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# Fastly, Inc. (FSLY)

Q3 2022 Earnings Call

## CORPORATE PARTICIPANTS

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**Ronald Wayne Kisling**

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

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## OTHER PARTICIPANTS

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**Matthew Terence Wilson**

*Analyst, Morgan Stanley & Co. LLC*

**Frank G. Louthan**

*Analyst, Raymond James & Associates, Inc.*

**William V. Power**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good afternoon. My name is Chris, and I'll be your conference operator today. At this time, I'd like to welcome everyone to the Fastly Third 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'd now like to turn the conference over to Vern Essi, Investor Relations at Fastly. Please go ahead.

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**Vernon P. Essi**

*Vice President-Investor Relations, Fastly, Inc.*

Thank you, and welcome, everyone, to our third quarter 2022 earnings conference call. We have Fastly's CEO, Todd Nightingale; 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-Q filed with the SEC and our third 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 attending two conferences in the fourth quarter, the RBC Capital Markets Global TIMT Conference in New York on November 15th, and the Credit Suisse 26th Annual Technology Conference in Arizona on November 29th.

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

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## Todd Nightingale

*Chief Executive Officer & Director, Fastly, Inc.*

Thanks, Vern, and hello, everyone, and thank you so much for joining us today. Let me start by thanking the Fastly team for such a cordial welcome and an amazing onboarding experience when I joined 60 days ago. The team here has been very supportive during my first few weeks in this role, and I want to thank Joshua for such a smooth handoff and the board for their support and guidance. I see tremendous opportunities ahead of us and I'm excited to work with this incredible team.

First, I will give a quick summary of our financial results and third quarter highlights, and then provide a brief overview of my first impressions and near-term path forward at Fastly. I will then hand the call over to Ron to discuss the third quarter financial results and guidance in detail.

We reported record third quarter revenue of \$108.5 million, which grew 25% compared to last year and 6% quarter-over-quarter. I'd like to congratulate the Fastly team on this rate of growth which take pride in its achievement. However, I believe there still remain more customer opportunities out there to grow beyond the 22% year-to-date revenue growth we just posted as I will explain in a moment. Our customer retention and growth engine remain strong.

Our last 12 months NRR was 118% in the third quarter, up from 117% in Q2, and our DBNER was 122% in the third quarter, up from 120% in Q2. It's great to see such a passionate loyal customer base and the continued growth from these existing accounts. Our average enterprise customer spend was \$759,000, representing a 4% quarter-over-quarter increase from Q2 and continue to demonstrate the success of Fastly's land-and-expand approach in strategic accounts.

In the third quarter, we saw continued momentum in our portfolio expansion strategy with strong cross-selling activity in both Compute@Edge and security. We saw Compute@Edge cross-selling wins in marquee accounts like New Relic and with Canada's leading content creation companies. With security, we saw cross-selling motion with one of the largest drugstore chains in Europe, which is now using our Next-Gen WAF on top of content delivery from Fastly, and from a major Japanese video game company, who is now using our Next-Gen WAF in addition to our content delivery and Compute@Edge capabilities.

Our total customer count in the third quarter was 2,925, which increased by 31 customers compared to Q2. Enterprise customers totaled 482 in the quarter, an increase of 11 compared to Q2. I'm pleased to report that our third quarter gross margin of 53.6% improved 320 basis points quarter-over-quarter. Ron will talk in more detail about this in just a moment. Of course, this is an area we are focused on intently and we've been able to remove duplicate site costs, improve our bandwidth costs, our network utilization and capacity planning.

It's important to me to run an efficiency healthy business, and to that end, we will be continuing to focus on margin improvement in Q4 and through FY 2023. It's also important to note, we've gone to great lengths to secure our supply chain to ensure that our platform expansion can continue uninterrupted, even in the presence of supply chain disruption, to support existing Fastly customer growth and new logo acquisition.

We continue to expand the Fastly's product offerings. In my first few weeks, I've been impressed with speed of innovation here. In Q3, these releases include: service search, allowing our customers more easily access our technology; compliance routing, which is in alpha right now, helping customers with data sovereignty requirements, better manage how and where their data is processed; and WebSockets, in beta, giving our customers real-time low-latency solutions capable of supporting the most-responsive engaging applications. We've also listed additional product releases in our investor supplement for your reference.

In my first few weeks at Fastly, I talked to customers, partners, key stakeholders, and I have immersed myself in Fastly's culture and organization. This process yielded an enormous amount of feedback in the form of praise and constructive suggestions. I'm grateful for everyone's thoughtfulness and for the teams who facilitated all those discussions. Fastly has an amazing culture and a talented employee base. The team here is passionate about every customer, passionate about the technology we build, and most importantly, passionate about our mission to make the Internet a better place where all experiences are fast, engaging, and safe.

