

**Fastly**  
**First Quarter 2022 Earnings Call**  
**May 4, 2022**

Operator: Good afternoon. My name is Lisa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Fastly First Quarter 2022 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] Thank you.

I would now like to turn the conference over to Mr. Vern Essi, Investor Relations at Fastly. Please go ahead, sir.

Vern Essi: Thank you, and welcome, everyone, to our first quarter 2022 earnings conference call. We have Fastly's CEO, Joshua Bixby; and CFO, Ron Kisling, with us today.

The webcast of this call can be accessed through our website, [fastly.com](http://fastly.com), and will be archived for one year. Also, a replay will be available by dialing 800-770-2030 and referencing conference ID number 7543239, shortly after the conclusion of today's call. A copy of today's earnings press release, related financial tables, and investor supplement all of which are furnished in our 8-K filing today, can be found in the Investor Relations portion of Fastly's website.

During this call, we will make forward-looking statements, including statements related to the expected performance of our business, future financial results, strategy, long-term growth and overall future prospects. These statements are subject to known and unknown risks, uncertainties and assumptions that could cause actual results to differ materially from those projected or implied during the call. For further information regarding risk factors for our business, please refer to our most recent quarterly report, 10-Quarter, filed with the SEC and our first quarter 2022 earnings release and supplement for a discussion of the factors that could cause our results to differ. Please refer in particular to the sections entitled Risk Factors. We encourage you to read these documents.

Also note that the forward-looking statements on this call are based on information available to us as of today's date. We undertake no obligation to update any forward-looking statements, except as required by law. Also during this call, we will discuss certain non-GAAP financial measures. Unless otherwise noted, all numbers we discuss today other than revenue will be on an adjusted non-GAAP basis. Reconciliations to the most directly comparable GAAP financial measures are provided in the earnings release and supplement on our Investor Relations website. These non-GAAP measures are not intended to be a substitute for our GAAP results.

Before we begin our prepared comments, please note that we will be hosting our Investor Day next week at New York Stock Exchange on Thursday, May 12th. We'll also be attending three

conferences in the second quarter. The virtual Craig-Hallum Institutional Investor Conference on June 1st, the Bank of America 2022 Global Technology Conference in San Francisco on June 7th, and the William Blair Growth Stock Conference in Chicago on June 8. We will be releasing further details regarding these events in the coming weeks.

With that, I'll turn the call over to Joshua. Joshua?

Joshua Bixby:

Thank you, Vern. Hi, everyone, and thanks for joining us today.

Before we jump into the quarter, I want to address another announcement we made this afternoon. As you may have seen, I will be stepping down from my role as CEO and from the Board after a successor is appointed. The Board has begun a search for my successor, and I will do whatever I can to ensure a smooth transition. I'm extremely proud of everything that we have accomplished, including enabling the best of the web, taking Fastly public, executing our acquisition of Signal Sciences and positioning ourselves for long-term success. It has been an incredible journey, but I know that there is much more to come and much more to be achieved in the next phase of the business.

As I reflect on this time and where we are in Fastly's history as well as my own journey and desires and through my discussions with my fellow Board members about where we want to take Fastly in the future, it became clear that now is a natural time for me to step back and let someone else take the reins, someone that can lead the Company through the next phase of the business.

Fastly has a large enterprise customer base, a world-class experienced leadership team and a robust product roadmap. We are differentiated by a delivery business that is one of the fastest in the world, an award-winning security business and an edge cloud platform with unrivaled flexibility and programmability. It sounds simple to say, but in reality, Fastly is where it is because of our differentiated approach.

We have built a platform that is highly programmable, agile, secure and fast, empowering our developers to innovate with ease and scalability. This, in turn, translates to performance, a critical indicator for our customers. As the Board searches for Fastly's next leader, a process that, as I mentioned, has begun, we are committed to finding a candidate that can help build upon this solid foundation.

As you may have seen from the press release we issued this afternoon, I will remain in my role until my successor has been brought in to ensure a smooth transition. Positioning Fastly for long-term success is my number one goal throughout this process.

With that, I will move on to talk about the quarter, and then will invite Ron to provide some more color on this quarter's results. Then, we will take some questions, which due to the limited time we have, we ask that you focus on the results and the outlook.

In the first quarter of 2022, we reported record revenue of \$102.3 million, representing a 5% quarter-over-quarter organic growth. Not only did this exceed the top end of our guidance range of \$97 million to \$100 million, but was also our first quarter revenue in excess of \$100 million. I'd like to congratulate the Fastly team on this exciting milestone. Our customer retention and growth engine remains strong. Our LTM, NRR was 115%, and our DBNER was 118% in the first quarter. Our average enterprise customer spend was \$722,000, representing a 3% quarter-over-quarter increase. Our total customer count in the first quarter was 2,880, of which, 457 were enterprise customers. We made good progress on our total customer count, adding 76 customers in Q1, up from 56 customers in Q4.

