alongside Cloud SIEM, Cloud Workload Security and Cloud Security Posture Management. With this, Datadog now provides security insights across metrics, traces and log, and we consider these altogether as Version 1 of our cloud security platform. Remember that we are still in early stages of our security effort and have much to do to further build out this product, but we are pleased with our progress so far and the usage we're getting from our customers.

Last month, we also announced that we expanded our Watchdog AI capabilities to include Root Cause Analysis and Log Anomaly Detection. Root Cause Analysis automatically identifies causal relationships between different systems across infrastructure and services, and pinpoints their root causes. Watchdog also automatically identifies the business impact of any given issue using data from our Real User Monitoring product. This means not only identifying which way mobile applications are impacted, but also the exact users that are affected. This new capability often solves in minutes the problem that would otherwise take hours for a [ph] revised (00:07:18) specialist in customers' organizations.

Log Anomaly Detection, on the other hand, automatically understands and baselines normal patterns in logs and proactively discovers anomalies such as new patterns, meaningful changes in existing patterns and other error outliers. By surfacing these unusual log patterns, Log Anomaly Detection helps teams find and fix issues faster.

In addition to this Watchdog announcement, our engineers released dozens of features and expanded product capabilities in Q1. To give a couple examples, in Real User Monitoring, we announced the general availability of iOS crash reports and error tracking, as well as a number of improvements to have customers analyze and understand their users' performance.

In Cloud Security Posture Management, we added support for the Azure platform, enabling customers to understand their compliance posture across AWS and Azure in one place. In Continuous Profiler, we now support all commonly used languages, including C/C++, RASP, PHP and .NET. And across Datadog, numerous addition of rules, data sources and integrations are enabling our customers to solve their problems from end-to-end without leaving the Datadog platform.

Finally, this morning we announced that we signed an agreement to acquire Hdiv. Hdiv is an application security product which provides a highly accurate vulnerability detection at runtime. It offers interactive application security testing capabilities which tie vulnerabilities to exact file and line numbers in the code. And unlike other solutions in this area, Hdiv's rate of false positive is very low, enabling customers to focus on vulnerabilities that actually matter. We believe Hdiv's capabilities and strong team will be an excellent part of our cloud security platform and we're looking forward to integrating their capability into Datadog as soon as this acquisition closes when regulatory requirements are made.

That's it for product update this quarter. I want to thank our engineering and product teams for their continued hard work. There are so many new features coming up and I can only highlight a few of them in this call.

Now, moving on to sales and marketing, our sales team continued to execute and have delivered a strong quarter. Let's discuss some of the wins in Q1. First, we signed an eight-figure upsell with a next-gen fintech company, which was our largest ever deal on an ARR basis. This customer is experiencing explosive growth in demand for its products, and availability and performance of their system is critical to avoid loss of revenue. This customer started with us three years ago with just Infrastructure Monitoring and its expansion now includes six of our products.

Next, we had a high six-figure upsell with a global shipping company. This customer is expanding with Datadog to have them move forward with their Azure migration. In addition to using five Datadog products, they are now working with our new services team to help implement best practices on a number of business initiatives that will increase Datadog adoption. This customer expects to consolidate 10 disparate monitoring tools as they expand their use of Datadog.

Next, we had a seven-figure upsell with a US Federal entity. We were able to deepen our relationship with this customer after we achieved Federal moderate status. Before Datadog, this customer had siloed infrastructures, applications, networks, database and customer experience monitoring. This caused blind spots and long time to resolution. With this expansion, they are replacing both homegrown and commercial observability tools, and are enabling DevSecOps cultures with a visibility across the full stack in a single source of truth.

Next, we signed a seven-figure upsell with a leading payment company. Earlier this year, this customer's open-source logging tool went down, leaving them blind. But they were able to regain visibility by getting Datadog Log Management up and running within a few hours of that crash. Not only did this customer regain log visibility very quickly, they were also able to use the Datadog platform to scrub personal identifiable information to meet security and compliance requirements. And as they had expanded with Datadog, they have been able to cut the number of engineers who maintained homegrown and open-source solution in half and reassigned engineers to other productive work in the organization. With this renewal, this customer now uses 13 products from Datadog.

Next, we had a six-figure land with a major US hotel company. This company lost half of its engineering team during COVID and needed to use its staff more efficiently. At the same time, it was embarking on an AWS migration and its existing tools were not providing the visibility it needed. By consolidating on Datadog, this customer expects to future-proof its cloud strategy and move towards unified end-to-end management across their on-prem and AWS environments.

And finally, we had a seven-figure land with a major European car manufacturer. This customer was frustrated with its existing monitoring tools, which left them with limited visibility into incidents sometimes impacting millions of users globally. As they were trialing Datadog, they were able to solve within minutes issues that usually take them days. With Datadog, this customer expects to consolidate multiple commercial and open-source tools across AWS and on-prem stacks.

