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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q1 2020 Datadog Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Mr. A.J. Ljubich, Director of IR. Thank you. Please go ahead.

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

Thank you, Jimmy. Good afternoon, and thank you for joining us today to review Datadog's first quarter 2020 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. This is our first time conducting our earnings call from separate locations. So we appreciate your understanding if we encounter any technical glitches.

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 second quarter and for the full year of 2020, our strategy, the potential benefits of our products, the potential contribution of customers with annual run rate or ARR of $100,000 or greater, R&D and go-to-market investments, expected capital expenditures, anticipated hiring, the size of our market opportunity as well as the impact of COVID-19 pandemic on our customers, their usage of our products, our market and our business and operating results.

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 the material risks and other important factors that could affect our actual results, please refer to our annual report on Form 10-K for the year ended December 31, 2019, filed with the SEC on February 25, 2020, and current report on Form 8-K filed with the SEC on May 11, 2020. Additional information will be made available in our quarterly report on Form 10-Q for the quarterly period ended March 31, 2020, and other filings and reports that we may file from time to time with the SEC. Our filings with the SEC are available on the Investor Relations section of our website. A replay of this call will also be available there for a limited time. Additional information may also be made available in our 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 table in our earnings release, which you can find on the Investor Relations portion of our website, for a reconciliation of these measures to the 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, A.J., and thank you all for joining us today. Before reviewing the quarter, I'd like to take some time to address the situation we're all facing with the COVID pandemic and in particular our internal response to the crisis, the ways in which the pandemic intersects with our business but also some of the data we've seen in March and April as well as our stance for the year and our perspective on the future.

So starting with our response. We communicated 3 objectives internally: first, to keep our employees safe, healthy and sane; second, to be good citizens and members of our communities and contribute to our collective health and economic success; and last but not least, to serve our customers, level down innovation and be the best at what we do for challenging times as well as good. In keeping with those objectives, we have mandated work from home since March 12. In addition to that, we have allocated a grant to each of our employees to support their productivity and safety. And [at this question], employees could elect to donate all or a portion of their grant to charities that help with COVID relief.

I'm very proud to say that this program has already resulted in $1 million of donations from our employees and reflects the generosity and our commitment to go through this crisis together with the communities in which we operate. I also have to say that I've been extremely impressed with Datadog employees' resilience, continued productivity and innovation through this time.

Our success in pivoting to operate remotely does demonstrate the advantage of being a digital-first cloud-based business. Regarding the way the pandemic may affect Datadog, there are a few important structural points to understand about our business. First, we have a very diverse customer base. We estimate that less than 10% of our ARR comes from categories most negatively impacted by COVID such as hospitality and travel, airlines and in personal entertainment. On the other hand, we also have exposure to categories that have experienced increasing traffic such as streaming media, gaming, food delivery, e-commerce and collaboration.

Second, we also have a great diversity of customer sizes. We have low concentration and approximately 75% of our ARR comes from customers that pay us $100,000 or more. Also less than 15% of our ARR comes from a long tail of small businesses.

Third, we price according to our customers' infrastructure footprint and not per seat. So our product usage is not directly affected by reductions in the workforce.

Fourth, our business model is low-friction land and expand, and our platform is adopted bottom up. We often land fast and small as enterprises begin their cloud migration, and then we frictionlessly expand from there as more workloads move to the cloud. This makes our sales effort less dependent on physical meetings and makes our model is extremely efficient and less reliant on larger front deals. Lastly, we are pure SaaS and require no professional services or hand-on-keyboard implementation.

Now turning to what we've seen in March and April. First of all, the COVID escalation happened late enough in the first quarter to not materially affect our financial results. Throughout the quarter, we saw consumption continue to increase across the platform and growth of the number of hosts, containers, metrics, traces and logs, for example, have remained consistent with historical trends. We started to see some negative effects in impacted industries such as travel, hospitality and airlines.

But we've also seen substantially increased usage from other categories such as streaming media, gaming, food delivery and collaboration as these customers scaled up their operations in this environment. We also saw a surge of usage and surge in accounts in March in response to COVID that we expect could be more transitory in nature and may normalize over time. In terms of new deals, we did have a strong end of the quarter with limited impact from COVID.

As far as due to Q2 goals, our pipeline is robust and relatively consistent with prior quarters, but it is still too early to know the impact COVID could have on the road. Because of that, and given the macro uncertainty, it is prudent to expect delay of some new cloud migration projects as well as some impact on churn. As David will discuss, the effect of COVID has been incorporated in our guidance.

To close on the COVID dynamic, let's step back and look at our stance for the rest of the year and perspective on the future. While there is a lot more certainty across the industry and the broader economy in the very near term, we believe it is more important than ever for businesses to operate online and that the trends of digital transformation and cloud migration remain very much intact over the long term and may even be accelerated or amplified. We believe we are well positioned to be a primary beneficiary of this trend and continue to win in the market. And we also believe that the efficiency of our business, whether it is our unit economics or balance sheet, our ability to innovate, will be an advantage in a difficult market.

As such, our plans remain clear. We are investing across the board. We're investing in the development of existing and new products, including aggressive R&D recruiting targets and taking advantage of the opportunity to attract talent that would otherwise not be on the market. We're investing in the growth of our go-to-market team across segments and geographies. We're investing in our relationship with customers as some of them go through difficult times and it is more important than ever for them to operate digitally. And we're investing in our existing employees to keep them safe and sane through this crisis.

