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Datadog, Inc. (DDOG)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Q3 2021 Datadog Earnings Conference Call. My name is Adrian and I'll be your operator for today's call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session. [Operator Instructions]

I'll now turn the call over to Yuka Broderick, Head of Investor Relations. Yuka Broderick, you may begin.

Unverified Participant

Thank you, Adrian. Good evening and thank you for joining us to review Datadog's third quarter 2021 financial results, which we announced in our press release issued after market close. Joining me on the call today are Olivier Pomel, Datadog's Co-Founder and CEO; and David Obstler, Datadog's CFO.

During this call, we will make statements related to our business that are forward-looking under federal securities laws and are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995, including statements related to our future financial performance, our outlook for the fourth quarter and the full year of 2021, our strategy, the potential benefits of our products, partnerships, investments in R&D and go-to market, our ability to capitalize on our market opportunities.

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 Quarterly Report on Form 10-Q for the quarter ended June 30, 2021 filed with the SEC on August 6, 2021. Additional information will be made available in our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2021, 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.

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

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 evening. We are extremely pleased with our performance in Q3, which was stronger than expected on robust growth with existing customers as well as strong new customer sales. We saw broad-based trends across product lines and across customer segments.

Let me give you a quick summary of the quarter. Revenue was $270 million, an increase of 75% year-over-year and above the high end of our guidance range. We ended the quarter with 1,800 customers with ARR of $100,000 or more, up from 1,082 in the year-ago quarter. These customers generated about 80% of our ARR.

We have about 17,500 customers, which is up from about 13,100 last year. The leverage and efficiency of our business model is coming through, with free cash flow of $57 million and our dollar-based net retention rate continued to be of over 130%, as customers increased their usage and adopted our newer products.

At the high level, positive business trends from recent quarters continued in Q3. Usage growth from existing customers was very strong this quarter across product. New logo ARR was robust with some large new deals closing, and churn remains low and in line with historical rates. Taking all these factors into account, we had a record quarter of ARR added, and we crossed the milestone by exceeding $1 billion in ARR in Q3.

Next, our platform strategy continues to resonate in the market. As of the end of Q3, 77% of customers are using two or more products, up from 71% a year ago. Additionally, 31% of customers are now using four or more products, which is up from 20% last year. And this quarter, about 70% of new logos landed with two or more product.

Most strikingly, our whole platform saw strong growth in the third quarter. I'd point out in particular that all of our major products added a record amount of ARR during the quarter, but also that the year-over-year growth of Infrastructure Monitoring ARR on its own accelerated this quarter.

And finally, that our Log Management and APM suite, which includes Synthetics, user monitoring and Continuous Profiler, remained in hyper growth mode. Together, in Q3, they exceeded $500 million in ARR.

Now let's move on to products in R&D. Our teams continued to innovate at a rapid pace. We had 40 new product-related announcements in Q3, and we made many announcements last week at Dash, our annual user conference.

You can review our Dash press releases as well as tonight's earnings for further description. But to summarize this briefly, we announced the availability of CI Visibility, Session Replay, Funnel Analysis, Network Device Monitoring, Datadog Apps, and Online Archives for Log Management. We launched private beta for Cloud Cost Management, Observability Pipelines, Universal Service Monitoring, and Application Security. And we also announced official Datadog support of the Vector open-source product.

Now looking back at a couple of these announcements. Some of them would increase Datadog's usefulness for business personas, users who are not engineers and can benefit from all the data flowing to Datadog. With Session Replay and Funnel Analysis, we believe support organizations, product designers, and product managers can get value from understanding user behavior and interactions with applications. And we expect Cloud Cost Management will be useful to anyone involved in understanding and controlling the expense of cloud implementations from engineering teams to product managers to finance teams.

We are also advancing our efforts to support our customers with large-scale complex data needs. So I want to talk a bit about Vector, Observability Pipelines, and Online Archives. Nine months ago, we acquired Timber, the developer of Vector. Vector is an open-source product that allows users to collect, enrich, and transform observability data and automatically route it to the destination of their choice.

Our Observability Pipelines product extends Vector and includes enterprise-level capabilities for its data pipelines, and the ability for users to seamlessly manage it from Datadog across both on-premise and cloud accounts. Vector and Observability Pipelines let customers make value-based decisions on data as early as possible before they send data to Datadog or any other partner. We are always looking for ways to give customers more control of how they use their data and how they manage the cost of their cloud deployments. This is another step in that direction.

And with Online Archives, we are aiming to solve the growing problem of storing old logs and being able to run complex historical investigations on them. Online Archives is an always-on log routing solution that provides 15 months or more of extremely cost-effective storage and live query capabilities.

I also wanted to mention Database Monitoring, which we announced for general availability in August and which gives our customers deep visibility into the performance and execution of queries across all of their databases.

Finally, as announced in the press release issued this evening, we acquired Ozcode, a live debugging solution for .NET applications, which lets developers solve problem in real time, whether in development or in production environments. It is another example of our growing push into developer workflows.