That's it for this quarter's highlights. I want to thank our go-to-market teams for their hard work in delivering a strong start to 2022 after a very busy end of year. I also want to give a special shout-out to our tech solutions and support team for making our customers successful, enabling them to expand with our platform.

Moving on, we feel very good about the demand environment. And as we look over the medium- and long-term, our outlook hasn't changed. We remain confident that cloud migration and digital transformation are drivers of our long-term opportunity and our multiyear trends that are still early in their lifecycles. We believe it is increasingly critical for companies to embark on these journeys in order to move faster, create competitive differentiation, enable strategic change, and serve their customers. And we believe we can help customers manage the complexity that comes with this transformation and that the Datadog unified platform is more than ever critical to understand, improve and secure their modern stacks and businesses.

With that, I will turn the call over to our CFO for a review of our financial performance and guidance. David?

David M. Obstler

Chief Financial Officer, Datadog, Inc.

Thanks, Olivier, and good morning to everyone. To summarize, we delivered strong financial performance in Q1. Revenue was $363 million, up 83% year-over-year and up 11% quarter-over-quarter. Usage growth with our existing customers was strong once again in this quarter. And new logo ARR growth was healthy, particularly given the typical slowness that we see in Q1.

Let's go into some more detail. First, growth of existing customers was strong in Q1 and our dollar-based net retention remained above 130% for the 19th consecutive quarter. Usage growth was strong across the Datadog platform and in line with historical trends. We also saw strong ARR growth in each geographical region and growth was similar across geographies, including EMEA. In early Q2, we began shutting off service to customers in Russia and Belarus. We have about 200 customers in these two countries and their contributions to revenue is immaterial.

Our go-to-market teams delivered another strong quarter. Total customers grew 30% year-over-year and customers with $100,000 or more of ARR grew 60% year-over-year. In addition, we saw strong growth in $1 million customers. We are pleased to be serving more customers and believe we are still in the early stages of our opportunity in worldwide customer acquisition. New logo ARR was very robust, particularly given that our sales teams participate in sales kickoff and other planning processes at the beginning of Q1. Remember that given our usage-based revenue model, new logo wins generally do not immediately transfer into meaningful revenue.

Our platform strategy continues to resonate with customers, with 81% of our customers now using two or more products, 35% using four or more products and 12% using six or more products as at the end of Q1. Finally, churn has remained low. Our dollar-based gross retention rate continues to be in the mid- to high-90s and was stable quarter-to-quarter, and it's similar across our customer segments and major products.

Billings were $444 million – $445 million, up 103% year-over-year. Billings duration in Q1 was similar to the year-ago quarter and within the range we've seen historically. We closed several large deals in Q1, including the largest deal by ARR that Olivier discussed earlier, which led to billings growth being higher than revenue growth in Q1.

Remaining performance obligations, or RPO, was $858 million, up 85% year-over-year and contract duration was similar to the year-ago quarter. Current RPO growth was in the mid-80s year-over-year. We continue to believe revenue is a better indicator of our business trends than billings or RPO, as those can fluctuate relative to revenue, based on the timing of invoicing and the duration of customer contracts.

Now let's review some key income statement results. Unless otherwise noted, all metrics are non-GAAP. We have provided a reconciliation of GAAP to non-GAAP financials in our earnings release. Gross profit in the quarter was $292 million, representing a gross margin of 80%. This compares to a gross margin of 80% in the last quarter and 77% in the year-ago quarter. We continued to experience efficiencies in cloud costs, reflected in our cost of goods sold this quarter. In the mid- to long-term, we continue to expect gross margin to be in the high-70s range.

Operating income was $84 million or a 23% operating margin, compared to operating income of $20 million or a 10% margin in the year-ago quarter. We are experiencing significant business efficiencies on strong revenue growth. And in Q1, we had not yet returned fully to in-person meetings, events or fully back in the office.

Turning to the balance sheet and cash flow statements, we ended the quarter with $1.7 billion in cash, cash equivalents, restricted cash and marketable securities. Cash flow from operations was $147 million in the quarter. After taking into consideration capital expenditures and capitalized software, free cash flow was $130 million with a free cash flow margin of 36%.

Now for our outlook for the second quarter and the fiscal year 2022. We remain optimistic about our long-term growth opportunities. We continue to see cloud migration and digital transformation as trends that are still in relatively early stages. And we are investing aggressively and are successfully executing against these long-term opportunities.

With the usual conservatism applied, our outlook is as follows. For the second quarter, we expect revenue to be in the range of $376 million to $380 million, which represents 62% growth year-over-year at the midpoint. Non-GAAP operating income is expected to be in the range of $49 million to $53 million. And non-GAAP net income per share is expected to be in the range of $0.13 to $0.15 per share on an approximately 347 million weighted average diluted shares outstanding.