To conclude on this point, I would say that while I can't promise for macro reasons that we'll see the same incredibly fast return on these investments as we have historically, we are very confident in the mid- and long-term opportunity in front of us and in our strategic plan to live up to it.

Now on to Q1. We are very pleased with our performance in the quarter. Results were once again driven by broad-based strength across new logos and expansions as well as across customer segments and sales channels.

To summarize Q1, revenue was $131 million, an increase of 87% year-over-year. We ended the quarter with 960 customers with ARR of $100,000 or more, which is an increase of 89% from last year. These customers generate approximately 75% of our ARR. We also continue to be capital-efficient with free cash flow of $19 million and a tax payback that is still around a year or less.

We ended the quarter with about 11,500 customers, which is about 40% growth from 8,200 last year, which means we added about 1,000 net new customers in the quarter, which was twice the number we added last year. And as in past quarters, our dollar-based net retention rate was over 130% as customers increased their usage and adopted our newer products.

From an R&D perspective, we continued a rapid pace of innovation. We recently announced the general availability of our Security Monitoring products to unify visibility across security, dev and ops teams. As with all our products, it is available in the same integrated, simple-to-use SaaS platform. We are pleased with the initial response to this product, and it has been the most demanded beta in company history. But I'll remind you that we are just beginning on the journey to break the silos between security dev and ops, and we plan for continued innovation in this category.

Additionally, we recently crossed 400 out-of-the-box integrations. And among a number of new and improved, I'd like to call out Tenable Nessus and VMware Carbon Black, which support our new security use cases.

Looking at product usage. Our platform strategy continues to resonate with customers. As of the end of Q1, 63% of our customers were using 2 or more products, up from 58% in Q4 and 32% last year. In Q1, approximately 75%, sorry, of our new logos landed with 2 or more products. And our success in both landing and cross-selling our platform has resulted in the number of customers using 2 or more products nearly tripling year-over-year. We are very pleased with this continued adoption of our platform, which includes strong initial uptake of our newest products, Network Performance Monitoring and Real User Monitoring. And as I mentioned earlier, we do continue to believe we have a significant opportunity to further expand our product portfolio and grow our addressable market.

Now let's move on to the go-to-market. I have been personally very impressed with our continued productivity across teams during this time. Enterprise sales teams, in particular, who are serving companies of more than 5,000 employees, have successfully adapted to selling by phone and video. And as you know, tradeshows and marketing events have been canceled or going virtual. So we have been redeploying those investments into online advertising, webinars and other activities. Our own user conference, Dash, is going virtual likely in Q3.

Now let's review some of our key wins in the quarter. First, we had an exciting 7-figure new logo win from a Fortune 100 pharmaceutical company embarking on a migration to a container-based hybrid cloud. Incumbent legacy tools didn't keep up with their new dynamic stack, and Datadog allows for mass adoption across dev, ops and executive teams through a single observability platform that all teams can use every day.

Next, we signed a 6-figure new logo deal to provide monitoring for a large health insurance company embarking on a multi-cloud migration. What's really interesting about this deal is that it was won through a new partnership with one of the world's largest system integrators. This is a great example of success after we announced Datadog Partner Network in January, though, of course, it is still early days for our channel and alliances go-to-market. By the way, both of the new logo deals I just mentioned were closed at the very end of March.

Next, we had a sizable upsell to a mid-market on-demand logistics company, which now spends more than $1 million a year with us. This company has been a customer since 2018, started with infrastructure monitoring and then adopted both APM and log management in 2019. Today, this customer is also using Synthetics, NPM and Security Monitoring. What's really interesting in this case is that this customer partnered with us to build out security products and has quickly found value in scanning logs to detect security threats. It is also worth noting that this logistics company has experienced dramatically increased demand with COVID, and it has successfully scaled up its operations, avoided performance issues and enabled all its engineers to collaborate remotely, all with support from Datadog.

Lastly, I'd note a large 6-figure upsell to one of the world's largest global financial institutions. This customer plans to migrate thousands of applications over the coming years with Datadog being the standard across multiple public and private clouds. This is an interesting customer to single out for both its extremely stringent security requirements and its adoption of our serverless monitoring capabilities.

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 were very pleased with our first quarter results. I will now review Q1 results in detail. Revenue was $131.2 million, up 87% year-over-year. The quarter's strength was broad-based, driven by new and existing customers, success across segments and sales channels as well as driven by continued platform adoption.

To provide some more context. First, in Q1, we saw strong new logo additions with contributions across sales channels and regions. Additionally, we saw strong continued expansion of existing customers. In the first quarter, our dollar-based net retention rate was above 130% for the 11th consecutive quarter. Our robust retention rate is driven primarily by increased usage of existing products as well as cross-selling to newer products. As Olivier mentioned, we are pleased with the initial uptake of our newest solutions, NPM and RUM. However, I would note that these newest products were immaterial to the results of the first quarter.

Lastly, we saw strength across segments with similar growth rates across enterprise, mid-market and SMB. We were encouraged to see this broad-based strength, including many large enterprise deals, which closed in March as well as strength from our SMB customer base. In the quarter, we saw continued robust dollar rates -- net and gross retention in each of these segments.