One of the key initiatives we have undertaken in 2022 is the deployment of our new architecture for key metro regions. As previously discussed, this will greatly increase our storage capabilities by merging entire regions into one storage unit, thus cutting duplication. This does require the duplication of new sites with new architecture over the year. One of the areas where we can gain gross margin leverage is doubling down our efforts on server efficiency with this new architecture. We have always prided ourselves on how closely we have tied hardware and software together, and we believe it is a key differentiator for us. Artur Bergman, our Founder and Chief Architect, will speak more to our plans at our Investor Day scheduled next week.

It is important to note that the pandemic has altered the landscape for hardware procurement and the availability of the types of data centers we rely on. It is not uncommon to have lead times in excess of 80 weeks for key components, to have orders cut or canceled, and to have long wait times to get into the most connected data centers in the world. We made the decision to get ahead of these constraints by prebuying and deploying capacity in key markets. This has left us with some underutilized capacity in some markets. And as we have discussed previously, this has had a drag on gross margin. With no end in sight to constraints on the hardware and data center side, we feel we are prudent to take these steps and we're trying to minimize the short-term impact they're having by redeploying assets where possible.

The team at Fastly remains united in our common mission, which is to fuel the next modern digital experience by providing developers with a programmable, secure and reliable edge cloud network that they adopt as their own. Central to this common mission is the key role developers play in our journey and the new and expanding power of distributed edge compute and security. As they use our trusted platform, they become more interested in its features and that keeps them engaged and retained as customers as they scale.

To reinforce this effort, we've acquired Fanout, announced in late Q1, a platform that creates a frictionless environment to build and scale real-time and streaming APIs. We will be integrating the Fanout technology into our Compute@Edge platform and launching a beta soon. Compute@Edge allows us to acquire technology and rapidly release it. Our delivery products, which are part of our network services portfolio, also received strong analyst validation. Fastly was recognized as a leader in the first quarter by IDC MarketScape for the worldwide content delivery network services. We earned recognition due to our network size and scale, our comprehensive product portfolio, excellent customer service and our modern network offerings.

Reinforcing these efforts in the first quarter, we announced our new Compute@Edge partner ecosystem designed to help customers build a variety of edge computing use cases. Partnerships include marquee integrations with the top three cloud providers. Margaret Arakawa, our Chief Marketing Officer, will be sharing more details at our Investor Day.

We are accelerating Fastly's product delivery. In the first quarter, we had 11 releases in total compared to 3 in the fourth quarter of 2021. We've launched our new global persistent Object Store for compute functions. With fast reads and writes rights from both the edge or via API, developers can store, control and cache data to reduce origin dependency and unlock new use cases. Also, in the quarter, we deployed HTTP/3 and QUIC, which are now available to our customer base. QUIC, the technology behind HTTP/3 is a new latency-reducing, reliable and secure internet transport protocol. It offers modern web performance with low-latency, built-in encryption and seamless developer platform integration.

We also launched the Observability dashboard, which will bring delivery, security and application metrics into one interactive window. The dashboard provides per second visibility and historical reporting on the performance and activity of our customer services and applications in a single customizable dashboard.

Each of these releases also represents another touch point with our developer base and another opportunity for revenue growth. Lakshmi Sharma, our Chief Product and Strategy Officer, will be providing you more details on our product roadmap next week at our Investor Day.

All of these new features would never reach our enterprise developers without our network services business fueled by our lightning fast delivery network. Since the beginning of the year, our worldwide network remains consistently faster in the U.S. and Europe than our largest competitor in most countries and regions as measured by independent real user data.

Our significant advantage in performance validates our unique architecture. Performance paired with security is one of the most critical decision-making metrics for our customers. That is why you will see us winning business with highly regulated customers, like a digital lending platform for Fortune 100 financial institutions. They need configurability at a per endpoint basis for highly regulated multi-tenant customers who demand speed while maintaining stringent security requirements. The size of our network matters as it opens up opportunities to us that are closed to others.

In the first quarter, we signed a Fortune 1000 multinational mass media and entertainment conglomerate by working closely with our partners at Google Cloud. They ultimately chose Fastly for our token authentication while further improving their performance across Latin America. The first quarter also brought strong analyst validation for our security product portfolio. For the fourth consecutive year, Fastly was recognized as the only vendor named by Gartner Peer Insights Customer Choice for web application and API protection. Fastly's Next-Gen WAF received an overall exceptional rating for web application firewall solutions among customers that have purchased, implemented and used a WAF.

Last quarter, we deployed the industry's first and only unified WAF built on the Compute@Edge platform. This quarter, we are thrilled to continue our momentum in security. We announced the support for ARM-based environments at scale. We are the first and only WAF that enables customers to quickly secure their apps and APIs using any combination of ARM and other processors. This is a major step forward in securing multi-cloud environments. We have also introduced GraphQL inspection. With API attacks becoming the most frequent attack vectors, we wanted to provide a customized and out-of-the-box GraphQL inspection that will detect, inspect and block attacks that can target GraphQL APIs. Developers can now customize this tool or choose a simple out-of-the-box option with no additional configuration on their part.

Our security business continues to shine. A publicly traded identity and access management application with a global presence adopted our next-generation WAF for its ability to offer isolated environments. They wanted to provide customized security for both their platform and their customers. The team is excited about the opportunity that lies ahead of us in 2022. We look forward to sharing with you further updates on our success at our Investor Day.