So, as you can tell, we were very busy in Q3, and I want to thank our engineering and product teams for their hard work and their relentless focus on our customers.

Now moving on to sales and marketing, our go-to-market teams continued to be very productive and we added 1,100 net new customers this quarter. So, let's review some of our Q3 wins. First, we had our largest deal ever by total contract value and over $60 million five-year upsell with a multinational financial services company. Our history of success with this customer has led to the use of nine products, including early adoption of newer products such as RUM, Synthetics, and APM. This customer began the second phase of their migration to the cloud and is standardizing on Datadog, adopting our newer products as we add them to our platform.

Next, we had a seven-figure upsell with a global fashion retailer based in Asia. This customer saw e-commerce sales increase dramatically during the pandemic and turned again to use Datadog after several outages resulted in missed sales. After a disappointing implementation of a competing solution, they chose Datadog APM across their global e-commerce sites and saw immediate improvement in stability.

Next, we had a six-figure land with a US-based professional sports league, which came in partnership with Google Cloud Platform. This customer experienced a large spike in application usage as fans are returning to games following the pandemic, but they had no client-side monitoring and therefore nowhere to analyze and optimize the user experience. With Datadog Real User Monitoring and Synthetics, along with Infrastructure Monitoring and APM, the customer now has a single solution to manage experience from front-end to back-end.

Next, we had a seven-figure land with the advertising division of a Fortune 10 company. This company has very strict SLAs for their platform, as their customers rely on always-on availability to adjust ad budgets in real-time. After conducting a full evaluation of internal solutions and APM providers, this customer began using Datadog Infrastructure Monitoring and APM, and are motivated to expand usage of our platform within the enterprise.

Finally, we had a large six-figure land with a US distributor of plumbing and building equipment. This company needed to migrate from on-premise to Azure and to deploy in Azure's Kubernetes Service, but its existing APM solution had limited visibility into containers. With Datadog, this customer is able to effectively monitor the health of their Azure ecosystem, allowing them to confidently and efficiently complete migrations and retain their legacy infrastructure.

As you can see, our go-to market teams had another quarter of strong execution. I want to thank them for once more successfully helping both new and existing customers to generate value from Datadog.

Now moving on to our longer-term outlook. If you could not join us for investor meeting last week, I encourage you to watch the video on the Investor Relations section of our website. At the meeting, we described our long-term opportunities, our differentiators, and the expansion of our platforms over the years.

To summarize my bit of the presentation, we see digital transformation and cloud migration as large forces driving exponential growth. We believe Datadog helps solve the growing problem of managing complexity for our customers and that our open-ended unified platform, designed to be simple but not simplistic, is deployed everywhere and used by everyone at our customers, and that it helps break down silos between teams.

We believe it is still early days for our opportunity in observability. And while we have made a lot of progress in building out a broad observability platform, we still have much to do to solve all of our problems customer pain points.

One next step for us is in security with our Cloud Security Platform, and we believe we have a part to play in breaking down silos between development, operations and security teams. But we're also making our first inroads in pure developer workflows with the general availability of CI Visibility. And we think over time we have opportunities to help our customers in several of the large adjacent markets as well. In other words, we are just getting started.

With that, I would like to turn the call over to our CFO. David?

David M. Obstler

Chief Financial Officer, Datadog, Inc.

Thanks, Olivier. In summary, we had a very strong Q3. Revenue was $270 million, up 75% year-over-year and up 16% quarter-over-quarter. Usage trends were strong and showed broad-based growth. Customers continued to adopt more products across the platform and new logo generation was also strong.

To provide some more context, first, growth of existing customers was robust in Q3 and our dollar-based net retention rate remained above 130% for the 17th consecutive quarter. Usage growth was very strong driven by customers' expanded usage of existing products and the adoption of new products. Our new customers from the last several quarters have expanded their usage quite rapidly and we had some significant renewals with large customers in Q3.

We also had a record quarter of ARR adds, including record ARR adds in all of our major products. And we saw strong growth across geographical regions, with all regions accelerated on a year-over-year basis compared to Q2.

New logo results were also strong. Our enterprise and commercial sales teams had a crisp execution in this quarter and new logo ARR was up strongly year-over-year. We continue to see opportunities broadly across industries and customer sizes. Remember that given our usage-based revenue model, new logo wins generally do not immediately translate into meaningful revenue.

Next, our platform strategy continues to resonate with customers. And as we mentioned, 77% of our customers are now using two or more products and 31% of our customers are using four or more products. And lastly, churn remained low and in line with historical levels. Our dollar based gross retention rate remained unchanged in the mid 90s and is similar across all our customer segments and products.

Turning to billings, the billings were $309 million, up 98% year over year. There were no pro forma impacts in the quarter. Note that we called out shorter term billings duration in Q3 of 2020 last year and billing duration in 3Q of this year is in line with recent quarters but is higher on a year over year basis, driving higher year over year billings growth.

Remaining performance obligations, or RPO, was $719 million, up 127% year over year driven by strong sales activity, increased contract duration, and it was growing against an easier compare in the third quarter of last year. The increase in contract duration was driven by several large renewals with multiyear terms. As a reminder, multiyear commitments are billed annually and we don't incentivize our sales team towards multiyear deals.