There's tremendous opportunity in Fastly as a complete application experience platform to deliver cutting-edge digital experiences for everyone everywhere. The more Fastly becomes a one-stop shop for the edge cloud, for content delivery from network services, security and edge compute with observability, the more it will drive a more complete experience for our users, and for our customers, it will drive a differentiated experience for their developers, for their operations teams, and I believe in staying true to that vision and by focusing on our users, our developers and our customers, we can have an incredible impact on the industry.

We have a real opportunity to run at high-velocity, low-friction motion at Fastly, and I will be focused on, number one, simplifying our product packaging, this will enable our customers to understand, quote, and purchase our technology more effectively and our team can operate with less friction. Number two, we'll also focus on more deeply embedding the Signal Sciences offering into the Fastly platform and continuing to expand our security offerings.

Number three, our Compute@Edge launch from last year has had a great early success, in part due to our developer relations investments and Glitch acquisition. I plan to continue to invest here as our customers demand even more dynamic capabilities of the edge. Four, I plan to align our go-to-market, service, and our customer success teams to focus more deeply on the customers they serve. And five, our goal is to make certain that our investments are in line with these priorities, while implementing cost controls and to ensure that every dollar at Fastly is being used to fuel growth.

With regards to investments, I am acutely aware of our high operating expense levels and I take this very seriously. We will focus on investing in our go-to-market and on our innovation engine to fuel growth while driving

efficiency in everything we do. You will hear more about our long-term growth and spending forecast next quarter, but let me leave you with the understanding that I am very committed to meaningfully reducing our operating losses in 2023.

Let me close by saying, I'm very excited about the opportunity at Fastly. Our customers have a real passion for Fastly's solutions and our employees have a real enthusiasm for Fastly's mission. Of course, we have plenty of work ahead of us, but I believe we can have significant impact on the way digital experiences are built and delivered around the world. I look forward to sharing more with you regarding our progress, our focus on fueling growth, our customer acquisition, and our velocity of innovation in the coming quarters.

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

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### Ronald Wayne Kisling

*Chief Financial Officer, Fastly, Inc.*

Thank you, Todd, and thanks, everyone, for joining us today. I will discuss our business metrics and financial results, and then review our forward guidance. Note, unless otherwise stated, all financial results in my discussion are non-GAAP based metrics.

Total revenue for the third quarter increased 25% year-over-year to \$108.5 million, exceeding the top end of our guidance of \$102 million to \$105 million. In the third quarter, revenue from Signal Sciences products was 13% of revenue, a 44% year-over-year increase, or a 33% increase after purchase price adjustments related to deferred revenue are reflected. While we are not immune to the macroeconomic trends, we are seeing healthy traffic expansion from our enterprise customers, and given our relatively smaller market share, we are benefiting from share gains in an otherwise challenging environment, and believe these dynamics position us for continued revenue growth.

Our trailing 12-month net retention rate was 118%, up slightly from 117% in the prior quarter. We continue to experience very low churn of less than 1% and our customer retention dynamics remain strong. As Todd stated, we had 2,925 customers at the end of Q3, of which 482 were classified as enterprise, those customers with an excess of \$100,000 of revenue over the trailing 12 months. Enterprise customers accounted for 89% of total revenue on a trailing 12-month basis, up slightly from their 88% contribution in Q2. However, the key highlight here is that our enterprise customer average spend grew to \$759,000 from \$730,000 in the previous quarter, representing 4% expansion in dollars spent, and further demonstrating our continued ability to expand our business within our largest customers and our strong customer retention.

Our strong trailing 12-month net retention rate and growth in average enterprise customer spend demonstrate our continued ability to expand within our enterprise customers due to our increased share of delivery traffic and adoption of new products in security and in our emerging compute business. Our top 10 customers comprised 36% of our total revenues in the third quarter of 2022, slightly above the 34% contribution in the prior quarter. Since I last spoke to our Q2 results, we made a great deal of progress within our financial organization with efforts that align closely with Todd's new leadership.

We've completed the transformation of our finance leadership team and continue to enhance our cross-cultural efforts to streamline and improve our business visibility, including forecasting and review process to better align capital investments with traffic expectations, and improved management of our balance sheet and capital structure. As I stated last quarter, these efforts not only strengthen Fastly's financial position longer term and allow us to drive increased efficiency in our business, but also improve Fastly's competitive positioning and its transparency to the investor community.