Now turning to billings, which was $137.9 million and up 55% year-over-year. There are 2 dynamics here I'd like to call out. First, while we saw billings duration come in a bit in some of our renewals and upsells in the quarter, as some of our clients move to quarterly or semiannual payment terms from prior annual terms, I want to note that this did not result in reduced duration of contract length, merely the payment terms. This was due to customers' cash flow planning amid COVID and our accommodation to their billing preferences. The impact of shorter duration on the quarter was approximately $10 million to billings. Given our very efficient land-and-expand model, however, we are still not dependent on large upfront payments for multiyear deals.

Next, there was a smaller impact from the invoice timing of a sizable existing customer that was invoiced $4 million in Q1 last year and then due to growth was invoiced a second time in 2019 but was not invoiced in Q1 this year. Normalizing for these 2 impacts, calculated billings growth would have been approximately 70% year-over-year.

In addition, as of the end of Q1, we our remaining performance obligations, or RPO, was $256 million and grew 82% year-over-year. RPO measures commitments rather than billing terms. The higher growth of RPO indicates increases in longer-term commitments even when billing terms may be altered. As discussed previously, we discourage the use of billings as a gauge of our momentum as it does not accurately portray the growth of our business. Revenue is a better indicator of growth given that our revenue is directly tied to consumption and due to the tight relationship between revenue and ARR.

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 earnings release.

Gross profit in the quarter was $105.2 million, representing a gross margin of 80%. This compares to a gross margin of 78% last quarter and 73% in the year ago period. Improvement in gross margin was driven by efficient use of our cloud hosting. As we said before, our gross margins may fluctuate quarter-to-quarter within an acceptable range as we prioritize product development and innovation as well as the build-out of cloud data centers in newer geographies.

R&D expense was $35 million or 27% of revenue compared to 31% in the year ago quarter. We have continued to invest significantly in R&D, including high growth in our engineering headcount. However, the growth of revenue has outpaced even our substantial investments. We continue to see meaningful opportunity to innovate and expand our platform and therefore plan to continue making meaningful investments in R&D.

Sales and marketing expense was $42.1 million or 32% of revenues compared to 42% in the year ago period. Similar to R&D, we continue to make substantial investments in sales and marketing, but the pace of revenue growth has also outpaced this investment. While we have experienced cancellation of marketing events due to COVID, we have successfully redeployed much of the events budget to advertising and other lead generation activities, but not quite on a one-for-one basis.

G&A expense was $12 million in the quarter or 9% of revenue, slightly lower than 10% in the year ago period. Operating income was $16.1 million, with a 12% operating margin compared to an operating loss of $7 million or a negative 10% margin in the year ago period. Beyond the improvement in gross margin and the other factors discussed above, I'd also like -- I'd also note that reduction in T&E and facilities overhead related to COVID contributed slightly to the operating margin improvement.

Net income in the quarter was $18.8 million or $0.06 per share based on 328 million weighted average diluted shares. We have a highly efficient business model and experienced a high return on our investments in sales and marketing and R&D. While we have delivered 3 consecutive quarters of breakeven to positive operating income, we note that our priority remains top line growth. And we intend to continue aggressive investments in R&D and go-to-market. We have been very successful in interviewing, hiring and onboarding remotely. As a result, our plans for hiring and investing remain largely the same as before the corona outbreak. We are investing across the board and believe we are well positioned to execute on our plans of growth.

Turning to the balance sheet and cash flow. We ended the quarter with $799 million of cash, cash equivalents, restricted cash and marketable securities. Cash flow from operations was a positive $24.3 million in the quarter. After taking into consideration capital expenditures and capitalized software, free cash flow was a positive $19.3 million in the quarter or a free cash flow margin of 15%.

I would now like to turn to our outlook for the second quarter and the full year 2020. Given our recurring revenue model, we have not yet felt the effect of COVID-19 on our top line results. It is early in the quarter, and we expect that we will see some deal slippage, particularly in new logos. We also expect that despite a relatively high net retention rate, we may see some downward pressure in net retention rate in the next 2 quarters.

As Olivier mentioned, the usage of some client surged in March and have adjusted somewhat in April but remain above pre-COVID levels. It is too soon to know how usage will trend for the remainder of the quarter. Therefore, we believe it is prudent to expect some impact from the above effects, most likely in Q2 and Q3 and potentially throughout the rest of the year given our ratable model. And as a result, we have incorporated this into our guidance.

Beginning with our second quarter guidance, we expect revenue to be in the range of $134 million to $136 million, which represents a year-over-year growth of 62% at the midpoint. Non-GAAP operating income is expected to be in the range of a loss of $1 million to income of $1 million. Non-GAAP net income per share is expected to be breakeven to $0.01 positive per share based on approximately 329 million weighted average diluted shares.

Turning to the full year. Given our first quarter strength and the drivers of our business, we feel comfortable raising our guidance for 2020 based on what we know today about COVID-19 and the macroeconomic environment. For the full year 2020, revenue is expected to be in the range of $525 million to $565 million -- sorry, $555 million to $565 million, which represents a 54% year-over-year growth at the midpoint. Non-GAAP operating income is expected to be in the range of breakeven to $10 million positive. Non-GAAP net income per share is expected to be in the range of $0.02 positive to $0.06 positive per share based on 330 million weighted average shares outstanding.