Current RPO growth was about 100% year over year, as our mix shifted away from month-to-month deals to on a year over year basis more towards semiannual and annual. We continue to believe revenue was a better indicator of our business trends than billings and RPO, as those can fluctuate relative to revenue based on the timing of invoicing and the duration of customer contracts.

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.

Starting with gross profit, our gross profit in the quarter was $210 million, representing a gross margin of 78%. This compares to a gross margin of 76% last quarter and 79% in the year-ago quarter. Due to our continued efforts to drive efficiencies in cloud costs, we expect our gross margin to increase sequentially in Q4. In the mid to long term, we expect gross margin to remain in the high-70s range, typical of our historical performance.

R&D expense was $84 million or 31% of revenue, compared to 30% in the year-ago quarter. We continue to invest significantly in R&D, including high growth in our engineering head count. Sales and marketing expense was $65 million or 24% of revenue, compared to 32% in the year-ago quarter. We continue to see strong efficiencies with our frictionless land-and-expand selling motion. We also had relatively few in-person events in Q3, but we continue to plan for increased travel and events costs going forward, depending on local health and travel guidelines.

G&A expense was $17 million or 6% of revenues, compared to 8% in the year-ago quarter. Operating income was $44 million or 16% operating margin, compared to an operating income of $14 million or 9% in the year-ago quarter. We continue to invest heavily against the large and dynamic market opportunity we see in front of us, but our product innovation coupled with the strong go to market effort and a frictionless land-and-expand model is driving strong revenue growth and business model efficiencies. Non GAAP net income in the quarter was $44 million or $0.13 per share, based on 344 million weighted average diluted shares outstanding.

Turning to the balance sheet and cash flow, we ended the quarter with $1.5 billion in cash, cash equivalents, restricted cash and marketable securities. Cash flow from operations was $67 million in the quarter. After taking into consideration capital expenditures and capitalized software, free cash flow was $57 million for a free cash flow margin of 21%.

Now, for our outlook for the fourth quarter and the full-year 2021. We remain highly optimistic about our long term opportunities and we continue to work hard to execute against these opportunities. Taking this into account, with the usual conservatism applied, we are updating our guidance as follows: For the fourth quarter, we expect revenues to be in the range of $290 million to $292 million, which represents 64% year over year growth at the midpoint. Non GAAP operating income is expected to be in the range of $38 million to $40 million. And non GAAP net income per share is expected to be between $0.11 and $0.12 per share based on 347 million average diluted shares outstanding.

For the full-year 2021, revenue is expected to be in the range of $993 million to $995 million, which represents a 65% year over year growth at the midpoint. Non GAAP operating income is expected to be in the range of $113 million to $135 million. And non GAAP net income per share is expected to be in the range of $0.39 per share to $0.40 per share, based on approximately 344 million weighted average shares outstanding.

Now, some notes on guidance. While usage growth remained strong in Q3, when providing guidance, as usual, we use more conservative assumptions. We would note that we typically see slower business activity towards the end of the fourth quarter as employees take vacations around the winter holidays.

Next, our strategic focus remains to invest aggressively in R&D and go to market to optimize for the long term growth. And our model assumes greater expenses related to travel and in person events going forward. However, we will remain flexible depending upon local regulations and our highest priority is protecting the health of our employees.

Regarding items below operating income, we expect approximately $0.7 million of Q4 non GAAP net interest and other income, which includes interest income on our cash and marketable securities and the interest expense of our convertible debt. We do not expect to be a federal taxpayer, but have a tax provision related to international entities. We expect that tax provision to be approximately $600,000 in Q4 and $2 million for the full year.

And now to summarize, we are very pleased with the results of this quarter. Our platform is resonating in the marketplace and we saw strong performance across our products in Q3. We continue to invest aggressively in R&D. And with the launch of Database Monitoring and CI Visibility, we now have 13 generally available products to offer our customers.

Our execution against our go to market goals remains strong. And our ability to help our customers manage through their cloud migration and digital transformation efforts continues to expand.

And with that, we will open up the call for questions. Operator, let's begin the Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now begin the question and answer session. [Operator Instructions] And our first question comes from Sanjit Singh from Morgan Stanley. Your line is open.

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

Q

Thank you for taking the questions and congrats on another really, really strong quarter. I had a question for Olivier. It's kind of more of a higher level product-related question coming off the user conference. And I guess the theme of it is that we hear the word observability much more often in 2021 than in 2019, and I think it's starting to refer to different aspects of software in different domains.

And I'm wondering from your perspective, you guys obviously have a lot on your plate, plenty of opportunity, but when we're talking about bringing observability into other domains, whether it's the data pipeline or going to potentially in process mining, because you guys do have a Log Analytics solutions. Are those potential opportunities in terms of bringing observability to different domains from the Datadog perspective or are you sort of kind of combining it to more of IT?