I will now turn to the rest of our financial results for the third quarter. Our gross margin was 53.6% for the third quarter compared to 50.4% in the second quarter of 2022. Recall, that excluding onetime true-up cost, the gross margin for the second quarter would have been approximately 52%. This sequential improvement in gross margin reflects our prior expectations that it would lift in the second half of 2022.

As we previously discussed, this is due to the discontinuance of site duplication expenses in the first half of 2022, improvements in our network investment capacity planning to more closely match our traffic patterns and demands, and are focused on reducing the cost of components of our cost of revenue, including in the third quarter a reduction in our bandwidth costs. As a result, we expect gross margin improvement of roughly 200 basis points in the fourth quarter relative to the third quarter.

We did not see any meaningful changes, positive or negative, to our pricing in the third quarter as compared to the prior quarter. I appreciate your patience through this phase of our gross margin volatility. As Todd stated, we will continue to be focused on gross margin improvement and efficiency through 2023 as our planned investments in our next generation network architecture, ongoing management of network investments in line with expected traffic, continued improvements in efficiency and traffic handling, and management of our costs positions us for further gross margin improvements in the medium- to long-term.

Operating expenses were \$78 million in the third quarter, up 24% over Q3 2021 and down 1% sequentially from the second quarter. This was higher than we had previously forecasted, but was offset by higher than anticipated revenue, resulting in an operating loss of \$19.8 million, near the midpoint of our operating loss guidance range of \$18.5 million to \$21.5 million. During the third quarter, we accelerate our sales and marketing investments to position us for strong revenue growth in 2023. Additionally, despite our more disciplined hiring in the third quarter, our head count costs were higher than we had previously forecast as we saw a decrease in our employee attrition rate during the quarter.

As Todd indicated, we are investing in our go-to-market efforts as part of our revenue growth initiatives. As these initiatives are put into motion, we anticipate fourth quarter sales and marketing expenses will increase sequentially, while R&D and G&A expenses will remain relatively flat. And despite our increasing investments in our go-to-market efforts, there are meaningful opportunities to drive greater efficiencies in our operations, especially across G&A that give us confidence in meaningfully reducing our operating losses in 2023 and beyond. Our net loss in the third quarter was \$16.8 million, or \$0.14 per basic and diluted share, compared to a net loss of \$13.2 million, and \$0.11 loss per basic and diluted share, in Q3 2021.

Turning to the balance sheet, we ended the quarter with approximately \$719 million in cash, cash equivalents, marketable securities and investments, including those classified as long-term. Our free cash flow of negative \$44 million was down sequentially from the second quarter's negative \$61 million, primarily due to a \$27 million reduction in advance payments of capital equipment and changes in operating cash flows.

Third quarter free cash flow reflects the advance payment on capital equipment of \$2 million, capital expenditures of \$15 million, which include cash purchases of capital equipment, capitalized internal use software, and payments on financial leases during the quarter. Our cash capital expenditures were approximately 8% of revenue in the third quarter. Our cash capital expenditures include capitalized internal use software and deployment of prepaid capital equipment. We continue to expect our cash capital expenditures for calendar year 2022 to be in the range of 10% to 12% of revenue.

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

Our fourth quarter and full year 2022 outlook reflects our continued ability to deliver strong top line growth via an 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 we have today. Historically, our fourth quarter sees strong growth relative to the third quarter and we see a similar trajectory in 2022.

I'd also like to note that given the nature of network traffic drivers in the fourth quarter, revenue is subject to volatility due to a variety of items, including holiday shopping patterns and live sports streaming viewership. As a result, for the fourth quarter, we expect revenue in the range of \$112 million to \$116 million, representing 17% annual growth at the midpoint. We expect the non-GAAP operating loss of \$18 million to \$14 million and a non-GAAP loss per share of \$0.15 to \$0.11.

For the calendar year 2022, we are increasing our prior revenue guidance by \$7 million to a range of \$425 million to \$429 million, representing 21% annual growth at the midpoint. We expect a non-GAAP operating loss of \$82 million to \$78 million and a non-GAAP loss per share of \$0.67 to \$0.63, reflecting the impact from increased revenue outlook, and as I discussed above, we now anticipate operating expenses will increase in Q4 relative to the third quarter and our second half operating expenses will be higher than the first half due to our investments in sales and marketing.

Before we open the line for questions, we would like to thank you for your interest and your support in Fastly. Operator?

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## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Our first question is from James Fish with Piper Sandler. Your line is open.

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**James E. Fish**

*Analyst, Piper Sandler & Co.*

Q

Hey, guys. Nice comeback on top line there, and Todd, welcome to Fastly. Looking forward to working with you again. Wanted to start on the sales cycles that you're seeing, particularly for new prospective customers, and obviously, you have some sales and marketing spending going on. But what are you guys seeing with sales cycles on those new prospective customers versus the willingness to consolidate more traffic and security functionality with your existing installed base?