A few things to take into account in our guidance. While we do not guide to billings and continue to discourage this as a key metric, when putting together your models, we would note that the shorter billing duration impact we talked about in Q1 is likely to continue for the next couple of quarters as customers plan for cash flow amid COVID-19. Related to cost drivers, while we've seen continued improvement in our gross margins, we are running towards the top of our long-term target. As we prioritize product development and diversifying our cloud hosting vendors and regions, our gross margins may fluctuate within a range of acceptability.

Next, our intention is to invest meaningfully and continue to do so in R&D and sales and marketing. As noted, we have been successful in hiring and onboarding during COVID. In Q2, we expect an approximately $5.5 million noncash tax adjustment related to the expiration of a payroll tax liability. Similar to Q2 2019, this will be a benefit to GAAP operating income, but we intend to normalize for it in our non-GAAP results. And therefore, it is neutral to non-GAAP operating income.

Then some notes below operating income. We expect approximately $2 million of interest income per quarter throughout 2020 based on our cash and investments. Next, we do not expect to be a federal taxpayer but have a tax provision related to our international entity. For the full year, we expect a tax provision of a range of $700,000 to $1.5 million. Note that our share forecast for Q2 and the full year are diluted given that we expect to be a non-GAAP net income profitable company for both periods.

Lastly, while we're not giving guidance to cash flow, a few things to note. Related to our employee stock purchase program, we've realized an inflow of about $3 million in cash flow from operations in both Q4 and Q1. As the first program concludes, there is a change in geography, whereby cash flow from operations will decline by $6 million and cash flow from financing activities will increase by $6 million, resulting in no net cash effect. In addition, our new ESPP will produce $2 million to $3 million of new positive cash flow from operations in Q2.

Lastly, we expect pressure on billings duration and potentially on DSOs related to COVID, which may cause lower cash generation in the near term. Given our efficient model, proven cash flow generation and meaningful cash on the balance sheet, this will have no impact on our liquidity.

To summarize, we were very pleased with the business performance in the first quarter. We continue to deliver growth at scale a few can match and have demonstrated efficiency in our model. While we recognize the challenges that COVID-19 and the macro environment may present, we continue to believe that we are well positioned for the long term and plan for continued investments to capitalize on the large opportunity ahead of us.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Sanjit Singh with Morgan Stanley.

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

Congratulations on a strong Q1. And I hope everyone in the New York headquarters is doing well, the employees are doing well, just given all the challenges that we've been going through over the last couple of months. So great to see the Q1 results. I had 2 questions, one more of a short-term -- shorter-term question and one more of a longer-term question for Olivier.

To start with the short term question, I guess what I'm trying to understand is from what you guys have seen in March and through April and now in early May, the -- what's the sort of the net impact in terms of what you're seeing in the business from the customers that are more impacted, the sort of less than 10% of ARR customer -- the spending trends in those customers that are less than 10% of ARR versus some of the increased spending you're seeing in some of the other verticals. So does that sort of net out to neutral in terms of your business plans for the year? Or is it -- are you seeing a net positive effect?

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

So I'll answer that. So, so far, what we see in March, April is that we see growth. April actually is a robust month. And we -- some customers are impacted and are going slower. Some customers have been scaling up. We have some questions on our end, as we discussed on the call, on which parts of the scale-ups are going to normalize in the future since we've seen some customers that scrambled late in Q1 and then in April to reorganize the operations and may normalize after that.

I would say it's too early to tell where everything nets up. I would think we need to be prudent in estimating what could happen over the next couple of quarters. But so far, from what we can see, we see a lot more reliance on online. We see actually a success story around the cloud. The cloud scaled up. All these companies have been able to move their operations and scale their operations. And we see more investment going on that side. So that's the story so far. And you had a second question?

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

Yes. My follow-up is sort of trying to think about the world post COVID. And when we look at the product portfolio, it seems like you guys have continued to maintain a rapid pace of innovation. And in terms of coverage, it seems like across security, across the, I guess, now 4 pillars, you have all the products in place that is going to drive really healthy growth for a long time. I'm trying to understand like what the next sort of key buying criteria is going to be.

So as we go from observability, is there going to be an element of taking action, right? And beyond just monitoring and alerting, do you have the data? Are the products going to be in a place where you can start -- where customers can start taking prescriptive action in terms of their environment? Or maybe even said more simply, where do you see the product portfolio going as we get past COVID?

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

Yes. So we -- look, we already have a lot on our hands, right? So I should just restate the fact that our more recent products like APM and logs are in hyper growth. The products we've added after that like Synthetics, for example, are growing very fast. And there's still a lot of investment that goes into all of these products, including our core infrastructure monitoring product. So we still have a lot that we're doing there.

When it comes to security, we're still very, very early. What we have is the first product. We're happy that it is in GA. We're happy that it's getting traction. But it's still very early, and it has a very long road map. And there's a lot more that we intend to build around it.

So now regarding the categories of product you've mentioned, like there definitely are some things that are interesting to us in there. And we do have some internal developments in a number of areas. I can't tell you exactly when that is going to be presented to customers, and we really have a lot going on.