To discuss the financial details of the quarter and guidance, I will now turn the call over to Ron. Ron?

Ron Kisling:

Thank you, Joshua, and thanks to everyone, for joining us. Today, I'll discuss our financial results and business metrics and then review our forward guidance. Note that unless otherwise stated, all financial results in my discussion are non-GAAP based.

Total revenue for the first quarter increased 21% year-over-year to \$102.4 million, exceeding the top end of our guidance of \$97 million to \$100 million. In the first quarter, revenue from Signal Sciences products was 12% of revenue, a 59% year-over-year increase or a 39% increase after purchase price adjustments related to deferred revenue are reflected. Our dollar-based net

expansion rate or DBNER was 118%, down slightly from 121% in Q4 '21, and our trailing 12-month net retention rate was 115%, down slightly from 118% in the prior quarter. The majority of this decline was driven by last year's outage related to impact from a single customer, which we have previously discussed.

As you can see, from a very low churn of less than 1%, our customer retention dynamics remain strong. As of March 31, 2022, we had 2,880 customers, of which 457 were classified as enterprise, those customers with an excess of \$100,000 of revenue over the previous 12 months. Our total customer count grew 17% over the year-ago quarter. And in the first quarter, we added 76 net new customers and 12 net new enterprise customers compared to 56 and 15 new customers, respectively, in the prior quarter.

Accelerating our customer acquisition is one of our key goals as the sales team continues to ramp and we increase our marketing activities around lead generation and brand awareness. Brett Shirk, our Chief Revenue Officer; and Margaret Arakawa, our Chief Marketing Officer, will share more of our plans at our Investor Day.

Enterprise customers accounted for 89% of total revenue on a trailing 12-month basis, in line with their contribution in Q4 and increased their average spend to \$722,000 from \$704,000 in the previous quarter, representing sequential growth of 3%. This also demonstrated our strong customer retention. Our top 10 customers comprised 33% of our total revenues in the first quarter of 2022, in line with the contribution in Q4 2021.

Turning now to gross margin. Our gross margin was 52.6% in the first quarter compared to 55.8% in the fourth quarter of 2021. As we discussed on our Q4 earnings call, we anticipated our gross margin would decline a couple of hundred basis points for the full year 2022 due to the rollout of our next-generation architecture, the continued investment in our network to support growth and accelerated investments to proactively address supply chain constraints.

I'll now address our gross margin dynamics in more detail:

As we described on our last earnings call, as we roll out our next generation architecture into new sites, we will continue to incur costs on the existing sites until the transition is complete. In the first quarter, we transitioned several sites and will transition more sites in the second quarter. We expect the older duplicate sites to be fully decommissioned by the end of the year. As Joshua described, we derisked our network expansion plans by accelerating the purchase and deployment of equipment. Given the volatile dynamics occurring in the semiconductor industry and the supply chain at large, we believe this was a prudent decision. We continue to invest in infrastructure and capacity and expand into new markets to support growth and new customers. In some locations, this has resulted in underutilized capacity.

In the quarter, we did not see any acceleration in price compression, and we continue to expect the mix of our product offering in security and compute to be a strong gross margin tailwind in 2023 and beyond. We are very focused on gross margins and the opportunities to drive leverage in our network. We look forward to providing more details on these dynamics and the changes we are making to improve the efficiency of our network investments during our Investor Day.

Lastly, looking at full year 2022, we still expect gross margins to be down a couple of hundred basis points with Q2 gross margins relatively flat with those in the first quarter and to improve by year-end.

Our operating loss and net loss per basic and diluted share for the first quarter of 2022 were in line with our guidance. Operating expenses were \$71.6 million in the first quarter, up 12% over Q1 '21

due to increased headcount across the organization. While attracting talent has been difficult, we are pleased with our success in attracting high-quality talent. With new leadership in place, we expect expense growth in 2022 will be higher in the first half and growth in operating expenses will be lower in the second half of the year.

Our operating loss for the quarter was \$17.7 million, and our net loss was \$18 million or a \$0.15 loss per basic and diluted share compared to \$11.7 million and a \$0.10 loss per basic and diluted share in Q4 2021.

Turning to the balance sheet. We ended the quarter with \$1 billion in cash, cash equivalents, marketable securities, and investments, including those classified as long term. Our cash capital expenditures were 6% of revenue in the first quarter. Our capital expenditures include capitalized software. This, along with our foundational technology, drives efficiency and leverage in our network, which is a competitive differentiator. Despite our transition to our next-generation network architecture and acceleration of some investments due to supply chain constraints, we expect our capital expenditures in 2022 to remain at 12% to 14% of revenue.

I will now turn to discuss our outlook for the second quarter and the full year 2022. I'd like to remind everyone again that the following statements are based on current expectations as of today and include forward-looking statements. Actual results may differ materially. We undertake no obligation to update these forward-looking statements in the future, except as required by law.

Our second quarter and full year 2022 outlook reflects our continued ability to deliver strong top line growth via improved customer acquisition and expansion within our enterprise customers, driven in part by new and enhanced products. Our revenue guidance is based on the visibility that we have today. And given our usage-based business model, we expect to gain additional visibility to our annual guidance as the year progresses.