For the full fiscal year 2022, we expect revenue to be in the range of $1.6 billion to $1.62 billion, which represents 56% year-over-year growth at the midpoint. Non-GAAP operating income is expected to be in the range of $240 million to $260 million. And non-GAAP net income per share is expected to be in the range of $0.70 to $0.77 per share on an approximate 349 million weighted average diluted shares.

Now some notes on our guidance. First, when providing guidance, as usual, we use more conservative assumptions than historical performance. Second, our strategic focus remains to invest aggressively in R&D and go-to-market to optimize for long-term growth.

In Q1, we are pleased to have had our best ever quarter of hiring and we plan to continue hiring aggressively throughout 2022. Our North America and EMEA employees returned to the office at the end of Q1 and our APAC employees are returning to office during Q2.

In addition, trade shows and other events are picking up in Q2, as is employee travel. In the past, we have framed the benefit of stopping in-person T&E and marketing events during COVID as 300 to 400 basis points of margin impact. We expect our return to office and increased in-person marketing events as well as our head count growth to more fully impact margins in Q2 relative to Q1. And even as we embark on these investments and our return from COVID, we remain solidly profitable, as indicated by our guidance.

Next, regarding income tax expenses, in Q2, we will have a provision of about $3 million related to the Sqreen acquisition, as well as our typical provision mainly related to our international entities. Finally, as we discussed last quarter, we are catching up on office build-outs in 2022 and expect CapEx as a percent of sales to roughly double compared to 2021.

In conclusion, we are very pleased with our results in Q1. We continue to attract more customers to the Datadog platform. We are broadening our platform's capabilities and observability. And we launched Application Security Monitoring in Q1. We are working very hard to execute against our opportunities. And I want to conclude by thanking Datadogs worldwide for their efforts.

With that, we'll open the call for questions. Operator, let's begin the Q&A.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] And the first question comes from Raimo Lenschow with Barclays. Please go ahead.

Raimo Lenschow
Analyst, Barclays Capital, Inc.

Q

Thank you. And congrats from me as well on amazing first quarter. I wanted to ask a question that I get a lot from investors, Olivier, and that's if you think about your efforts around security, how do you see that playing out in the long run against like the pure-play security players? Is that complementary? Are you kind of moving to same turf? Is it – it's like [ph] competition? (00:24:45) How should we think about that?

And then second thing is on the ongoing investment into R&D, etcetera, can you talk a little bit about the benefit you're getting from being just a pure cloud provider and hence your speed of innovation potentially could just move quicker than other players that have to work in on-premise and on the cloud environment? Thank you very much and congrats.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

So, on security suite, so first of all, the way we see ourselves in the ecosystem is we don't compete with everyone in the field there. Security is very wide. It has many different categories and sub-categories in there. Where we want to play a major role is in securing the production for the applications and products environment and all of the lifecycles that relate to that in terms of development, operations and iterative changes in these environments.

So, that's where we're starting. We expect to compete with others there. We come from a different place in that we come from having all of the observability data already being deployed end-to-end on those systems and having active users, the integrity of the development and the productions team in this company, and we think that that's what gives us strength there.

To the other point you brought up around the dispute of iteration, we definitely benefit a lot from being cloud-native and from being SaaS-only. We actually get a lot of information about what customers do with our product and how they use it and which theme exactly was being used or not and what's working or not. So, that helps us iterate very faster.

We also benefit from having a lot of users. As I mentioned that in the first part of my answer that we're being used every single day by every single developer [ph] in-house (00:26:42) person. That's a lot more that what you see on a typical security product. And so, that gives you a lot more information about what you can do and what you can do better. It also gives you a lot more leverage when it comes to actually solving the issue at the security level and that's part of the value prop we give to our customers.

Raimo Lenschow
Analyst, Barclays Capital, Inc.

Q

Perfect. Thank you. Congrats.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Thank you.

Operator: The next question comes from Kash Rangan with Goldman Sachs. Please go ahead.

Kash Rangan
Analyst, Goldman Sachs & Co. LLC

Q

Well, thank you so much and congratulations on a phenomenal quarter. Olivier, I'm curious to get your take on the hyperscalers. And given the broadening product suite that Datadog is undertaking, how are these conversations changing with the hyperscalers?

And one for you, David. As the economic environment and the outlook for GDP growth continues to be a little bit wobbly with higher rates, how should we think about the defensibility of the Datadog consumption business? Thank you so much. Congrats, again.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Thanks. On the question about hyperscalers, so we work hand-in-hand with hyperscalers more and more. So we cover a lot more of, I would say, the management surface for our customers who are also their customers. We help their customers be most successful and move to the cloud faster. And so, as such, we help generate revenue for the hyperscalers and that's why this partnership works so well with them.