Operator

Our next question comes from Chris Merwin with Goldman Sachs.

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

Okay. Great. And congratulations on the phenomenal results. So in the prepared remarks, you talked about some impact from the delay of projects. But I guess at the same time, there's an opportunity for the pace of digital transformation to actually accelerate in a recovery. And perhaps that's particularly true for customers that were unprepared for a remote workforce. So can you talk a bit about your customer conversations on that particular topic and how you think about how these trends could impact Datadog post COVID and in recovery?

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

Yes. So I mean look, we see what's happening with our customers that have one foot in the digital world and one foot in the, I would say, physical brick-and-mortar world. They're investing heavily in digital art, and they see these parts scaling like crazy right now. So that is not going to slow down. And that is actually going to, we think, accelerate the transformation for the broader industry. Now at the same time this is happening, it is difficult for companies to transform and modernize and make big investments or new investments at a time where many of them are in trouble and have pretty stern constraints on cash and have to make some very hard choices in the short term.

So this is -- this is not new. Many other companies have discussed that before over the past few weeks. But I think what we're trying to balance here is the uncertainty in the short term as these companies go past this urgent transformation or urgent survival mode and the fact that the underlying trend that underpin our success of digital transformation and move to the cloud are just going to accelerate and become more prevalent once the world starts recovering. So the balancing act, it would end up in the guidance we've given basically.

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

Got it. I guess as a related question, I think one of the themes we've seen in the space is convergence, and that was actually true before COVID. So I mean particularly as customers go through a time when they got to think about perhaps consolidating some of the tools that they have, are you seeing actually any benefit from that? I mean could there be a tailwind to the cross-sell motion for specific products? Just curious how you think about.

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

This is definitely -- like this was appealing to customers before COVID. It's as appealing, if not more, to customers now. Some customers might look into ways of rationalizing costs in the short term. So these are all opportunities. At this point, none of these -- we don't have data on any of these to be -- to tell you whether it's going to be a big factor or not over the rest of the year. Look, this is our strategy. We've been building towards that. So obviously, in the long term, we believe in it.

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Operator

And our next question comes from Sterling Auty with JPMorgan.

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

I'm curious, in terms of the net new ARR that you added in the quarter, how would you characterize how much of that is coming from kind of high-level CIO, large complex transactions versus maybe some more kind of day-to-day orders that you get at a divisional or departmental level?

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

Well, the way we sell in general is always bottom up. Even in large enterprises, even when we start the conversation at the CIO level and we end it to the CIO level, the adoption of the product is bottom up. And we start small. Even when we land -- I mentioned earlier on the call, like some 6- or 7-figure land deal, even when we land those deals, these are still a small fraction of what the total opportunity looks like at these customers. And this represent bottom-up adoption and some deals that are going to grow significantly over time. So that's the way it used to work. That's still the way it's working as far as we can tell in Q2.

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

That makes sense. And then can you give us maybe some qualitative color on the mix of business in terms of -- you gave us the 75% that landed with 2 or more products, but just give us some color in terms of the strength of infrastructure versus APM versus logging in the quarter.

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

Well, I mean, look, they're all growing. Infrastructure alone would be one of the best SaaS companies around, APM and logs. So if we single out those products -- and look, we don't really like to do that because, as we like to say, there's quite a bit of fungibility between the different products and which you attribute to one, you could attribute to another. But the -- those products are in hyper growth. They're growing a lot faster than that or used to grow when we were at the scale-up of those products. And that's still the case. That growth hasn't slowed down.

Synthetics is still growing much faster than we thought it would. And it's a great product for us. We're pleased with the initial uptake of NPM, but it is still not material to our results. We mentioned it earlier, but it's a product that has a higher friction than Synthetics, for example, to get adopted, but it has a very long runway. So we're investing in that product.

We've seen some adoption of RUM. We started charging in March for some portion of it. So we started charging for a part of it that is -- part of our customers' contract is committed as opposed to being usage driven. So it's still also not material to Q1, but we should see more of it in Q2. And the security product we haven't started charging for yet in Q1, we started in Q2. So we don't have anything to say about it yet.

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

Sterling, I think the trends have really continued. The net retentions were very consistent in Q1 to what they had been and also the contribution from usage and new products and cross-sell. So much of what we've been saying in the last 2 quarters has continued in Q1 with really strong contribution to net retention from both those effects of usage and cross-sell.

Operator

Our next question comes from Raimo Lenschow with Barclays.

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

The -- if you -- you talked about the net retention and the assumptions that you're making as the crisis kind of continues. Can you remind us -- if there's going to be more churn, then it's probably going to be more in the SMB space. Can you talk a little bit about your exposure there and what you're seeing so far? It's my first question.

And then on the billing side, can you remind us, David, like in terms of what's monthly versus annually versus where the quarterly, biannually that you talked about, just to get an idea about the mix.

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

Yes. I'll about SMB, and maybe David can talk about the billing mix. So we actually -- or ARR is, as we discussed before, is, what, split evenly between enterprise, mid-market and SMB. But even within SMB, we -- most of that revenue comes from companies that are on the larger side and on very solid footing financially. Some of them are publicly traded and tend to be closer to the 1,000-employee limit there. We mentioned on the call that less than 15% of our revenue came from companies that are on the smaller side, which is less than 100 employees.