Historically, our first and second quarter revenues are generally flat with revenues increasing in the second half of the year. As a result, for the second quarter, we expect revenue in the range of \$99 million to \$102 million, representing 18% annual growth at the midpoint. We expect a non-GAAP operating loss of \$21.5 million to \$18.5 million and the non-GAAP loss per share of \$0.18 to \$0.15 per share.

For the full year 2022, we are increasing our prior guidance by \$5 million to a range of \$405 million to \$415 million. We expect a non-GAAP operating loss of \$70 million to \$60 million and a non-GAAP net loss of \$0.60 to \$0.50 per share, unchanged from our prior guidance.

Before we open the line for questions, we would like to thank you for your interest and your support in Fastly and look forward to seeing you at our Investor Day. Operator?

Operator: [Operator Instructions] We will take our first question from Frank Louthan, Raymond James.

Frank Louthan: Great. Thank you. Maybe just walk us through a couple of the puts and takes in the gross margins and how we should expect that to progress to only be down a couple of hundred basis points for the year? And then, secondly, you had a competitor stated recently that the rate of growth and traffic growth has slowed, that they're seeing. Are you seeing anything like that? What are sort of the traffic trends that you're seeing? Thanks.

Joshua Bixby: Hey Frank, it's Joshua here. Let me take the traffic question. I'll hand it over to Ron for the gross margin side. I think, like we are seeing across the prints that are happening on the street, we are definitely seeing a change in growth rates. For some industries, it's going up, for some, it's going down. And I think that thankfully for us, we're exposed to both sides of it. In general, the

industries that we're hearing our competitors talk about slowing down are industries we don't have a lot of exposure to. So on the streaming side, as you know, we've talked about this many times, we don't take the commodity stream business, in the areas of streaming that we do work in, those are the high growth areas, the high-value areas, and we don't have a lot of exposure. You're rarely going to see us as sort of the number 1 or number 2 provider. There are some exceptions. But in general, we have a tremendous amount of room to grow in that because we've been picky, we've been selective about who we work with, and we don't work across the board.

So in general, I wouldn't see Fastly as a good proxy for some of the overall trends in the industry because of how selective we've been in some of those industries. But unquestionably, in industries, for example, like travel, we're absolutely seeing an uptick. So, I would say, we are seeing both sides of the coin, but we have much less exposure, I think, to the generally commoditized side of the business, which is what a lot of the other vendors are speaking to. Ron, why don't you take the gross margin question?

Ron Kisling:

Yes. So, I think, let me start with kind of how we see the year, and then I'll talk about the dynamics driving it. So, I think as we said, we expect for the full year still to be on a couple of hundred basis points. That plays out over the course of the year with Q2 being relatively flat with those in the first quarter. And then, we see improvement in gross margins in the second half toward the end of the year. The biggest driver to the change in dynamics really is that rollout of the next-generation architecture. As we talked about in the past, as part of this rollout, we continue to incur costs on the existing sites. So, in the first quarter, we transitioned several sites. We'll transition a few more in the second quarter. And then, as you get into the second half, we expect the older duplicate sites to be fully decommissioned by the end of the year. So, that's going to drive some reduction in our cost of revenues in that second half.

The other driver, if you just look at historically kind of how our revenue plays out, we typically see an acceleration in revenue in the second half, that drives an increase in utilization. And so, we typically see an increase in network utilization, and that also drives an improvement in gross margin. So, those are the two biggest drivers. I think the other drivers that we've seen is we haven't seen, as Joshua said, any acceleration in price compression. Our mix product didn't really change materially from quarter-to-quarter. And then, we continue to see strength in our security product, which is a positive or a tailwind to our gross margin.

Operator:

Next, we'll take a question from Sanjit Singh, Morgan Stanley.

Sanjit Singh:

I wanted to revisit the gross margin topic once more if I could. I guess, in some sense, I'm trying to understand maybe just the magnitude of the sequential decline in the sense that if I look at sort of the second growth on the network of capacity, that seems like that's slowing or starting to improve on the network capacity side? On the expansion rate side, in the in-quarter net revenue retention improved decently versus the prior quarter, your sequential revenue growth improved versus last year, your year-over-year growth improved versus last quarter. So, it would seem to me that like there'll be more sort of utilization or more absorption of some of the sort of stale capacity. So, I'm just trying to understand, like the magnitude on the gross margins of this quarter versus prior?

Joshua Bixby:

Sure. Sanjit, let me take the first -- sorry, Ron, let me take the first section and I'll hand that off to Ron. I think in general, as you're pointing out, the growth in the customer base is good, the growth in the network expansion is good, but we're also growing the network. And so, Ron can sort of speak to those two things, racing ahead. As I talked about in my comments, the general sense that we have in the industry is that we're in a lucky position to have the access that we have. We think that's going to come into good -- really good use in the latter half of the year. But I think you're

just sort of seeing two things race ahead and ones racing ahead a little bit higher or faster than the other.

If we saw a difference in the pricing environment or a difference in the mix, that would be different. But that's really the main driver. But Ron, why don't you expand on that?