We keep improving on those partnerships and developing them. I think we've announced this quarter some improvements to our Azure partnership, for example, where we're now part of, I would say, the Golden Path presented by Azure for migrating into the cloud. And we're seeing some great customers onboarding thanks to that.

David, you want to take the other question?

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

Sure. Thanks, Kash. Hello. We believe that digital and cloud projects are still very high priority and are not being de-prioritized, we haven't seen that. We think we're still early on. So, with the data we have so far, we think there will be continued strong investment.

There is always some volatility across our customer base. Our customer base is very well diversified across industries and we benefited from that over time. So, whereas we're not macro forecasters and there may well be some sensitivity, we believe the long-term trends in digital migration and cloud will also be very strong throughout that cycle.

Kash Rangan
Analyst, Goldman Sachs & Co. LLC

Q

Super. Thank you so much.

Operator: The next question comes from Fatima Boolani with Citi. Please go ahead.

Fatima Boolani
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. Thank you for taking my question. Oli, one quick one for you. Just as it relates to the deeper strategic and technical penetration within the DevSecOps arena, I mean, it sounds like your thesis was very much because you have the critical mass of data and the data gravity as it relates to your observability use cases, you're able to parlay that in a more meaningful way for security. And I'm wondering, why not partner with some of your peers in that space versus kind of go at it alone. And then a quick follow-up for David, please.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Yes. So, that's a good question. So there's two things we bring to the table on security. One is we have, as you mentioned, the data gravity and we're in the path of data for pretty much everything that relates to our customers' infrastructure applications in their own users, which is obviously fantastic.

The other thing we're bringing, we have – we're being used all day by everyone in development and in operations. And that's not typically something that the other security products or the typical security products are built for. So it's actually hard – if you wanted to partner, it's hard to find a product that's built for those people, right? Most security products are purely built for security teams. So, that's why we've been building a lot of that on that one.

Of course, we're still partner with lots of the other players in the industry. But we embarked on this journey because we think we have – we come from a different spot. We think we have different take on the problem that in the end offers us and our customers a lot more average and an actual chance at solving the security issues, not just throwing software and resources at it. So, just this is where we come from.

Fatima Boolani
Analyst, Citigroup Global Markets, Inc.

Q

I appreciate that. And David, just with respect to that delta between your reported revenue growth in billings. It's probably one of the bigger delta as we've seen in relation to recent quarters. And given your commentary around invoicing duration having stayed pretty stable, I believe that would imply seven to eight months. I'm still curious as to why you'd see such a meaningful acceleration in billings head and shoulders above revenue growth. If you could just unpack that for us a little bit and when you expect that divergence to narrow? And that's it from me. Thank you.

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

Yeah, yeah. And I have to – as I mentioned, there is variability in billing and RPO versus revenue based on when bills go out. We still have, for the most part, in our larger contracts pretty much annual billing. So the sending out of a large annual bill might move the duration a little bit, but not a lot. And the strong performance – the billing was very strong and indicative of the business. It was complemented by the fact that, in this quarter, we sent out the bill for some large contracts up-front annual billing and the timing of that causes the variability.

Over the average and over the course of the year, that balances out with the timing of the billing, and we believe that billing converges with revenue growth. We remind everybody that revenue growth and implied ARR growth is a better metric of the progress of the business. Thanks.

Operator: The next question comes from Sanjit Singh with Morgan Stanley. Please go ahead.

Sanjit K. Singh
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Thank you for taking the question. Olivier, in your script, you mentioned FedRAMP. Those should have brought on kind of another topic than we were sort of sharing about from your partners, which is penetration observability in some of the underpenetrated industries. And from your perspective, if you look at the different industries that Datadog participates in, which of the industries do you see can become greater adopters of observability versus some of the kind of traditional technology e-commerce verticals?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Well, look, we're seeing pretty much every single industry show some signs of moving to the cloud already. I think the order in which this industry has moved really depends on their appetite for being at the leading-edge of technology changes and their exposure to interacting with their users online. So, what we saw first, I believe, was the – so finance, for example, which is ahead in technology in general, or things like e-commerce, online media, that sort of thing. So, today, we actually see the full range of categories in the industry is coming to the cloud.

For example, we mentioned an auto manufacturer in our call, we mentioned a hotel chain, we mentioned on the – in previous calls, we mentioned plumbing supplies company. Pretty much every single part of the economy is coming there. You're right, though, in your comment that some of those are later to the game than others. And so there is less penetration I would say in the more traditional less tech-focused parts of the industry. But we're confident that everybody is coming to that party.

It's also the case in regulated industries, government in particular, where not only the moves are a little bit more conservative in terms of technology transitions, but also these part of the industry are also more limited in what they can purchase, which is why it was very important for us to get FedRAMP certified, which is also why we keep investing in more FedRAMP and more similar certifications, so we can go into more of these categories and more geographies.