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

A

We know – we're all about breaking down silos and bringing more use cases and more personnel under the same roof. And we're strong believers that with digital transformation, the application is going to run the business. And so, if you understand the application, you understand everything that happens around the business, which gives you an opportunity to bring many more teams in.

So, long-term, yes, I mean, all of these are interesting things for us to do and we see some of our customers implementing some new use cases that we haven't productized on Datadog already today. I would say, today we're still focused on the products we have go-to market and the ones that are still in beta, and we're taking it step-by-step. But, yes, there's much more we can do and want we do.

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

Q

Understood. And then sort of talking about some of the usage and cohort behaviors that we've seen over the last several quarters. Coming off the slowdown that we saw at the end of last summer, I think the theme has been that the usage trends and the expansion trends have sort of been reverting to normal and getting back to even higher than the pre-pandemic – sort of in line with the sort of pre-pandemic levels.

As we stand and sort of going into the end of the year, how have those cohorts sort of changed? Is it just sort of continuing sort of usage or are you seeing different [audio gap] (00:26:52) longer-term contracts? And what sense – what commonalities are you seeing across these cohorts that are different than just sort of the recovery off the end of last year?

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

A

There's actually not many differences between what we see in the most recent cohorts and the previous cohorts. The two main trends that we see that are underpinning the success you've seen in the past few quarters, as you identified earlier, the fact that the pace of cloud migration and digital transformation has resumed to where it was. That's the first ingredient.

The second ingredient is that our newer products are reaching scale and are being successful and are basically propping up our growth as we solve a larger and larger problem for our customers. So, the combination of those two things really is what drives the success you've seen.

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

And we continue to have our usage increase be about two-thirds usage of products the client had already and about one-third adoption of new products. That's been pretty consistent over time. So we continue to see similar types of adoption paths.

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

Makes a lot of sense. And very helpful, David, in terms of shedding some light on the split between those two vectors. Thank you very much and congrats on the strong Q3.

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

Thanks.

Operator: And our next question comes from Raimo Lenschow from Barclays. Your line is open.

Raimo Lenschow
Analyst, Barclays Capital, Inc.
Q

Hey. Thanks. Congrats from me as well. Olivier, can you – you've mentioned some of the launch renewals you saw this quarter, and obviously you think they're kind of heavy users of Datadog. Can you just describe like how much of their estate is actually getting monitored by you, i.e. like how much have you penetrated them? And what kind of differentiates those customers from the guys that are kind of smaller on your platform? So, is that just a maturity thing or what are the drivers here that we need to think about?

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

I think it depends a little bit on the customers obviously. But for some of the customers we've mentioned, it's very clear that they are standardizing on Datadog. As I mentioned, a very large five-year deal, which is still somewhat atypical for us, but what this shows is that this is a customer that is far enough in their cloud information that they know where they are going. They're standardizing on us. And they plan over those five years to be basically bring substantially everything they have into the cloud and in Datadog. So, that's what's behind it.

And again, right now, we only see that from those of our large customers that are far enough in their cloud migration and many of our large enterprise customers have started this cloud migration more recently. But we think it is representative of what's going to happen at a larger scale a few years from now.

Raimo Lenschow
Analyst, Barclays Capital, Inc.

Q

Yeah. And then one for David. If I look at the billings growth that you pointed out that you had slightly better duration this year last year, like, do you think you would be able to quantify that a little bit? Is it like – like is that a 20 points win, a 10 points win, like some materiality but not too much? Like, could you help us there?

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

A

What we said in billings duration was we had large – generally been in sort of the seven months plus or minus, then we had had some contraction when in COVID last year down into the 6s. And we're back up into that same range on billings duration that we had before in sort of the seven to eight months.

The same thing happened in contract duration, although the contract duration we said was complemented by some multiyear contracts which expanded the RPO in this quarter, and maybe a bit unique in terms of the number of multiyears that happened this quarter.

Raimo Lenschow
Analyst, Barclays Capital, Inc.

Q

Okay. Perfect. Congrats. Well done.

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

A

Thanks.

Operator: And our next question comes from Kash Rangan from Goldman Sachs. Your line is open.

Nikolay Beliov
Analyst, Goldman Sachs

Q

Hi. This is Nikolay Beliov sitting in for Kash. The question we have for you is, number one, can you please [ph] spec-rank (00:31:23) for us the factors that are contributing to revenue reacceleration? You talked about all the various pieces of the puzzle here, but is there any way to [ph] spec-rank (00:31:32) them in terms of most influential versus least influential? What drove the revenue reacceleration here?

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

A

Yeah. There are two main factors really. The resumption of cloud migration to the speed it had before the pandemic, that's number one, and this one we don't fully control, right? I mean, that's something that is highly dependent on the business environment around us.

The second factor is the success of our new product and the fact that we are – we mentioned on the call, our APM and log products together reached more than $500 million in ARR. So, not only are they growing very fast, like they are still in hyper growth, but also they contribute quite a bit to the revenue of the company. And we have more products coming up after that that are also growing very fast. So this is the second factor.

The third factor is that on the back of that, like with all the demand environment being there and with us solving a larger and larger problem, we successfully scaled the go-to-market teams, so we can actually go after this opportunity. So, combine all those three, that's how you get the reacceleration of growth.