Ron Kisling: Yes. The only thing I would expand on that thing, Joshua, is in addition to what we saw around the new architecture is we did accelerate some of the purchase and some deployment of equipment, given kind of the volatile dynamics we saw in the supply chain at large. And so some of that deployment that we did actually increased capacity ahead of the demand. And so, we did see in some locations, some underutilized capacity as a result of accelerating some of the deployment in response to the supply chain. So, that's probably the additional factor on top of the other drivers that we spoke about earlier.

Sanjit Singh: Understood. And then on the comment on pricing sort of being in line with historical trends or no sort of incremental sort of pricing headwind. If I were to think about quantifying that pricing impact, in some sense, you have the customer base expanding sort of 15%. The customer base overall is growing 17%, sort of implies kind of low 30% growth. You're posting about 20%, 21% growth, which implies kind of a high-single-digit, low-double-digit sort of pricing headwind. Is that sort of the right way to think about what you're seeing on the pricing side?

Joshua Bixby: Yes. I mean, from a pricing dynamic perspective, we're in a number of different markets. And I think it's important to sort of carve those out. When you look at the security enterprise compute side of our business, I mean, you really -- that's not a price compressing market in a meaningful way. I think where price compression has traditionally sat is on the streaming side for the most part. And in that market, it's interesting things are changing. Our -- the large companies that we work with are also buying hardware there. They buy data centers. They understand the inflationary costs inherent in all of those components and the environment in their own. I was in a recent conversation with a large customer that normally would come back and ask for a little bit of discount for some more if we brought you more capacity this year. But we understand the pressures you're under. We understand that, and we think we're going to hold off till next year.

So, I would say, in general, the math is in line. But overall, we're actually seeing with the kinds of partners we work with, and I think that's important because the kinds of partners we work with are the ones whose revenues are also going up, whose viewership is going up, who has high-value content, but the organizations who really care about quality, these are very strong partnerships, and they want to see us be successful. I mean, they really value what we do.

So, I think the dynamics are similar to what you've described. But overall, I'm seeing the environment change even in the last few weeks, where people are really understanding the pressure that everyone is under, trying to get these components out into the field and the inflationary costs around them.

As I said, I think we've been very prudent in getting ahead of this. And I think a lot of the calls that you're on and others are on are hearing about chip shortages. We're not saying that at all. I would say, we're sort of in the opposite category, but we're confident we'll get utilization.

Operator: Next up, we'll take a question from James Fish, Piper Sandler.

James Fish: I wanted to inquire about the non-top 10 enterprise customers, really good strength with top 10, but it looks like the non-top 10 only grew like 3% year-on-year. And I get it was a tough compare, but what's going on with that lower end kind of customer base that aren't growing as fast? And underneath your guideline, Ron, it looks like it implies a relatively flat net retention rate compared

to what we saw in Q1, despite easier compares coming, just being conservative and prudent, given some of the macro stuff going on or how should we think about net retention for the rest of the year?

Joshua Bixby: Sure. Ron, why don't you take the top 10 and the guide question?

Ron Kisling: Okay. Yes. So, I think as you point out, the overall customers, we saw about a 3.4%, 3% increase in customer count. We did see an increase over the previous quarter was relatively low. I think, when we look at overall customer acquisition, I think accelerating that overall number, both across enterprise and sort of that below enterprise kind of is a key priority. And there's a number of things that we're doing around increasing market activities and lead gen and brand awareness. And so, at the Investor Day, Brett Shirk, our Chief Revenue Officer; and Margaret will share a little bit of the specific plans we're doing around customer acquisition to accelerate that as we move into sort of the second half.

I think on the second point with regard to guidance, I think what -- if you look at either LTM NRR, DBNER, those are 12-month metrics, and it continues to reflect some impact from the outage we saw in June '21. So, we'll continue to see some impact of that reduced traffic until that outage impact is no longer within the metric. And I think for a number of those customers, most of them came back within a week or two. We have talked about one large customer who took a couple of quarters to really come back to kind of the pre-outage level. We've seen good increase in that, but that will continue to be somewhat of a drag on the LTM metrics until that outage impact drops out of the calculation.

James Fish: Okay. And then, have you -- we've seen the hyperscalers trying to promote their own CDN services more recently to get really workloads into their own public cloud and now Akamai acquired Linode for public cloud capabilities. I guess, how are you guys thinking about the need to have your own cloud environment to meet that host as well as delivery mechanism versus just partnering with the hyperscalers, like you did with that Fortune 1000 media conglomerate? Thanks, guys.

Joshua Bixby: Yes. Thanks, Jim. I mean, we continue to see the world through the same lens as we've seen it for a long time, which is we think the hyperscalers and the edge cloud coexist together. Our customers are multi-cloud. They want to be multi-cloud. And one of the things that they're asking us. is to allow them to load balance between clouds, have one security perimeter approach to all of the clouds. And in so doing, what we have seen is a lot of cooperation. So, we are absolutely seeing that for certain types of workloads, the hyperscalers are looking at putting some edge caching capabilities. And we think that's great.