Sanjit K. Singh
Analyst, Morgan Stanley & Co. LLC

Q

Makes total sense. And then just one follow-up on one of the wins that you guys called out. I think it was the European manufacturer who, I think, was sort of engineering talent sort of constrained and then moved off from their DIY solution. And so, if we take that as a topic more broadly, because you'd think that the demand for talent – demand for engineering talent is probably going to get worse. And so, in terms of the DIY observability market, converting more to more commercial out-of-the-box value like a Datadog provides, how much of an opportunity do you think that can be for the business?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Well, I think that's part of our – it's always been part of opportunity and that's really what makes the value prop even more attractive in the future. As you correctly pointed out, there's not going to be as many software engineers in general as the market will need. There's not this year, there's not going to be – I think it's going to be even less the case 2 years, 3 years, 5 years, 10 years from now. So what our customers will need is a way for their existing staff to be more productive and a way to direct them to what is actually going to be differentiating for them, as opposed to building a differentiated infrastructure. So, we clearly play and this is a trend that benefits us in the end.

The other thing to bring up is that software, in general, is deflationary in nature and that's also the case for us. We help our customers make more with what they have. We help them automate. We help them make people more productive. We help them use their infrastructure better and we help them ship projects that help them interact with their own customers better. So, that's where we're playing.

Sanjit K. Singh
Analyst, Morgan Stanley & Co. LLC

Q

Thank you for the thoughts, Oli. Thank you very much.

Operator: The next question comes from Brent Thill with Jefferies. Please go ahead.

Brent Thill
Analyst, Jefferies LLC

Q

David, in your guidance, I know you mentioned you're not really seeing any macro issues. But are you assuming a similar close rate on your pipeline? Are you taking a more conservative close as it relates to the back half of what you're guiding to for the year?

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

Like all – as we've talked and like all of our guidance, we tend to take more conservative close rates, i.e. new logos, and more conservative usage than we've experienced historically. So, that principle continues with our guidance and is consistent with what we've done in the past.

Brent Thill
Analyst, Jefferies LLC

Q

Okay. Great. And Olivier, that $10 million upsell, can you just speak to the pipeline of these larger transactions and what you're seeing as your customers expand?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Well, we see many more customers in that range, right? So, customers are riding this adoption curve with us. Where we saw the bigger and bigger problem for them, they use more and more of our products, they move more and more of their infrastructure in the cloud to start with, and they themselves are scaling. So these are all multiplayers that end up increasing our footprint with them. So we have a healthy pipeline of those.

We mentioned we handpick a few in every one of those calls, but that's definitely not an isolated case. And that customer is actually in the tens of millions and it's – I think, at the end, we don't expect that to be an isolated case.

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

And I think we mentioned the strong continued growth of $100,000 plus and mentioned – even though we don't give out the $1 million customers every quarter, mentioned continued strong growth in millions. And that's indicative that we have many customers who are graduating from smaller lands to the $100,000, the $500,000 class and the $1 million class and above, as our model has been all along.

Brent Thill
Analyst, Jefferies LLC

Q

Thank you.

Operator: The next question comes from Kamil Mielczarek with William Blair. Please go ahead.

Kamil Mielczarek
Analyst, William Blair & Co. LLC

Q

Thank you. Good morning, everyone, and congrats on a great quarter. A question on pricing, as your largest customers scale and standardized on Datadog, can you talk about how conversations have changed around pricing? And are there any particular modules where you're seeing relatively higher levels of pushback on cost, given the rapid growth in data recently and the pricing changes made by some of your competitors in the last two years?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Yes. So the – look, any time somebody is paying you tens of millions of dollars a year, there's going to be a conversation about price because this is a line item that shows up. Typically, what's going to be the most negotiated as part of that is the biggest part of the deal, which for some customers is infrastructure, for some others is APM, for many customers it's logs because that's the one where data can grow in a way that's somewhat decorrelated from the size of the accompanying infrastructure or the value of the accompanying applications.

And our approach there really is to give as much flexibility as possible to customers, so they can align what they pay with the value they get. And we've shipped in the past, many, many new features around that to give them more tiers for storing data, more ways of doing just-in-time sampling, archiving, bringing back data from archives, give them more controls, more levers, and we expect to do more of that in the future.

But it's a very healthy conversation. We do expect that when customer is at fully at scale with us, we'll get more and more of a wallet share from them, but at the same time the revenue will get – won't grow linearly with the data volumes they send us. That's natural. That's healthy.

Kamil Mielczarek
Analyst, William Blair & Co. LLC

Q

That was helpful. And if I can just follow up on free cash flow, generation has been very strong, 36% margin in the quarter and I think 28% for the last year. How are you thinking about managing free cash flow margin going forward? Is the strength just a function of better-than-expected growth and may be a tight labor market? Or do you see high-20s, 30% as a sustainable level?