Nikolay Beliov
Analyst, Goldman Sachs

Q

Thank you. Thank you. And as a follow-up, can you please comment on the hyperscalers? To what extent are they contributing to growth? You signed deeper relationship with Azure last year and GCP as well and others. How important of that – how important those partnerships can become in terms of the go-to-market motion for you? Thank you. Thank you for taking our questions.

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

A

So, we see that in a number of our deals. I would say, there's no drastic change from what we've seen before. It's a continuation of what we've done with hyperscalers before. I think, in summary, we're a bit more deliberate now in terms of the partnerships we put in place. And I think they're a little bit more defined than they used to be before maybe in some cases. But I would say they're not – like these partnerships don't have any specific capacity, sales capacity attached to them online. They are not part of our model for growth going forward. They're all upside from where we are. So we keep investing in those partnerships. We think they're a part of what we do, but they're not the main where we go to market.

Nikolay Beliov
Analyst, Goldman Sachs

Q

Got it. Thanks so much.

Operator: And our next question comes from Sterling Auty from JPMorgan.

Sterling Auty
Analyst, JPMorgan Securities LLC

Q

Yeah. Thanks. Hi, guys. I'm curious in terms of your existing customer growth that you saw in the quarter. Can you characterize how much of that growth is just coming from their growth and expansion, the number of cloud hosts versus adopting more Datadog products?

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

A

Yeah. I think we said that similar to previous quarters, about two-thirds of our growth, and that's comparing the size of the customer today versus the previous year, comes from – has come from expansion of their use of products that they had already bought. And about one-third has come from their adoption of the new products. And that's been pretty consistent over time. So, that's how that splits.

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

A

And as a back of the envelope, I mean, you can – you know roughly how the cloud providers are growing and you see how we're growing compared to them. So it gives you an idea basically of the lift we're getting from additional sales capacity, around additional coverage, but also the growth of our product suite.

Sterling Auty
Analyst, JPMorgan Securities LLC

Q

Understood. And then just one quick one on sales. Can you characterize where you are on sales capacity and your efforts to continue to hire to fuel the growth?

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

A

Well, so we're doing – we have more capacity than last quarter and much less than next quarter. So we're still investing heavily. We're growing those teens. And we're also investing not only in the hiring, the retention, but also in all of the enablement and training and career pathing and also we can make the most of our go-to-market team. So, there's no – again, no big change there from previous quarters where we'll keep investing.

Sterling Auty
Analyst, JPMorgan Securities LLC

Q

Got it. Thank you.

Operator: And the next question comes from Brad Reback from Stifel. Your line is open.

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

Q

Great. Thanks very much. Oli, on that massive financial services deal that you signed in the quarter, how much influence did newer on-prem products like networking and pipelines have on the decision there? Or is that potential longer-term upside even with that large client?

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

A

With that specific client, without getting into too much detail, not much, because it's a client that is, I would say, a bit further along in their cloud migration and they're moving a lot of their workloads into cloud environments in the end. For some other of our customers that we're not mentioning on this call, this is a big deal and this is something that they're spending quite a bit of time on with us right now. So it's – you probably will hear about it in further calls I would say.

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

Q

That's great. Thanks very much.

Operator: And the next question comes from Tyler Radke from Citi. Your line is open. Tyler, if you're on mute, could you unmute your phone.

Tyler Radke
Analyst, Citigroup Global Markets, Inc.

Q

Hi there. Can you hear me now?

Operator: Yes.

Tyler Radke
Analyst, Citigroup Global Markets, Inc.

Q

Sorry about that. Wanted to talk about the strength that you saw on some of the larger lands. And I think you called out a number of seven-figure lands. And I'm curious, do you think at a high level this is mainly driven by specific go-to-market investments? I know you've obviously been growing sales force, including the enterprise. Or is this simply just the product set kind of at a maturity point where you're just kind of seeing this demand more organically?

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

A

It's a bit of everything, right? So, obviously, the product strength is what we rest on, so that it solves the customer problem really well and it's very easy to adopt and low friction. So, that's not new. That's what we've built the company on the whole time and it's still there. But with a product that is growing very fast at customers, as you grow your go-to-market teams, you have to be deliberate about the way you organize this go-to-market team, so that you don't just stop at the customers you have today. They already drive a lot of growth. You also go out of your way to acquiring new ones.

And so we're also always tweaking the way we run the go-to-market teams to make sure that we focus the teams and we award the teams for landing new customers. So, yes, we keep tweaking that all the time to make sure that we don't become victims of the success of our product when it comes to organically growing within customers.

Tyler Radke
Analyst, Citigroup Global Markets, Inc.

Q

Yeah. Thanks. And just a follow-up on that. I'm curious, obviously at Dash, you talked about a lot of security products. To what extent is the product road map around Application Security really influencing these larger deals? And is that an important consideration with these customers making these commitments? Just kind of where they see your product road map going?