Our customers are looking for other things from us, from security to compute as well as caching. And right now, it's this multi-cloud personalized edge world that is really driving the decision-making. So, we see this cooperative, unlike some of the other competitors who I think are seeing themselves as competitors to the hyperscalers. We don't see that. And we think so far that has played well. We have very cooperative relationships and great partnerships in that regard.

Operator: Next up, we'll have a question from James Breen, William Blair.

James Breen: Can you just talk a little bit about the capital spending you need to get you where want go in terms of top line growth? It was fairly low this quarter from a CapEx perspective, capitalized software was up a little bit. How should we think about that going forward and as a percentage of revenue? Thanks.

Joshua Bixby: Ron, why don't you take that one?

- Ron Kisling: Yes. So, our -- as you pointed out, our cash CapEx in the quarter was a little bit on the low side. I think broadly for the year, we expect to be in line with kind of our historical guidance of somewhere between 12% and 14%. I think despite the transition to the architecture and some of the acceleration of investment, we'll still be within that historical 12% to 14% of revenue for CapEx for the year. So, that would imply some increase over what we saw in Q1 in terms of CapEx investment.
- Operator: [Operator Instructions] Up next is Will Power, Baird.
- Charlie Erlikh: This is Charlie Erlikh on for Will. Just first, I wanted to ask about the Fanout acquisition and maybe just get a little bit more detail on what that gives you and the path forward on that?
- Joshua Bixby: Sure. This is an exciting one for us. Our customers have been asking for this for a long time. It's something that is -- it requires for our customers a lot of work, unlocking this real-time app development and all of what is built into this. So, think about a live chat support or gaming examples of this. This is what our customers do all the time. And in most cases, they've got to do it themselves. And so, with the acquisition, it really positions us to support these use cases, they can migrate away from really complex existing in-house web socket stacks, and they don't have to engineer it themselves. So, this has been a long time coming on the top of the priority list and something that we thought when we saw what Fanout was doing and how they were being viewed in the market, it just was a natural acquisition for us and very exciting.
- Charlie Erlikh: Great. And if I could just squeeze one more in. How are you guys thinking about profitability timing in the future, balancing a lot of growth initiatives you want to invest in, but also keeping an eye on profitability, of course? So, how should we think about just the timing around that?
- Joshua Bixby: Sure. I mean, we're certainly going to talk more about that at our Investor Day, but Ron, I don't know what you want to share before that. Ron, you there?
- Ron Kisling: Sorry about that. Yes. I think, we're certainly starting to spend more time about it. And I think there is an opportunity to drive growth. We've talked about growth and increased investment business to grow both security and managed computing platform, those are accretive to gross margin. And we believe that drives long-term margin as we see that growth play out and the accretion we see in gross margins. In terms of the long-term model and getting to profitability, we plan to share kind of our view on what that long-term model looks like at our Investor Day.
- Joshua Bixby: Yes. Charlie, what I can tell you is it's a high priority for us. We believe that there's a tremendous amount of leverage as we talked about just briefly on the gross margin side in the call and in the script, and we believe that across the business. So it's a priority, and it's something that you'll hear a lot more from us about at Investor Day.
- Operator: Our next question is from Philip Rigby, RBC Capital Markets.
- Phil Rigby: Just one for me, following up on the idea of traffic, traffic growth in streaming. Can you just remind us sort of what those higher-quality streaming businesses you're in that you have a higher mix to? Like, is that all just more of [break in audio] capacity and increases, is there potential to sort of go into the lower, call it, more commoditized business to kind of maintain utilization? You talked before about how important video is to kind of max out utilization and lower times. Any color there would be really helpful?
- Joshua Bixby: Sure. Thanks, Phil. It's a great question. I think it's a misunderstood part of our story, which is how important video is we feel to the long-term success of our business. I think to answer the first -- the second part of the question, we have no intention of going into the commoditized side of this

market in any meaningful way. We are interested just to sort of segue off the last comment in building a profitable business. And it's extremely difficult, if not impossible, I think, to build a profitable business off the lowest end of this market. So that won't be interesting to us.

I think coming to the part of the question, for us, it's always been who cares about quality, who is able to monetize their content. And traditionally, that sort of started, as you recall, with live events, right? If you're a live event, you're streaming important, Tiger Woods is walking down the 18th green in the Masters or the Super Bowl is on, those events are so high profile, the advertising revenue is significant in those, you care deeply about quality.

Where we saw transition over in the last three years is that video on demand has actually had similar characteristics. So, when Game of Thrones is on and launches all the same day or some other show of that magnitude and gets that much attention, when something isn't high quality, it actually has the same reaction within the consumer environment as it would if it was live. Twitter blows up, everyone starts talking about it. People get egg on their face. And those huge shows, the ones that really matter, be it a Netflix show or a Disney show or whatever the case may be, are the drivers for new sign-ups, and we've seen that.

So, the dynamics have really shifted, where we have those whose quality deeply matters, who can monetize those users and those who don't. You're not going to see us shift away from those who don't. But as I say, our exposure to those who do remains very limited. And therefore, there's a lot of upside, a lot more traffic that we can get in the high value area of this.