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

I think we've experienced long-term free cash flow to be slightly higher than EBIT. So, correlate it with our EBIT. We have – it is indicative of the growth of the business and the efficiency of the business. As we mentioned, we will be returning, we believe, in Q2 to more investments, whether it be marketing events in the office, etcetera. So, where we expect it to continue to evidence the efficiency in the business, it would be, as it has been, correlated to be slightly higher than the EBIT performance.

Kamil Mielczarek
Analyst, William Blair & Co. LLC

Q

That's helpful. Thanks again.

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

Welcome.

Operator: The next question comes from Matt Hedberg with RBC Capital Markets. Please go ahead.

Matthew Hedberg
Analyst, RBC Capital Markets LLC

Q

Great. Thanks, guys, for the questions. Oli, I wanted to go back to security. You've obviously had a lot of success there and you're adding Hdiv this quarter. How do you see your sales force evolving over time and maybe even the thought of a security overlay team at some point?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Yes. So we're open to anything there. We haven't made any drastic changes to that. We're still focused right now on getting in front of our existing customers with these products and getting them to adopt the products and writing the maturity [ph] play (00:43:51) of those products with us to make sure they are as broadly applicable as possible, before we accelerate on the go-to-market for them. And we're very happy with where we are. We're exactly where we wanted to be. Actually, we get a lot of paying customers with skin in the game and a lot of eyes on their products and a good amount of velocity in terms of development.

We are expecting to test a few things on the go-to-market side, I would say, in the coming few quarters. And then we'll see where this leaves us. We see some successes today already with app mobility and we think it might actually, turning a few different things, might accelerate things a little bit, but it's still early to tell.

Matthew Hedberg
Analyst, RBC Capital Markets LLC

Q

Got it. That's super helpful. And then you guys have always had a very services-light model, so easy to use. As you continue to scale up in the G2K, are there additional steps you can do to maybe even enable more synergies within a GSI community?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Yeah. So there's two things we're doing. So one is we're investing in our partnerships with GSIs and with the channels in general. So we're doing more there. And we also started prioritizing some service offerings. We actually called one out in one of the customers recently listed in the call.

We have a small services team today that has a few packaged offerings that mostly revolve around accelerating adoption of Datadog and making sure we help customers that need that help, transform their businesses around the way things are running with Datadog. So we're investing on both sides. I mean, obviously, whatever we package ourselves with our own team will then be scaled through third-party partners, GSIs and others.

Matthew Hedberg
Analyst, RBC Capital Markets LLC
Q

Got it. Congrats on the strong Q1.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.
A

Thank you.

David M. Obstler
Chief Financial Officer, Datadog, Inc.
A

Thanks.

Operator: The next question comes from Michael Turits with KeyBanc. Please go ahead.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.
Q

Hey, guys. Great quarter. I wanted for Oli first, you're doing more application security and you've announced some things for observability in development pipeline. Can you talk about how far you will be going in terms of a shift left towards more of the development side of things, including possibly around a static code or a source code? And does that shift left towards developers?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.
A

Yeah. So, that's a great question. We definitely are doing more and more on the shift left and developer side. Obviously, we've talked about security quite a bit, and a big part of that is application security, which is a bit of a known category. So it's there, I think it's a little bit different in how we approach it, a little bit different in the cloud, but the category has been there before.

We're also investing in new categories, and you mentioned the CI/CD observability. That's a brand new category. That wasn't there before. And we actually have a product in the market today that we started charging for. And we don't have any numbers to share today, but we are actually very, very pleased with the way this product is being received by customers. So, overall, we think we're going in the right direction there.

There's obviously more we'll want to do. I mean you brought up Hdiv, which also brings a bit more around closer to the source code and vulnerability management, things like that. There's more we'll want to do there, but we don't have anything to announce today.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.
Q

Yes. And can I just ask, I think, an expansion or a take to Matt's question in terms of facilitating your broader product line. Anything in the customer success area that has to be changed or post-production engineering or professional services, as you have a more broader and more complex offering?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.
A

Yeah. So we're scaling those teams quite a bit and we're constantly also refining the way those teams are segmented, so they can target specific types of customers, and in some situations, not many situations, also setting types of product. So, that's part of scaling the teams on the customers' success, on the tech solutions, on the support side. So, we're investing quite heavily there. I gave those teams a shout-out because really they've been doing a fantastic job at helping our customers scale and adopt a very broad product portfolio today and I think that there's going to be more successes to come there.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks, Oli. Thanks, David.

Operator: The next question comes from Brad Reback with Stifel. Please go ahead.