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

A

It starts coming up in conversations more and more, but it's still early for the convergence of DevOps and security. So, when you talk about five-year strategic alignment with customers, security is a part of the conversation. But for most of our customers today, it's still a second step. Like, they start with observability, they start with the cloud, they start with what we have today, and then they want to actually bring security under the same roof as the observability data.

Tyler Radke
Analyst, Citigroup Global Markets, Inc.

Q

Thank you.

Operator: And your next question comes from Matt Hedberg from RBC.

Matthew Swanson
Analyst, RBC Capital Markets LLC

Q

Yeah. Thanks. This is actually Matt Swanson on for Matt Hedberg. I'll add my congratulations on the quarter as well as the new acquisition in Ozcode. Could you go a little bit more into the technology there? And specifically, kind of what you're adding that's differentiated from your automated Incident Management product? Because I know you said you could do debugging and production. Is it just part of the actual beginning stages of the DevOps life cycle? Or is that maybe you could get merged into that product?

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

A

Yeah. So it's actually – where it stands in the stack is it's like debugging, meaning that the same way you can use a debugger on your laptop and place a breakpoint and see what the code is doing and what the variables in the code are and things like that. This is a technology that lets you do that in production environment. So you can – in your ID, you can place a breakpoint in the code and the code in production is actually going to tell you what's going on in the code at that moment at that time. You don't have to update the code. You don't have to shift software. So it's something that developers are used to doing in development environment. And this is technology that lets you do that in production as well.

So it's very interesting to us. It's also something that corresponds to some of the work we've been doing internally. So there's three things that are interesting to us about the Ozcode acquisition. One is the live debugging technology, which is very interesting. Second is it's a [indiscernible] (00:41:21) that focuses and specializes on .NET, which is a capability that is very interesting to many of our large enterprise customers. And that is often underserved by, I would say, newer innovations in the market. And then the third thing that's interesting to us is that this is going to be our first engineering team in Israel. And we do intend to grow that team and invest quite a bit.

Matthew Swanson
Analyst, RBC Capital Markets LLC

Q

That's really helpful. One other thing, I guess, thinking more from a higher level, when we think about DevSecOps, I feel like it's a term that we're hearing more and more from more companies. So I mean, kind of core to establishing – breaking down those silos is going to be consolidating spend down to certain vendors. Is there a way you guys think about kind of the gravity of those budgets between the three sections? Is there one area that you need to be at the core of? Do you think developers have the most power, security has the most power? I'm just trying to think as more and more companies try to build across those three areas, what do you see as deciding who wins that consolidation?

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

A

Well, I think there are three things that are very massive. One is there's many more developers than any other role. So they have power by virtue of being the most populous and the largest salary mass and everything else. So you get quite a bit of yield in serving the developers. The second thing that is massive is the amount of friction for instrumenting applications. And the third thing that is massive is the data volumes in terms of logs. And I think we have a strong advantage on all three compared to pure-play security vendors for that space.

Matthew Swanson
Analyst, RBC Capital Markets LLC

Q

All right. Fantastic. Thank you.

Operator: And the next question comes from Brent Thill from Jefferies. Your line is open.

Brent Thill
Analyst, Jefferies LLC

Q

David, the numbers are obviously all accelerating. I guess, kind of underpinning the numbers, is there anything new you would call that was striking to you that you haven't seen? Is there any common themes that maybe we can't see in the numbers that also account to the strength and what you're seeing in the overall results this quarter?

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

A

I think it's a combination of a number of things at the same time, strong lands over a number of quarters, which then began to use the product and accelerate; acceleration of budgets around cloud migration, which caused the usage to increase and continue to be strong; and cross-sell of other products as our product suite gets adopted; and the success there, more of the products, as we showed, are getting adopted by the clients. So the combination of all of those at the same time and strength geographically across all the regions caused the acceleration from last year's post-COVID type of results.

Brent Thill
Analyst, Jefferies LLC

Q

And maybe for Olivier, just as it relates to cloud migrations, one of the themes we continue to hear about is a dual-cloud strategy or even multi-cloud strategy. Are you seeing that starting to help your business or is that still yet to come?

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

A

Well, we definitely see it. Our customers are very clear on the fact that they are going to be multi-cloud. They often start multi-cloud, even though initially they're going to have more weight in one cloud than another. So it's frequent for customers when they start the cloud migration to pick two of the major clouds to have maybe 95% of their volume in one and 5% in the other. But their goal is always to be able to, further down the road, choose whether they make further investment in one or the other or even on a third on-prem option and that would be a private cloud.

So this is a plan that we hear more and more from pretty much all of our customers. And we see that – as we see our customers getting further along, like there were some of the ones we've mentioned on the call today, we definitely see them making multi-cloud decisions there.

Brent Thill
Analyst, Jefferies LLC

Q

Thank you.

Operator: And our next question comes from Michael Turits from KeyBanc. Your line is open.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.

Q

Hey, guys. I just want to ask two overlapping questions about the sales force. On the one hand, and I think Tom may have talked about this a bit at Dash, but how are you addressing with the single primary sales force, the different buying centers and buyers between security, development and business users? And also, how is the sales force evolving from reps that probably really sold essentially one product and now have to sell so many more products? That's frequently a tough time for transition in a sales force.