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

That's a great question and great to see you again, too. Appreciate you being here. I think that the – as far as the length of the sales cycle goes, we haven't seen any very significant change in the last couple of quarters. But we have seen some very relatively quick sale cycles in some large strategic deals, especially when we are talking about expansion deals, customers that might be in our content deliveries out of the house and are moving to security or moving to expand to edge compute. And so, those cycles have definitely – are definitely far shorter

than the initial local acquisition, and that's been helping us quite a bit as we see expansion in those areas. As far as new customer logo sales cycle changes, haven't seen any yet, but I think it's a good thing for us to look out for.

**James E. Fish**

*Analyst, Piper Sandler & Co.*

Q

And then, just to follow-up on gross margins, couple of things. Obviously, some of the colocation companies out there are raising prices, just given energy cost increases, particularly in the EMEA region. I guess how is that impacting your gross margins for the next year or so or what are you guys seeing on that end? And at what point should we be through kind of the duplicative sites headwinds that you guys are, I'll say, self-carving?

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Yeah. We've seen some of the changes on the power side, especially in Europe. So, we're seeing what you're seeing. But we have very close relationships with those providers and I can probably be able to manage that. As our scale continues to increase, our ability to find good pricing comes along with. And so, we've actually done a good job bringing down our bandwidth costs, and I think that trajectory will continue. Specifically, not just for bandwidth, but when we look across all of the cost of revenue, we're leaning in pretty hard right now in really driving our margins up. We saw great results this quarter. I believe that there's a real opportunity to continue that trajectory, and I think that is sort of core to our success as well. So, you're going to continue to see a ton of focus in this area. We have opportunity with peering, we have opportunity with the higher utilization of our infrastructure, higher utilization of our network to drive our margins up, even if we do find a little bit of incremental cost around energy usage.

Anything you'd add there, Ron?

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

The only thing I'd add and I think to Todd's point, we're seeing good improvement in cost, particularly around bandwidth, managing our CapEx is helping our depreciation. And bandwidth and depreciation are kind of the biggest drivers of our cost of revenue, with colo being a little bit smaller. So, that tends to help against some of the increases we're seeing from colocation providers.

**James E. Fish**

*Analyst, Piper Sandler & Co.*

Q

Thanks, Todd. Thanks, Ron.

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Sure.

**Operator:** The next question is from Frank Louthan with Raymond James. Your line is open. Frank Louthan with Raymond James, your line is open.

**Frank G. Louthan**

*Analyst, Raymond James & Associates, Inc.*

Q

Sorry about that. I think the telecom guy could work the mute button, but – hey, Todd, good to meet you thanks for being on there. Talk to us a little bit – give us a little bit more details about the tech upgrade and the gross

margin here. Can you just remind us the 200 basis points of pressure, was at the GAAP or non-GAAP, and any chance that bleeds into next year? And then, walk us through what you've seen on pricing, good revenue trends, how is pricing going in the market currently?

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**Ronald Wayne Kisling***Chief Financial Officer, Fastly, Inc.*

A

Yeah. So, I'll start on the 200 basis points in pricing. I think the 200 basis points that we saw in Q2 was sort of onetime event. The duplication associated with our architecture migration was largely completed in the first half as we planned. So, that's really driving some of the Q3 improvements. And then, I think as you look to Q4, you get a little benefit from the revenue accretion you see in Q4 as well as, as we indicated, we saw some improvements in our bandwidth pricing that we'll actually see that benefit for the full quarter in Q4. So, that's why – that's really the drivers behind the couple hundred basis point improvement we'll see going into Q4. And then, I think on pricing, we really haven't seen any meaningful changes in the quarter, positive or negative, compared to the prior quarter.

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**Todd Nightingale***Chief Executive Officer & Director, Fastly, Inc.*

A

I think, as we look forward, there is real opportunity for us to continue this trajectory of margin improvement and we are deeply focused on this. One is just around really diligent capacity planning. We've seen some stabilization in the supply chain, maybe not complete, but enough and we are focusing deeply on doing very rigorous capacity planning, so that we are deploying our equipment as efficiently as we possibly can, and that goes beyond just how much we deploy, but where we deploy it. We're deploying our equipment into the right regions as we predict load.

The second is network efficiency. We have a real opportunity as Fastly scales to push more of our bandwidth costs to peering links, which are radically less expensive for us, and that give us an opportunity to find serious efficiency and Fastly continues to scale that, that opportunity continues to be available to us. And last is really the efficiency of the system. One of the first things that I did when I first arrived at Fastly is to work closely with our infra team to understand all the work that's going on just to build the most efficient infrastructure possible, capable of really maintaining the trajectory of margin improvement for the next few quarters and that's what we're planning to do. That's our focus right now.