Brad Reback
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks very much. Oli, as the sales force and the marketing team return to face-to-face events, any reason to think that we shouldn't see some level of acceleration in upsells to the larger part of the installed base as well as the potential to land even bigger with new deals? Thanks.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

It's possible. I mean, look, we definitely have return to investment in some things that we were not doing for the past two years that we're doing again in in-person events in particular. I would say it's too early to tell whether it gives us an edge again on that side or whether it's just upping the table stakes for everyone for that. But definitely, we're investing with expectations of returns on that.

Brad Reback
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's great. Thanks very much.

Operator: The next question comes from Gray Powell with BTIG. Please go ahead.

Gray Powell
Analyst, BTIG LLC

Q

Great. Thanks for taking the question, and congratulations on the strong results. So, yeah, I mean you've clearly been seeing very good traction moving into larger enterprise and Fortune 500 accounts. How does the competitive environment change there as you move up-market? And then do end up baking off against the different set of vendors or just how should we think of that impact in the sales cycles? Thanks.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

So, I'm sorry, I'm going to give you the most boring answer ever, but we see no change. The situation there is very much the same as it was last quarter and even last year. We still focus largely on net new and cloud environments. We land fast and small mostly, and we end up growing quite a lot with those customers at the largest enterprises.

Sometimes, but not all the time, we're going to do a big displacement of usually a suite of tools that mixes homegrown and some of the other players in log or APM or infrastructure or all of the above. And these tend to be the larger lands because they start larger as they replace a bunch of existing things. But this is still not the majority of the go-to-market and customer acquisition. I think it shows that the product wins in about all sorts of situations, but our focus is still on net new and cloud environment.

Gray Powell
Analyst, BTIG LLC

Q

Got it. That's helpful. And then maybe just a quick follow-up on the security side, if it's okay. Is there anything more you can just say on the road map in the security space or just like talk about the most natural capabilities that could be included as you start to move into Version 2 of the security platform? And I guess, more specifically, and this might be a tough one, but do you see a scenario where you could more directly address the endpoint security use case?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Well, so endpoint I think is – it's not all we have in mind today, right? I mean, there's plenty we want to do at the intersection of DevOps, production environment, applications. Like, it's a gigantic problem space and one that's not well-handled today. So we definitely are – have that in our sights today.

In terms of what we can do and the road map, interestingly there are many things we're doing today that are not branded security that are part of other products that actually play a big role in security. And so, one of the questions we have internally is how do we actually draw the line around the security suite versus the rest of the DevOp platform in a way that doesn't confuse everyone.

I mean, for example, we mentioned in the last call our Sensitive Data Scanner products, which actually is used for security use cases but is currently part of our log management product. We have some similar situation with our network monitoring product that also listens to data and uses it for security use cases but is not part of our security offering. So there are some branding and packaging and product suite questions that we'll have to answer ourselves there.

Gray Powell
Analyst, BTIG LLC

Q

Understood. Very helpful. Thank you.

Operator: The next question comes from Steve Koenig with SMBC Nikko. Please go ahead.

Steven Koenig
Analyst, SMBC Nikko Securities America, Inc.

Q

Hey. Thank you for getting me on the call, gentlemen, and congrats on the quarter. It's a pleasure to be covering you guys. I wanted to ask about pricing with kind of a little different angle. And thanks for your color on how you help customers manage their costs as they scale out with Datadog. That's very helpful.

If I think about it from a different angle, more from the perspective of how you keep your pricing in check with infrastructure costs as the hyperscalers improve their price performance over time on compute and storage, how does – you have a relatively simple pricing model in the space, which is a good thing. But I'm wondering, does host-based pricing, do those prices need to change over time as hyperscalers ride their cost curves down?

And also in log management as well, as your – you do have some data charges. And do those need to come down over time as hyperscalers become more price performing? Thanks very much and congrats again on the quarter.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Thank you. Well, so there's a few things to consider there. So, one is like the type of hosts that our customers buy also is changing over time, like, they're also getting larger and larger instances from the cloud providers that cost more and more, even though the price for the same CPU on two different years is going to maybe get reduced a little bit by the hyperscalers.

The other factor to consider is that, overall, even with all the improvements from the cloud providers and, I'd say, the software industry at large, our customers' experience is still a dramatic increase in complexity. And overall, what this means is that a lot of the value gets shifted from actually running the infrastructure itself to understanding it and managing it, which is what we do. So, in the end, we are in a position where we can maintain or even increase prices, while still delivering more value for our customers and saving them more money. So, that's the general dynamics there.

Now, when you look at the things that are tied to very specific units, so for example, the price per gigabyte and things like that. Like, it's a – of course, price per gigabyte is going to go down over time in some point. Right now, the form it takes is that there are more and more options that we keep giving our customers, so they can do different things with different price points. But in the long run, if you fast-forward 20 years, of course, you wouldn't expect to pay the same thing for a gigabyte in 20 years than you do today.

Steven Koenig
Analyst, SMBC Nikko Securities America, Inc.