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

A

Yeah. So, today we're still not specializing the sales force. We've discussed it a little bit in past call, we still – we think with security we might have to do a little bit of specialization. We're testing a few things, but we haven't felt the need to do anything drastic just yet.

For the rest of our products today, it looks quite well to have the same sales force carry the various products. And a lot of that has to do with the fact that the adoption of those products tends to be frictionless. And so we don't need to land all the products at once. We're going to land a few. And then we need to nudge our customers a little bit to start adopting more of them over time as they get more and more values from Datadog, but the lift there is not as heavy as if we had to come back and do a big bang sale every single time. So, today, no specialization yet. I think some of it is likely to happen over time in all likelihood with security, but we haven't done anything yet there.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.

Q

And as I said, do you find that the sales force that's been with you selling – I mean your product was always diverse, but was essentially an observability product more in a traditional monitoring sense. Is that same sales force adapting to this much wider portfolio or are you starting to see a turnover in that sales force to accommodate that?

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

A

Yes, the sales force is adapting. I think mostly what we're working on is the structures behind the scene to target the sales force and to enable the sales force, so they know basically who to talk to about what product when. And it's actually one of the things that Adam Blitzer has been working on, bringing to us a bit of his experience with similar problems at his previous company.

Michael Turits
Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks, Olivier.

Operator: And our next question comes from Kamil Mielczarek from William Blair. Your line is open.

Kamil Mielczarek
Analyst, William Blair & Co. LLC

Q

Hey. Thanks for taking my question and congrats on an amazing quarter. It's great to hear about the record deal and the record ARR adds across the platform. As your largest customers scale and standardize on Datadog, can you talk about how conversations have changed around pricing? Are there any particular modules where maybe you're seeing relatively higher levels of pushback on cost and given the rapid – especially given the rapid growth in data and the pricing changes made by some of your competitors over the past two years?

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

A

Well, I mean, usually the module for which is the most pushback is the one that happens to be the biggest item for that customer. Overall, there's one thing that you've correctly identified, which is data volumes are just going to explode much faster than customers' revenues are going to go up. And so we need to be able to differentiate from a technical perspective to solve these problems in a different way for our customers or to give them more control, so they can target what they need to keep.

A number of these things we've announced at Dash last week actually where it meant to help with that. So I've talked about Observability Pipelines as one of them. The live archives for logs is another one of them. And there's going to be more of a time to address that. So we didn't make any pricing changes, but we are innovating from a product perspective to have new ways of solving these problems and to give more control to our customers.

Kamil Mielczarek
Analyst, William Blair & Co. LLC

Q

And it makes a lot of sense. And on following up on the product innovation, your R&D expense is up more than 80% year-to-date, well above the 2020 levels of growth. It's great to see the fruits of these investments with the numerous announcements at Datadog Dash. But can you give us more detail around the decision to accelerate the level of R&D spend over the past year? And has anything changed about the broader opportunity versus pre-pandemic to drive this elevated level of spend? And how should we think about the targeted cadence of future product introductions? I know there's a lot there, but thank you.

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

A

Well, we're going as fast as we can on the engineering side. It so happens that we could sustain a very high growth on the recruiting and retention side. And we're very confident that our platform lends itself to solving bigger problems, more problems, and to making those products successful. So we're scaling them as fast as we can.

It's important to go fast when scaling those teams because there's quite a bit of a lead time between the time when you hire engineers and the time when you get new products on the other end. I've mentioned in other calls like maybe hiring now is a good predictor of output two years from now on the engineering side. So we should get started. That's why we're doing it.

Kamil Mielczarek
Analyst, William Blair & Co. LLC

Q

That's great. Congrats again. Thank you.

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

A

Thank you.

Operator: And our next question comes from Yun Kim from Loop Capital Markets. Your line is open.

Yun Kim
Analyst, Loop Capital Markets LLC

Q

Great. Thank you. Congrats on the solid quarter as well from me. But, Oli, you're already bigger than all your near-term – or nearest competitors, growing faster than all of them by a couple of magnitude. You talked about enterprise standardization trend that led to your largest deal in the company's history.

So, are you seeing more and more of that enterprise standardization trend with large organization? And as a result, are you seeing more and more displacement deals out there rather than just simply selling into large greenfield opportunities?

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

A

So I would say it is still – like the bulk of the standardization still has to come, right? And it depends on the maturity of our customers' migration into the cloud more than the adoption of our product, I would say. But we definitely think that it's something that's going to play a big role in the years to come.

When that happens, when standardization happens, there is typically some displacement because what was used on the legacy side or on the other side of the shop is going to be left behind, and we're going to replace that. And that's part of the valid rationalization that takes place. But again, today, it's still a small part of what we do. The bulk of our business is still net new cloud environment, a lot of growth in this cloud environment, with the occasional replacement of unsuccessful deployments of previous tools.