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**Frank G. Louthan***Analyst, Raymond James & Associates, Inc.*

Q

How high a priority is it to get to EBITDA positive and in what timeframe do you think you can do that?

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**Todd Nightingale***Chief Executive Officer & Director, Fastly, Inc.*

A

I'll tell you that, I believe, we have a real opportunity to post a far more profitable or a far better operating losses next year from this year, and it's something that is incredibly top of mind for me and our whole leadership team. In fact, the discussion of deploying every single dollar spent at Fastly to fuel growth, to see radically more efficient with our spend, more judicious and even scrappy with that spend is incredibly top of mind for us, because it's not lost on me that we have to improve profitability here and specifically our cash burn.

As far as the exact timing of our EBITDA turnaround, we're going to try to give you as much information as we can in our next call and we'll be going to be discussing the entire FY 2023 plan and guidance, and I think that would be the right time for us to give you a further outlook there.

**Frank G. Louthan**

*Analyst, Raymond James & Associates, Inc.*

Q

All right. Great. Thank you very much.

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Thanks.

**Operator:** The next question is from James Breen with William Blair. Your line is open.

**James Breen**

*Analyst, William Blair & Co. LLC*

Q

Thanks for taking the question. Just on the capacity side, where are you right now, given the growth that you're seeing? Do you think there's – staying in the CapEx range is reasonable, given some of the new products and some of the growth you're seeing within your existing customer base? And then, the gross margins have improved. How much of that is just from increased revenue on a fixed cost basis in terms of where the network is? And going forward, do you continue to expect – I guess, what do you think the gross margin potential is as you sort of reach scale? Thanks.

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah. So, on the capacity side, I think, earlier this year, we kind of brought down our expected CapEx from 12% to 14% to 10% to 12% of revenue. I think there are opportunities as we get into next year to continue to see opportunities to improve around the CapEx side. As we use CapEx, A, more efficiently and continue to make sure we're aligning with traffic expectations, despite what we see is a really good growth and expansion within our existing customers.

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

And I think, look, as far as the – especially, the capital expense goes, supply chain stabilization is going to help us control CapEx, and specifically, the demand planning improvements. And I think that's really key or getting – we have been getting a better handle on being able to predict demand and that's going to help us being more efficient in how we deploy capital, and that's going to be key to this.

Again, I believe that the trajectory here that we're on is something that is incredibly important. We are deeply focused on this, our demand planning, efficiency of our every single cost of revenue dollar, not just the CapEx side, but the entire cost of revenue line. Being more efficient with our bandwidth is going to be incredibly important to us and I don't want to lose track of that. CapEx depreciation is a big deal, but the bandwidth cost is enormous. And so, our efforts around more efficient use of that bandwidth, better peak management, better peering utilization is going to be driving us, and we're going to be really building that muscle more and more over the next few quarters. We're going to continue this trajectory. I don't want to speak to how high I think I can go in this earnings call, might just be a little early for me. I'm still unpacking the business, but we will get into it much more deeply as we give FY 2023 guidance in the next call.

**James Breen**

*Analyst, William Blair & Co. LLC*

Q

And just as a follow-up, DBNER was 122% or so, just below where your total growth rate is, on the revenue side, what's the opportunity outside of your existing customer base and how to think about that from a go-to-market perspective? Thanks.

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Yeah. That's great. I mean, of course, we look at the existing customer base with organic growth in technology we're already delivering and portfolio growth, especially with the early success we're seeing on Compute@Edge and with security, and with Signal Sciences acquisition. But as far as new logo acquisition goes, we've been seeing some real – we've seen some real progress in the high tech space and we're looking at additional verticals where we can really make a concerted Fastly-wide go-to-market surge in terms of driving new enterprise logos in new verticals.

And I think with the product packaging improvements that we mentioned, we actually have an opportunity to reach some of the midmarket, especially the high-end of the midmarket with a simpler motion, a lower friction motion to onboard new accounts. And so, as we start to get our packaging in order, I think we're going to be able to see some improvement in how well we penetrate, not just large enterprise accounts, but the high-end of the midmarket as well.

**James Breen**

*Analyst, William Blair & Co. LLC*

Q

Great. Thanks.

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Thanks.

**Operator:** The next question is from Sanjit Singh with Morgan Stanley. Your line is open.

**Matthew Terence Wilson**

*Analyst, Morgan Stanley & Co. LLC*

Q

Hi. It's Matt Wilson on for Sanjit. Thanks for taking our question. Maybe just back to that last one, can you talk about the opportunity in midmarket through the better packaging? How large is this opportunity? When can it kind of start to show up in financials?