And why this is so important is because video is critical. Our goal has always been, and I talked about it earlier, efficiency when we are deeply efficient. We're using all parts of our network, all parts of our servers. And also, it allows us to change the dynamics on the bandwidth side to the eyeball users when we serve the content that they need. And when I think about the future, content being served in different ways, it's going to matter who has the majority of the content, because those are going to be -- those are going to be the suppliers that are invited into satellites. Those are going to be the suppliers that are invited into cruise ships. Those are going to be the suppliers that are at these critical junctions where content is being consumed. So, we see it as critical. We think it's strategic to our story but no plans right now. And I don't think ever to go into the commodities part of this business.

Operator: Our next question is from D.A. Davidson's Rudy Kessinger.

Nima Rad: This is Nima on for Rudy. I just had a question on an update. You guys said last quarter that you had 40 sign-ups for the three credit program on Compute@Edge. I was just wondering where you guys are at on this quarter and how many you guys have converted to paying customers at this point?

Joshua Bixby: Hey Nima, it's Joshua here. One of the things that we're going to be sharing is a comprehensive view of this at Investor Day. I can tell you that we've had growth, we've had conversion, but we're going to share that in sort of when we have a little bit more time to walk through those, the nuances of that. I have been very happy with those programs, including how many enterprise developers around the platform. So, a little wait and see on that because I'd like to give you all the context all at the same time. But we've seen progress, and it's Compute@Edge remains, I think, the most exciting, if not one of the most exciting opportunities that we have here for really significant growth.

Operator: And now, we'll hear from Fatima Boolani, Citi.

Fatima Boolani: Josh, it was nice working with you and good luck on your next ventures. The question is just around your security momentum. I know you sort of spoke to it at a high level, but I'm curious about how that business is trending. If you can sort of quantify for us some of the year-over-year and quarter-on-quarter momentum within that specific side of the house in your portfolio? And then, as an extension, Josh, you had talked about security and compute being pricing accretive, right? You have a lot more pricing power. These are very important challenges you're helping solve customers. So, I was curious if you can help reconcile that with the average enterprise customer spend only up 3%. So, hoping you can sort of bridge some of that gap from vis-à-vis the pricing power on the security side and maybe a lighter wallet share growth on some of your larger enterprise customers? Thank you.

Joshua Bixby: Sure. Let me take a couple of those and I'm going to hand a few of those off to Ron. I think in general, if we zoom way out, we have discussed our -- the contribution of sort of the legacy SigSci product line, but we have not yet sort of collected together and published what our entire security portfolio is because it extends well beyond that. Before we bought Signal Science as fast we had a WAF, we have a DDoS business, we have a TLS business, we have an emerging bot business. So, Ron will speak to the -- and already did on the SigSci business, but that's not the entirety. I think in general, I gave you color on the entirety of that portfolio, which continues to drive tremendous growth. And as we have talked about in the past, we do have a great margin profile on that business as well as the compute business.

So, Ron, why don't you sort of give some of the stats on it? And then, I think coming back to the wallet share and growth question, you can also address that, if you could?

Ron Kisling: Yes. So, just to give you a couple of stats. So, in Q4, revenue from Signal Sciences was 11.9% -- in the quarter was 11.9%, up from 10.9%, reflecting about a 15% growth rate. As I mentioned on the call, on a year-over-year basis, Signal Sciences revenues increased about 59%, if you take into account the purchase price adjustments. It was about a 38% growth on a year-over-year basis. So, we're seeing really strong growth there.

And as Joshua points out, the Signal Sciences is only a portion of our security business, does not include some of the Fastly products such as DDoS TLS. And I think over time, as we add more security products and launch more products, we expect to see more growth in security in the overall portfolio. I think, this goes back to -- if you go back earlier, we talked about substantial growth in terms of our long-term goals of sort of 10x growth on security. And so, we see it as an important part. Every sort of conversation around delivery includes security. And as we build that portfolio out, we see opportunities to grow that.

And then I think in terms of margin opportunity, the gross margins on the security business are substantially higher than on the delivery side. They don't use lot of bandwidth. And then secondly, predominantly, most of the Signal Science products today are sold on sort of a SaaS basis. So, they're also a little bit less volatile. They're not traffic or volume-based sales. And so, that's the other sort of differentiation in terms of the security business versus the delivery side of that product.

Fatima Boolani: Fair enough. If I may ask you a follow-up on the delivery side of the house. I think you sort of characterized the quality of the traffic on the network has not been commodity, right? So I'm hoping if you can take a step back, if you can help us appreciate the composition of the estate in terms of your traffic and traffic volumes on the network, whether that's across very premium high-end video, streaming VOD, gaming, software downloads, social media, anything to help us sort of think about that pie of traffic on your platform to give us a maybe more crisper understanding of why it isn't necessarily the commoditized trends that some of your peers maybe are seeing?