If you look at our SMB customers, they're very diverse. And we're actually less exposed on the SMB side to some of the higher-risk categories around COVID. And so far, we haven't seen a big change in trends. I mean we did see a tiny uptick in churn in SMBs, but it's actually consistent with levels we've seen just a few quarters ago. So there's nothing out of the ordinary. And at the same time, we saw an increase of net retention for that same cohort of SMBs. So it has nothing conclusive there. We don't see anything that we didn't see before.

Now when we try to guide for the future, we have to try and guess where our exposure is going to be and what can be weaker. We'll have to guess that the SMBs are going to feel more pain and are going to be where we'll see more churn. And so that's what we've incorporated in our guidance.

David, do you want to take the billing mix?

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

Yes. And in billing, 2/3 of our -- of ARR is associated with annual commitments or greater. And 3/4, when you add in the usage related to that, so 3/4 of our billings are associated with annual commitments or longer. What we said before was our average length of commitment went out slightly in the quarter, resulting in an acceleration of RPO. And our average period of billing duration came in a little bit more, resulting in the billings discussion. But about 3/4 are related to annual commitments or more.

Operator

Our next question comes from Brad Zelnick with Crédit Suisse.

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

Great. Congratulations on a strong start to the year. And as well, I hope everybody at Datadog and everyone listening is doing okay these days. My first question, I wanted to follow up on what Sanjit has asked and I think Raimo is alluding to as well. Just trying to understand the impact on the business from COVID. Specifically, if I hear your comments about the potential for deal slippage, obviously, with more pressure on new logo business and the downward pressure that you might see on net expansion, to what extent are you seeing it coming versus just preparing for it? And maybe if you could, perhaps, can you compare and contrast consumption trends versus pipeline progression and the conversions on that pipeline that you're seeing in March and into April?

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

Do you want to go first, Oli, and I'll weigh in?

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

Yes. Yes. So -- yes. So look, it's -- for the most part, we're guessing because it's too early in the quarter to actually have a good sense of what may slip or not. At the end of Q1, we did have a few deals that slipped and that were marked. The reason for slippage was uncertainty around COVID. And several of them have closed right after. And I would say it's not like every quarter, there are a few deals that slip. And the number of deals that slipped in Q1 was actually not out of the ordinary compared to previous quarters. So we don't have really anything to quantify the effects we might see, but we do anticipate that we will see some.

When it comes to usage, again, it's also a little bit more difficult to compare because some of the usage patterns have changed a little bit as companies have scrambled to reorganize. So there's a little bit less predictability in there, which is also why we're baking that into some of our guidance.

So overall, look, we do anticipate some uncertainty and some pressure on some fronts in Q2 and Q3. I would be worried if that didn't happen. But we don't have anything that makes us particularly concerned in front of us right now.

David, do you want to add anything?

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

Yes. Yes, I agree. Our pipeline remains consistent. We don't know, as Oli said, is -- what is the harvesting percentage, what's going to happen this quarter. So we think that our model, given our model of land and expand and usage that were less dependent than other models on going to land in a large 3-year deal, but we don't know, in new logos particularly, what's going to happen as the quarter progresses. The main request we've gotten so far has been some modest can you chunk our builds up a little bit. That's been probably what we've seen a little more. But again, it hasn't been a significant percentage of our ARR either at this point.

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

That's both very helpful. If I can follow up with just a quick housekeeping question for you, David. RPO, up 82% in the period, I think, is strong by just about any way you look at it. But to just put a finer point, can you give us a duration-adjusted RPO growth or even a current RPO growth?

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

We don't release that. We're just making comments on the fact that it was higher than the pro forma billing due to longer contract commitment duration in 2 and 3 year deals, but we haven't really commented and broken that up publicly.

Operator

Our next question comes from Matt Hedberg with RBC Capital Markets.

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

I'll echo the strong results this quarter. Your ability to sell 2 or more products is obviously impressive. I'm wondering if you can share maybe some examples of how some of your largest G2K customers are adopting APM and logging. And in particular, when they do, are you seeing these customers migrate off of other vendors' APM and logging solutions? Or are they often run in parallel for a while?

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

So we do have a number of G2K customers that are adopting APM and our logs. In all of those cases, when we start, we don't actually replace whatever they were using on-prem because they're still using that. Their on-prem world is still separate from their cloud world, which is the net new, which is where we come in. So we typically land usually with 2 or more products, and we grow in that footprint in the cloud. We're still, in most of these cases, very early in that growth because those customers are very early in their migration to the cloud, which is where we solidify our footprint. And we basically set ourselves up to later -- much later offer standardization of the whole tool set on us as the majority of their footprint ends up being on the cloud. But we're still not there with most of these customers.

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

That's helpful. And then I just wanted to make sure I understood churn a little bit better, Oli. You noted earlier that you're not being impacted by workforce reductions. But when we think of higher level churns embedded in your guidance, is that assumption that some customers might go out of business on the smaller side? Or might we see some seat-based contraction inside of existing customers at some point?

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

So we don't sell per seat. So we don't -- there's no user-driven -- these are account-driven component to 1 billion. So that part doesn't affect us directly. What we might see is some effect from our customers contracting their infrastructure. But in most cases, our customers actually have to keep that infrastructure up to serve their own customers. And there's a limit to what they can contract there. So that's not an effect we've seen so far.