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Sure. Look, I think the better packaging, really it's not just a benefit in the midmarket, it gives us opportunity to lower our – the lower the friction really increase the velocity of our sales motion, the way we do our billing and invoicing, the way customers – and how easy it is for customers to really understand what they've bought and use as much of that as possible, really becoming platform users. And so, I think from a packaging point of view, the opportunity impact our kind of core existing enterprise motion for sure. I will say though, as far as midmarket goes, it's absolutely a requirement that we have simpler packaging that can be bought holistically, so that you can deploy a – our content delivery technology with a single SKU, and that SKU can be transacted quickly and easily.

It also – and this is, I think really maybe the most important part of that packaging when it comes to midmarket, it unlocks the opportunity for us to bring content delivery to our channel. And we've had some early success in the security side of our business, bringing that to the channel, especially from what Fastly has learned from the SigSci acquisition and by building really simple, straightforward packaging for content delivery with the opportunity to bring that to the channel as well. I'm pretty excited about that. As far as sizing it, I think that's a good question, but something we'll probably have to take to the next call, so.

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**Matthew Terence Wilson**

*Analyst, Morgan Stanley & Co. LLC*

Q

All right. Great. Thank you.

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Thank you.

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**Operator:** The next question is from Will Power with Baird. Your line is open.

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**William V. Power**

*Analyst, Robert W. Baird & Co., Inc.*

Q

Great. Thank you. Yeah. No. I appreciate all the color on and focus on improving the cost structure. I guess, Todd, one of the questions might be, as you think about the cost reduction opportunities and improving cash flow, how do you balance that against also trying to improve revenue growth? It sounds like you have some initiatives there. So, I guess, what's kind of the confidence level and prioritization there between those two areas?

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Yeah. I think that's an amazing question, because it's incredibly top of mind for Ron, myself, our entire senior staff right now is ensuring that every dollar we spend is fueling growth, and ensuring that as we get a lot more serious about controlling expenses that we're doing in the most judicious way. We don't want to throw the baby out with the bathwater, and maybe there's a parallel to be drawn here. We've worked hard at removing duplicative expenses in our infrastructure, in our cost of revenue, and we have some of that same thing in the – on the OpEx line.

So, we're pushing really hard to ensure that we're, first and foremost, taking an opportunity to cut expenses everywhere there's low-hanging fruit where it won't be a tradeoff between growth and OpEx. And I think at that point, we will then have the opportunity to really figure out how much we want to balance our kind of spend and growth line. But there's a huge amount of opportunity here for us to sort of get our house in order and make sure that every single dollar is being used as efficiently as possible, that we're stepping away from vendors and contracts that aren't really driving and fueling growth.

And so, I think realistically, there's opportunity here for us to do better without having to make the trade-offs between spend and growth. That's what we're really focused on right now. I've been here about 60 days, so we're still unpacking all the details. I want to make sure I make these decisions as carefully as I possibly can. But the opportunity is there and we're going to get that done as fast as we possibly can and really try to set ourselves up for a much better profitability number for next year, and be careful and very judicious about doing that without

sacrificing growth number. But I think we'll be in a really good place to discuss that in detail at the next earnings call.

**William V. Power**

*Analyst, Robert W. Baird & Co., Inc.*

Q

Okay, great. No. I appreciate that color and good luck with those initiatives. Maybe if I can just do a quick follow-up for Ron here. Upside to revenue in the quarter, guidance is a bit higher, I mean, is there anything in particular as you look across product lines, whether Signal Sciences or something in media that's providing upside maybe relative to where prior expectations might have been. And then, I guess tied to that, any additional color on any macro headwinds you might be seeing in either longer sales cycles, is there anything else to call out?

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah. I mean, I think, on the first part of the question, I come back to what Todd said in terms of seeing fairly short sales cycles in terms of customers quickly adopting either additional delivery or even more importantly, additional products around security or compute, where we're starting to actually see some traction in those areas. And so, I think that expansion is one area that we saw in the quarter driving some of the sort of increased growth, particularly around the timing trajectory of when customers sort of took on that additional business.

I think in terms of the macro headwinds, I think today, I sort of come back to what's been driving the business thus far is expansion with our existing customers where we've actually seen maybe even less friction in expanding in existing customers. And again, given a relative market share – market share gains have sort of helped us against any sort of macro headwinds that we see. I mean, ultimately, I think the service that we do is pretty key to customers, and if you look at kind of the dynamics, whether it's M&E or shopping, I think you see opportunities for that traffic to continue to grow.