Joshua Bixby: Sure. I mean, I think we've spoken in the past about that being an equal balance between video non-video and it changes, it remains about the same. As Ron said, nothing changed quarter-to-quarter. And the mix has remained relatively stable over the last 18 to 24 months. So, I think we've -- one of our goals is to keep that stable. We think that that's really important. And as I say, not go down into the commoditized side of it. So, I would say a lot of stability. We see growth. And all of it is important for us to make money and to get a great margin because it all has different impacts in the sort of line of our business. So, it's hard to break it out and just sort of say, well, the pricing is this or that in some ways because if you think about a large really high-value streamer who then gets us into an eyeball network that we otherwise would have had to pay for, some of that math is very valuable to our business and something that we are constantly looking at. So I think, in general, not a significant change in the quarter or over the course of the last couple of years.

Operator: [Operator Instructions] Next up is Tom Blakey, KeyBanc Capital Markets.

Tom Blakey: I have a couple of questions, starting with Ron, on the gross margin side. It seems like things are pretty identifiable in terms of duplicative costs. Have you ever -- I mean, on the calculations Ron to say what, as we go into 2023 with those costs alleviated from a basis point perspective, what type of release that that would be in terms of gross margin? And similarly, with regard to utilization, impossible to probably track the level of demand. But for like every 10 points of utilization in terms of increase, what kind of basis point expansion that could have on gross margin to give us like some sort of flavor for the longer term? And speaking in that longer term, what about this new improved network? What's it going to look like? Is it going to be more in line with peers of yours, which significantly higher gross margins, or should we expect something -- some other number? Then I have a follow-up.

Ron Kisling: Yes. So, a couple of data points. I think as we look to 2023, the headwinds from the new architecture transition sort of fall away, and we expect to continue to drive toward higher utilization across our network. And there's a number of other things that we're doing internally in terms of our traffic forecasting and investment process to drive even tighter alignment around those investments and traffic expectations. And we'll talk more about on Investor Day, which should also drive better utilization and higher gross margins. So, we haven't quantified kind of the gross margin for 2023 other than to say that we expect to see further accretion and improvement in gross margins in 2023 from efficiencies in our cost of revenue, from the completion of the transition of the architecture, driving better utilization across our network. And also the -- as we see the higher growth in the security products, those become a bigger mix of the products, and those are also a contributor.

So, we've got a lot of tailwinds going into 2023 that will drive gross margin accretion over what we've seen this year. And that should play out as accretion off of kind of what that exit rate is as we get to the end of the year, but we haven't explicitly quantified that.

Tom Blakey: That's fair. And just maybe one more try then. Is it -- it sounds like if I'm hearing you correctly, Ron, it's more going into '23, '24, '25, it's more utilization in terms of what the expansion of the gross margin will be going back to those 60-plus-percent rates versus some sort of identifiable duplicative cost overhang be meaningful..

Ron Kisling: Yes. I think the way I would look at that is, I think we did have a headwind in '22 from this transition, and that sort of falls away. And then, as you get into '23, '24, '25, it's really going to be driven by utilization and efficiency on the network because we build more efficiency, leveraging the new architectures and driving efficiency there and product mix. So, sort of the fundamentals of the business that will be driving ongoing accretion in gross margin.

Tom Blakey: Great. That's helpful, and we'll see going into '23 what that looks like. My second question is around security, obviously, and related kind of longer-term strategic vision on adding functionality that's less bandwidth intensive and more kind of a SaaS like on your platform. Just given - the question here is about, we'll see about the profitability going forward. So kind of all-in-one question about capital structure and cash usage and what the long-term strategic vision of Fastly is in terms of long-term growth on the non-delivery-related businesses, would that be more organic or inorganic in your kind of intermediate term vision for the Company?

Joshua Bixby: Yes. Thanks, Tom. I think we said this in the past, I think we view our trajectory on an organic view at this point. I think we feel like security will continue to grow, and we haven't even scratched the surface of that market, if you look at the scale that we are at. There are a few places in the portfolio that we're beefing up, particularly on the bot side, but we -- in terms of sort of large-scale inorganic growth, that's not how we feel we are going to hit the long-term goals that we've set out. So right now, we have teams working on -- diligent working on the bot portfolio and continuing to improve that. And the rest of the portfolio is strong. It's world-class, and it's something that we go up every day against our competitors and win with as you can see the growth in that market and the trajectory is strong. So right now, we're really confident in the portfolio and we're confident in the team. There may be small things here and there, but that would be more on the talent side than it would be on the revenue side.

Tom Blakey: That would be excellent to see from an organic basis, Joshua. And I agree, you've anniversaried here with solid growth. So, congratulations and look forward to keeping in touch with you in the next endeavor.

Joshua Bixby: Thank you. Yes, it's been a great success.

Operator: That does conclude our question-and-answer session. At this time, I would like to hand things back to Mr. Joshua Bixby for any additional or closing remarks.

Joshua Bixby: Great. Thank you. Before we sign off, I want to thank our employees, our customers, our partners and our investors. We remain as committed to ever -- as ever to fueling and security in digital experiences and moving forward remain focused on execution, bringing lasting growth to our business and delivering value to our shareholders. I will remain in my role until my successor has been brought in, to ensure that we have a smooth transition. And I want to assure you that positioning Fastly for a long-term success is my number one goal throughout this process. We look forward to connecting with many of you at our Investor Day on May 12th. Thank you.

Operator: That does conclude today's conference. Thank you all for your participation. You may now disconnect.