Yun Kim
Analyst, Loop Capital Markets LLC

Q

So, just for your existing customers, are you seeing many of your customers having mixed vendors of the observability product like, for instance, they have your product, along with some of the other parts of the organization may have some of your competitor's product as well? So it's just a matter of time before the customer needs to standardize on one platform.

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

A

Yeah. So there's a – what we see is any time we land into a large enterprise, for example – and we're going to start in the cloud environment – their on-prem environments are going to have a collection of other things. They're going to have older infrastructure monitors like the BMCs and [indiscernible] (00:54:02) of the world. They're going to have older ATMs. They're going to have a Splunk or an Elastic somewhere in on-prem as well. It's a given.

But we're not going to displace that from day one. We're going to be a solution that are going to be in environment and we're going to displace those products as the customers reach critical mass in the cloud and they start standardizing. So we – but we think from what we see, the customers that are doing that today are the ones who are far along in their cloud migration and started that one like a few years ago. So we think this is going to play a big role in the years to come.

Yun Kim
Analyst, Loop Capital Markets LLC

Q

Thank you. And David, just a quick question on cash flow dynamics. Obviously, your contract length is increasing. You're getting more and more large number of deals. Do you expect the cash flow to be more or less – see more greater seasonality, maybe weighted towards more second half of the year going forward?

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

A

No. I think we said in the script that even though we've gone – we had some more multiyears, there's still annual billing at most. We don't go for financing the company through collecting events. So there really is very little, as we talked about, long-term change in the billing dynamics.

In terms of cash flow, we tend to see a little bit of seasonality at the end of the year when we go through our end of the year sales cycle and then collect in the first quarter. But I wouldn't see too much change in the cash flow dynamics from either the longer duration of contracts or seasonality.

Yun Kim
Analyst, Loop Capital Markets LLC

Q

Okay. Great. Thank you so much.

Operator: And our next question comes from Gregg Moskowitz from Mizuho. Your line is open.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

Okay. Thank you. Olivier, just a follow-up on the security go-to market. Your security monitoring product has now been GA for a while, whereas some of the other components of your cloud security platform are much newer. But what I'm wondering is, how would you assess the readiness of your sales force and your channel to sell security to your installed base today.

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

A

Today, it's still a product that is being adopted by customers when they're already at our customers, like we don't – we already land with it first. And that's by design, right? I mean, that's – as we keep developing it and as we keep making it applicable to a broader set of customers. We are starting though – we're getting to the point where soon we'll have the full V1 of our cloud security platform. I think for that, we're still missing the general availability of the application security component. Once we have that, I think we'll look into accelerating the go-to-market side a little bit and maybe doing some of the specialization we've been discussing earlier in this call. But we haven't done that yet.

Gregg Moskowitz
Analyst, Mizuho Securities USA LLC

Q

Okay. Perfect. Thank you.

Operator: And the next question comes from Kash Rangan from Goldman Sachs.

Kash Rangan
Analyst, Goldman Sachs & Co. LLC

Q

I suppose it's two-for-one deal today. Thank you so much for sneaking me in along with my colleague here. As you look at calendar 2022, you've had a slew of new products that you've added to the portfolio, including some of the demos that you aptly and ably demonstrated to us last week, I believe. Any changes, enhancements or tweaks to go-to market as you look at 2022?

And also, as you look to clearly signing these five-year contracts and mega contracts are, a change in the way customers look at Datadog? I'm curious if you're emboldened to pursue a specific enterprise sales channel and having a separate go-to-market effort that is pinpointedly in pursuit of mega deals. Thank you so much. Just like our friends at Salesforce started doing some five, six years back or so, and it was definitely fruitful, I'm wondering if you see the same kind of opportunity.

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

A

Yeah So we do – so, first of all, I mean we – I mean, yes, customers see us differently over time. I mean, we are definitely – like we're becoming one of the platforms that they are going to standardize big points of their business around, and that's definitely a different relationship with them than just something some people on their team are using. So, that's the change that we see and we see across a large number of our customers.

Now, in terms of pursuing the larger deals, I mean we do have different ways of structuring our teams internally, so that we have folks that are going after new logos that might be smaller, folks that are going after growth of existing customers, folks that are going after the growth of the very biggest customers. And we have some segmentation internally around that, and we'll have more and more segmentation as we grow, as we need to focus a little bit every one.

But we're still not looking for those very large deals. We do them today when our customers want them. When they need for their own planning purposes. And when they want to commit their own organizations, we'll do those deals for them. But this is not something that we actively seek. Our products, and we've seen throughout the years that our product is very sticky and then our product grows very well within our customers. So there's no point on our end in pushing for very large, very long-term deals.

Kash Rangan
Analyst, Goldman Sachs & Co. LLC

Q

Wonderful. Thank you, Olivier. Congratulations.

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

And I think, yeah, on this good word, I think we'll close the call. So I want to thank you all for sticking with us through the call. We're all very happy obviously with the performance this quarter, which is all thanks to the team at Datadog and Datadog's worldwide and their hard work. And so I want to congratulate again to everyone and thank everyone for job very, very well done. And we'll see you all next quarter. Thank you.

Operator: Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.