**William V. Power**

*Analyst, Robert W. Baird & Co., Inc.*

Q

Okay. Thank you.

**Operator:** And the next question is from Fatima Boolani with Citigroup. Your line is open.

**Mark Zhang**

*Associate, Citigroup*

Q

Hey, guys. This is Mark on for Fatima. Thanks for taking our question. Todd, congrats on the first few months in the role and it's great to see top line raises on 2022. But just on the operating margin points coming down 1 point, on the sales and marketing investments, is there any specific areas there that's really driving the lion's share of the investments or just a function of the opportunity ahead that you could call out? And then, maybe can I get a sense of how much incremental investments may be needed just going beyond 2022, just given your initiatives? Thanks.

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Sure. Yeah. I can speak to that. Look, on the sales and marketing side, we try to focus any incremental investment on quota carriers and that's been sort of religion here is focusing on covering as much – as many of

the accounts as possible with the strongest possible teams. So, really quota carrying – carriers account executive and SE roles that's where we've focused any incremental spend.

As far as looking at the projections beyond FY 2022, I think it will be a little bit early for me to make the call and I recognize that this is a question that keeps coming up. We are deeply concerned about it, especially the operating loss side of the house, and it's absolutely the area where my whole team right now is engaged in our planning for next year. And I do want to be just as judicious as I possibly can to put that strategic plan and budget plan together before we talk about it publicly.

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**Mark Zhang**

*Associate, Citigroup*

Q

Got it. Thanks. Thanks so much. Maybe just a follow-up on that, just going to 2023, I noticed there was probably meaningful – opportunity to reduce operating losses, any areas of low-hanging fruit outside of the gross margin levels, the maintenance expense? Thanks.

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

I'm sorry, low-hanging fruit in regards of?

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Q

Just on the operating – I guess, operating expense structure outside of the gross margin side?

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

I think that there is actually some low-hanging fruit in duplicative systems [indiscernible] (00:41:20) and we've seen this in a couple of areas. Of course, we saw in the cost of revenue, that's going to help us drive up the margin side of the house. We see it on the OpEx side, too. We have an opportunity to clean that up and drive some real savings there. I think there's also an opportunity for us to find efficiencies in our systems and how quickly our teams can operate with less outside contractor support. Simplifying our motion, moving our sales, our default sales motion over to package system is going to help us run a simple motion, a leaner motion with fewer resources needed, and I think that's – it's going to be important in driving our profitability for next year, it's also going to be important as we look to scale over the next three to five years.

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Q

Great. Thank you very much.

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Thanks.

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**Operator:** [Operator Instructions] The next question is from Jeff Van Rhee with Craig-Hallum. Your line is open.

**Daniel Hibshman***Associate Analyst, Craig-Hallum Capital Group, LLC*

Q

Hey. This is Daniel on for Jeff. Just a quick question for me, you mentioned quota carriers. Can you just refresh us on where the sales heads are at right now in terms of accounts and just update us on what you're thinking in terms of accounts moving forward?

**Todd Nightingale***Chief Executive Officer & Director, Fastly, Inc.*

A

That's a great question. I don't have the numbers right in front of me and I don't want to quote you something wrong here. We'll have to get back to you with the exact numbers. I don't want to give you a number that's close.

**Daniel Hibshman***Associate Analyst, Craig-Hallum Capital Group, LLC*

Q

Yeah. And just a second question there for you, Todd. A lot of conversation on the call about margins understandably so, but just kind of wondering as you're entering or looking at the opportunities facing the company, what other areas are focus of emphasis for you as you're looking at potential changes and things you're interested in that you're stepping in?

**Todd Nightingale***Chief Executive Officer & Director, Fastly, Inc.*

A

Yeah. Well, I think the cost control as an opportunity, for sure, top of mind for us, improving the margins, I think, it's a huge opportunity we have, the ability to deploy technology and resourcing to improve margins which is great, too, but I think as far as the opportunity goes, it really is around driving growth for us. We have the opportunity to drive organic growth, both within the technology we already deploy and portfolio expansion. We have logo acquisition along a line of expanding from one vertical to the next, but also driving beyond the enterprise account sets. And we've got a real – I think, a real opportunity to look at driving growth in a very significant way, even beyond those dimensions, demographic expansion as well. And so, for us, trying to balance like there's a huge opportunity in managing these different dimensions of growth and trying to really focus ourselves on the areas and the opportunities for growth where we have the best investment leverage.

Q

Thanks for taking my questions.

**Todd Nightingale***Chief Executive Officer & Director, Fastly, Inc.*

A

Great.