I think we don't exactly know where the churn is going to come from if it comes. It's a fair assumption that a number of small businesses are going to disappear. We also see some medium and large businesses that are affected and we'll need some form of help or bailout to survive. We're all aware of that. So some of that might happen. So we want to be cautious. We want to be cognizant of the fact that if the economy as a whole is affected, some of it is going to ripple to us considering the fact that we have a very broad-based customer base.

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

And this is David. Yes, we said -- as we said in the comments that we do have some new logo accumulation and some lower retention rates implied in the guidance. We said we haven't really seen that materially yet, but we're trying to be prudent relative to what might happen in the world.

Operator

Our next question comes from Brent Thill with Jefferies.

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

I realize the security SKU is brand new, but just if you can just give us any color initially back from the field. And I have just a quick follow-up after that.

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

Well, we're actually very happy with the uptake there. It's -- we've had -- while the product was still in beta, we had some customers that wanted to buy, and they did buy, and some customers that already adopted the product at scale. So that's very good. Now it's still super early, both in terms of the -- what's inside the product, all of the feature set, the integration and everything else, also very early in the way we make customers or go to market for it. So for now, we should assume that there's going to be a lot more investment, and going to take us a lot more time to get these new products to interesting scale.

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

And then just as a quick follow-up. Are you changing any of your hiring plans or product plans from here given everything that's gone on? Or are you still tracking to kind of original plan going into the year?

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

We're tracking mostly to original plan. We've made a few adjustments for areas where it didn't make sense to hire, for example, things around organizing local marketing events or office management. Obviously, that's not -- that's less of a topic when we don't have an office and you can't meet people in real life. But for everything else, we stick to the plan. And we have ambitious plans. And we think it's actually a great time to be hiring and a great time to be building up our team.

The thing I warned about in the call earlier was that it might take a bit longer for those investments to pay off because the market might be a bit softer on the customer side. They might be more uncertainty. But we are -- we think, for us, it's an opportunity to stand on the ground of our strong platform and the efficiency of our business.

Operator

And our next question comes from Brad Reback with Stifel.

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

Great. David, when a customer comes to you and asks, as you said, to chunk a payment up in smaller bite-size amounts, do you ask for anything in return, like a longer contract or anything along those lines?

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

Yes. Yes. We try -- we have a discussion with the contract -- with the customer, and we try to extend contract or do something around products. So we do that. But we're also here to grow with our clients, and what we care about given what we've seen is keeping our clients and having them grow with us over time. So we have a discussion, but we try to extend contract or get something else.

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

Yes. And I can comment on that. We're doing this on a case-by-case basis, really. But we do it in the spirit of partnership with our customers. And that's what I mentioned in the call, too, that we're co-investing not only in our product and our team. We're also investing in our customers. We're investing in relationships. We know some of them are going through a very difficult time, and we think there are some 2-way partnerships to be built on that.

Operator

And our next question comes from Robert Majek with Raymond James.

Robert S. Majek - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Congrats on the strong results. Can you break out the vertical exposure of your customer base and perhaps more specifically, what the contribution is from some of the more macro-sensitive sectors, including travel and entertainment? And I have one follow-up question.

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

Yes. Let me pull up my number and call back.

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

Yes. Let me -- while Oli's doing you're that. Do you want me to go or...

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

Sure, yes. Go ahead.

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

Yes. We said we have 10% or less that are subject to -- that are in the most exposed, which are travel, hospitality, dining and those types. So about a 10% exposure. And we have exposures on the other side to some of the work-from-home collaboration and food deliveries and others. So we're pretty diversified. We've always said we have a diversified customer base, and our concentration is not above 10% in those impacted industries.

Robert S. Majek - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Just perhaps one more. You touched on it earlier in prior questions, but can you just give us some more qualitative insight into your conversations with new potential customers and the willingness of these customers to pursue new modern deployments in an uncertain macroeconomic environment?

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

Yes. So actually, I can speak to that. So, so far, these conversations are not any different. Obviously, there is some scrutiny on spending and cash outlays. In particular, everybody is careful about cash in the face of uncertainty, which is why we discussed also some -- in some cases, different payment terms for some customers. But the conversation so far, as I'm saying, we actually see an interesting effect where some customers in very affected industries will reach out now because they actually have time to invest and prepare for the future because they are less -- they have less to operate on a day-to-day basis. So we've seen some of that happen.

It is anecdotal. There's not -- we can't tell that if any of that is actually going to come to fruition before the world's fast recovering, but we see some of that happening. In general, we're still early in the cycle still that we don't really know if there's going to be -- if the impact will be really felt in Q2 and Q3 or not. But we've been careful in the way we set guidance.

Operator

Our next question comes from Bhavan Suri with William Blair.

Bhavanmit Singh Suri - *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

Can you hear me okay?

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

Yes.

Bhavanmit Singh Suri - *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

Congratulations for a great quarter. I guess I wanted to touch quickly on some of the product stuff. You obviously talked a little bit about the new Security Monitoring product last quarter. It's fairly early days for that product. You weren't charging for it at the time. But I'd love to understand. I think became it generally available towards April. Early traction, early interest, how is that playing out? And obviously, security is a big part given remote access, given everything else that's happening with COVID. Just how that's going.