Q

Terrific. Thanks for the color. I appreciate it.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

But at the same time, I would say, you also will have many, many, many others who are managing more data at the time.

Steven Koenig
Analyst, SMBC Nikko Securities America, Inc.

Q

Yeah. Got it.

Operator: The next question comes from Joel Fishbein with Truist Securities. Please go ahead.

Joel P. Fishbein
Analyst, Truist Securities, Inc.

Q

Thanks for taking my question and great quarter. Olivier, you spoke a lot about several different potential products in the pipeline as you guys are developing internally. I'm hoping you might give us a little bit more color about the mid- and longer-term plans with regard to maybe areas that you plan to address with new products.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Well, we have plenty of new products in the works, but for that, you'll have to show up to our events and conferences. We do expect to show more of that in the quarters to come. The areas we're going after, obviously we're still doubling down on observability. We're early in observability. There's a lot more we can do. We want to do a lot more that's going to drive value for our customers, and it's a very large market.

Obviously, we've been very open about the fact that we are investing massively in security and DevSecOps in particular. So you'll see more from us on that. We also are pushing towards the developer workflows, as we had mentioned, with CI/CD and some aspects of security and some other things that we might show. We're also investing in pushing or extending our user experience products in APM suite to behavioral and user analytics, as well as business analytics. So we keep pushing more and more functionality towards that, and you should expect to see more products from us in that area, which takes us into real-time BI. And then, finally, we also are investing in ITSM-minded products, starting with incident response and incident resolution. And you should expect to see more from us in that area in the future as well.

Again, I can't give any more details. We have a lot of those in the year right now, lots of products in flight. We're very bullish about the opportunity. We think – we see it at a privilege part of the ecosystem where we have such a large surface of contact, so customers' infrastructure, their application as well as their teams, their developers and their operations teams and other security teams, that we can solve an increasingly larger problem for them over time while benefiting from frictionless adoption of our platform, which is what [ph] yield this really forgetful (00:58:54) margins that we've talked about today. So, again, very bullish, a lot of products in flight, a lot of things we're working on, but nothing more to announce today.

Joel P. Fishbein
Analyst, Truist Securities, Inc.

Q

Thank you so much.

Operator: The next question comes from Adam Tindle with Raymond James. Please go ahead.

Adam Tindle
Analyst, Raymond James & Associates, Inc.

Q

Yeah. Thank you. Olivier, I just want to start on Hdiv, the acquisition announced today with the vulnerability focus. Could you help us characterize where this competes in the stack? And specifically, are we focused on endpoint like CrowdStrike with the Spotlight product or critical assets like server and data center where VM players like Tenable, Qualys and Rapid7 fit? So, where does this fit within the stack in vulnerability and talk about the competitive advantage that you'll bring?

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

Well, it focuses on applications, and these are the applications that our customers build as well as the various libraries and dependencies that are brought into the mix as well, customers build those applications. So this will find its place on the application side of our cloud security platform.

We don't have much more to share on the way this will be combined from a product perspective. But we see it as great technology, great product, and also great expertise to add to the team and add to our momentum on the security side. And by the way, this hasn't...

Adam Tindle
Analyst, Raymond James & Associates, Inc.

Q

Okay.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

A

We – as is often the case for security companies, there are some regulatory approvals to get this closed.

Adam Tindle
Analyst, Raymond James & Associates, Inc.

Q

Understood. I know I'm going to be out of time. David, seasonality has just been a constant topic it seems like since last quarter. I'm sure you're answering a bunch of investor questions intra-quarter about it. And the second half is a little lower as a percent of total than years past based on guidance. Anything for us to consider on seasonality now that you're a $1 billion-plus organization moving forward? Thank you.

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

No, it's always been – it's a similar type of thing where the fourth quarter tends to be strong on customer acquisition. We have had, like every company, a little slower in new customer acquisition in Q3 that didn't hold last year. It was a very, very strong Q3. And as we mentioned, generally, as you start the year in the first quarter, you have a little bit of slowness in getting going, and this quarter we didn't have that as much. So, it's really the same types of seasonality, which is quite minor relative to the previous years.

Adam Tindle
Analyst, Raymond James & Associates, Inc.

Q

Very helpful. Thanks and congrats.

David M. Obstler
Chief Financial Officer, Datadog, Inc.

A

Thanks.

Operator: This concludes our question-and-answer session. I will hand the conference back over to CEO, Olivier Pomel, for any closing remarks.

Olivier Pomel
Co-Founder, Chief Executive Officer & Director, Datadog, Inc.

All right. Thank you all for attending the call. And I want, again, to thank all Datadogs and there's many more of you out there, as I should remind everyone that we've had our most successful hiring quarter in Q1. So, thank you all, and we're all excited to be here, and we'll see you next quarter.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.