**Operator:** The next question is from Tom Blakey with KeyBanc Capital Markets. Your line is open.

**Thomas Blakey**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Hey, guys. Thanks for taking my question or questions. Some interesting comments about expanding our existing customers, I was wondering if you could maybe qualify some of those statements in terms of penetration rates at any of the customers generally or any one specific? And then, those opportunities there, is there room for – is some of the room for expansion from taking share from existing CDN and security vendors as well? And I have a follow-up after that. Thank you.

**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

A

Sure. Yeah. I think, when it comes to logo acquisition, I mean we are largely looking at picking up share, no doubt about it. In some cases, that means actually transitioning customers over from another CDN provider or bringing in first CDN provider, in both cases really focused on picking up share. And picking up market share in CDN space is an enormous part of our focus, no doubt about it. But I do think it's important to remember, Fastly, while we deliver CDN, it's really an edge cloud and that edge cloud platform is our offering, which is why this has been, I think, an enormous opportunity for us to do portfolio expansion with existing accounts.

Expansion from content delivery to security, especially in the WAF space has been, I think, an incredibly powerful force right now, especially because the industry is focused on WAF right now, and Web Application Firewall is becoming more and more de facto standard in the requirement for application developers, website developers. It's a great and growing market, so we are focused on that expansion and that's really – that security portfolio we really think of as our growth – as the growth portion of our portfolio. We look at edge compute, I think of that a lot in terms of incubation, of an incubation business.

I mean, something that was really a pleasant surprise when I got here is to see how mature that business has gotten in such a short time. We've had very significant deals in edge compute and customers who were content delivery customers who are actually going to be spending more on edge compute next year than on content. I think that's a motion that we can replicate and it's an important one, because as app developers especially are looking at how dynamic, how real time their applications can be, pushing that compute to the edge as a huge opportunity to have that outcome for them. So, we're super bullish on that opportunity and that's something we are really deeply focused on.

**Thomas Blakey**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Very interesting. Thanks, Todd. And then, a follow-up on the talk about improving the supply chain in order to get equipment a little faster. I was trying to square that comment along the lines of capacity utilization. If you could try to connect like that comment with like current gross margins today and I was under the impression that maybe there was enough capacity on the network, but I could be wrong, that would be helpful. Thank you.

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah. So, this is Ron. On the commitments, what we did I think going into really the pandemic when we realized, there were going to be supply chains, we basically made commitments with the number of our suppliers to lock in a certain supply of equipment and that supply of the equipment, we're taking delivery on that as we need to deploy it in line with those kind of traffic patterns. So, from a cost perspective, and we did talk about last quarter that we did make some payments associated with these prepayments, but we haven't taken delivery of the equipment. So, from a gross margin perspective, we don't actually start taking depreciation until we take title and

deploy this. And we're going to deploy this, in line with our build plans that are aligned very tightly with what that demand is. So, we see the demand, the equipment is available, and that's where we really start taking title to the equipment and reflecting the cost of that in our gross margins. So, with a cash commitment, it positioned us really well to be able to meet the increasing demand and still allows us to deploy in line with expected traffic patterns.

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**Thomas Blakey**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Ron, just maybe if I could, is there any type of capacity utilization rate overall you can share with us relative to the gross margin structure of the company today? Is this, like from a – is this a geo-location issue or just you keep saying deploying more equipment with demand and just maybe not trying to pin you down on a number, but.

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**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah. It's a good question. I think the challenge is that utilization varies a lot geographically as well as when you are on the quarter. There's a little bit of seasonality on our business which is you have to build capacity for the demand you see in Q4, so that traffic has to be – that capacity has to be there for that expected traffic. So, you build a little bit of that. And then, as we've talked in the past, the other driver which does affect utilization is, typically when we do expand particularly into a new region, that initial deployment maybe running at below our normal or desired utilization as we would deploy that to cover a certain opportunity, and as we add traffic in that area, we bring up that utilization. So, the impact on utilization is really a combination of what traffic levels we're seeing and where we're expanding the footprint of our global market, our global platform.

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**Thomas Blakey**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Thank you, Ron.

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**Operator:** We have no further questions. At this time, I'll turn it over to Todd Nightingale for any closing remarks.

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**Todd Nightingale**

*Chief Executive Officer & Director, Fastly, Inc.*

Thanks so much. Thanks, everyone. Before we close the call, I want to take the opportunity just to thank all of our customers, our employees, our partners, and our investors. At Fastly, we remain as committed as ever to making the Internet a better place where all experiences are fast, engaging, safe, and moving forward, we remain focused on execution and bringing lasting growth to our business and delivering value to all shareholders. Thank you, all. Thanks so much for the time today.

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**Operator:** Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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