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

So far, so good. We -- the customers that have been -- part of the beta are using it, and some of them have actually turned to paying customers. So some of the beta users are turning to paying customers already. So we're happy with the traction. But again, there's a lot more that needs to happen there.

One thing that's interesting to us is that we've seen adoption from the -- both sides we were trying to bring together. We've seen adoption from dev and ops in one side but also some security folks on the other side. So that's very interesting, and that's what we're shooting for. But again, still early, but a lot is going to happen to it. I'm sure we'll talk about it again in future calls.

Bhavanmit Singh Suri - *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

Okay. And then one quick question on the pricing environment. Obviously, given the conversation with Dynatrace and others, AppDynamics, New Relic, et cetera, you view it as kind of the most attractive price point out there. How often would you say pricing is an important driver of the conversation, especially in this environment? Like are people -- are customers really thinking about pricing right now? And is that something that comes up as a decision point right now? Would love to understand sort of what the sales guys are seeing in these conversations.

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

Yes. So in general, we -- the way we differentiate is through the integrated platform and the outcomes we give through our products and less so the pricing that we have. We do have a pricing model that disaggregate certain elements so that our customers can align the price they pay with the value they get and especially when it comes to matching data and logs and things like that.

I would say the -- we haven't seen any changes in that environment. The one thing that we think is -- might be an advantage is that we also -- we operate by starting small and growing with our customers. Our model is not predicated on very large multiyear upfront deals. And that's something that is attractive to customers, especially in an environment where they're trying to manage cash.

Bhavanmit Singh Suri - *William Blair & Company L.L.C., Research Division - Partner & Co-Group Head of Technology, Media and Communications*

Yes. Obviously, that's an issue given cash constraints. But you obviously have small SMB exposure, as you talked about today. It's interesting you haven't seen those conversations, but appreciate the color.

Operator

And our next question comes from Pat Walravens with JMP Securities.

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

Great. Congratulations on running such a tight ship over there. So Oli, you've been doing this for 20 years, a little more. I would love to hear your thoughts on how you think this recession is different and maybe similar to 2008, 2009.

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

All right. That's a hard question. Well, I think the one thing I remember from the previous one is that you don't really know where they're going until they're over. So that's why we've been prudent.

Another thing that we wanted to communicate through this call is that we -- look, our business is very healthy. We see growth. We -- from everything we can tell, the drivers that made us successful so far are still there and everything is working. At the same time, we've been growing 80%, 85%, 87% now year-over-year. And for that to work, you pretty much need every -- to fire on every single cylinder, right? Everything needs to come together. And this almost guarantee that not everything will come together in the end if part of the world is impacted by COVID. And we're trying to be cognizant of that.

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

Great. And then, David, if I can ask you one, RPO growth has been sort of in the same ballpark as revenue the last couple of quarters, 3% less in Q4, 5% less in Q1. Is that a reasonable way for us to think about it going forward? Or should that diverge?

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

Well, as I mentioned, we've had extension of average contract. We've had a number of companies who we developed long-term partnerships with, and they've wanted to -- and together commit out to the door 3 years. So I think that's going to depend much like on billings as to the timing of those contract renewals. And I think you'll see in some period that happened and in other periods not mainly because of individual contracts that are up for renewal during that period or extension.

Operator

And our last question comes from Jack Andrews with Needham.

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

Great. Congratulations on the results. I just want to ask about what trends you're seeing in terms of Network Performance Monitoring and Real User Monitoring. Do you see these as more displacement opportunities? Or are these greenfield markets? And I was also wondering if you -- how big do you think that the market opportunity is around this given perhaps a different pricing point than your core infrastructure and APM products?

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

Yes. So the strategy there is the same as with the rest of the product, which is we start from cloud environment, which tend to be new. In most cases, our customers are using other products. In some cases, they did. But the vast majority of the cases is net new in cloud environment. And the way we charge for those products is also aligned with the rest of our pricing philosophy, which is -- it's charge per usage while giving the control back to the customer so they can align the price they pay and the value they get.

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

Got it. Okay. And then just as a quick follow-up. Are there any international trends that are worthwhile noting in terms of just specific regions, pockets of areas of strength or just other changes that you're thinking about in terms of aligning resources, in particular, international regions?

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

No. I mean at this point, we see success -- some success in all regions, even though some are fairly recent. Even when you think of impact of COVID, we've had [an adjustment] everywhere, but we don't have any -- we don't have anything that makes us think that any region is going to behave very differently from the other at this point.

I'll give you an example. We even closed some new logo deals with large enterprises in Italy while the whole country was completely locked down. So there's no -- there's really no data point to tell us anything is going to be different in any part of the world today.

Operator

Thank you. And I'd like to turn the call over to Olivier Pomel for closing remarks.

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

All right. Well, thank you. In closing, I'd like to repeat that we are very pleased with the results for Q1. We continue to invest in our long-term opportunity, and we believe we are very well positioned for it. In what has been an unprecedented time for all of us, I want to thank Datadog employees for their dedication and resilience. And of course, I want to thank our customers for their trust in supporting their businesses through a challenging time. Thank you all.

Operator

Ladies and gentlemen, thank you for your participation on today's conference. This does conclude your program, and you may now disconnect.
