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# Fastly, Inc. (FSLY)

Q4 2023 Earnings Call

## CORPORATE PARTICIPANTS

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**Todd Nightingale**

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

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

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## OTHER PARTICIPANTS

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*Analyst, BofA Securities, Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good afternoon. My name is Christa and I'll be your conference operator today. At this time, I would like to welcome everyone to the Fastly Fourth Quarter 2023 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there'll be a question-and-answer session. [Operator Instructions] Thank you.

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

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**Vernon P. Essi**

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

Thank you, and welcome, everyone, to our fourth quarter 2023 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](https://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, product sales, 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 filings with the SEC, including our most recent Quarterly Report filed on Form 10-Q, filed with the SEC and our fourth quarter 2023 earnings release and supplement for 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 first quarter, the 2024 Raymond James Institutional Investor Conference in Orlando on March 4 and the Morgan Stanley Technology, Media & Telecom Conference in San Francisco on March 6.

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. Hi, everyone, and thanks so much for joining us today. First, I will give a quick summary of our financial results and fourth quarter highlights. I will then provide an update on our go-to-market efforts, customer acquisition and product developments before I hand the call over to Ron to discuss our fourth quarter financial results and guidance in detail.

I'm pleased to report that we closed out 2023 with revenue of \$506 million, representing 17% year-over-year growth and coming in above the original \$495 million to \$505 million range we guided to one year ago. We reported record fourth quarter revenue of \$137.8 million, which grew 15% year-over-year and 8% quarter-over-quarter. This result came in at the lower end of our fourth quarter guidance range, driven by weaker-than-anticipated international traffic, offset by seasonally strong live streaming and gaming activity.

Most quarters, we set a new traffic milestone at Fastly, but this quarter was special. For the first time, the Fastly platform handled more than 100 terabits per second on November 8. As part of the celebration of hitting this milestone, we've decided to retire the live traffic gauge on our website.

Its original intent was to prove the viability of the Fastly platform to prospective customers as Fastly was just starting out. Obviously, we've outgrown the need for this tool and we'll celebrate its retirement.

Our customer retention efforts were stable in the fourth quarter with our LTM NRR at 113%, down slightly from Q3's 114%. Our total customer count in the fourth quarter was 3,243, which increased by 141 customers compared to Q3 and increased by 181 customers year-over-year. Enterprise customers totaled 578 in the quarter,

an increase of 31 from Q3, representing the highest level of sequential growth since we acquired Signal Sciences back in 2020.

Our new packaging, channel program and a renewed demand gen focus are driving a change in the velocity of customer acquisition at Fastly. And this is finally starting to show up in these disclosed customer counts. As these customers grow at Fastly, they will fuel our revenue growth for years to come. This customer growth is also diversifying our revenue among verticals, which helps us optimize traffic across our fleet, yielding higher profitability.

Our sales team has been energized by our recent success with large customer wins. Of the 31 new enterprise customers this quarter, 19 were net new to Fastly. In addition, our average enterprise customer spend was \$880,000, up 7% on a year-over-year basis. While these results demonstrate success in expanding wallet share with existing customers and driving customer acquisition, our journey towards expanding these efforts with a focus on product, on marketing and go-to-market initiatives has just begun.

Our marketing team is elevating Fastly's brand with an eye towards efficient spend. This involved clever marketing campaigns at trade shows as well as digital ad campaigns to drive demand gen. We're closer than ever to delivering complete platform unification for our customers, allowing a far smoother cross-sell and onboarding with the simplicity of a single click. This will dramatically improve the customer journey in 2024 and we expect to see gains in our customer retention and expansion efforts.

In the fourth quarter, we continued our momentum in landing key new logo wins in strategic expansion verticals. Our sales teams are winning new logos in these expansion verticals with pre-built use cases. One great example of this is in social media, where we serve some of the largest players in the space and have recently won a handful of follow-on logos in this area.

This is highlighted most recently by BeReal and their new authentic approach to social media. BeReal chose Fastly due to the power of our platform and its unique ability to quickly scale for their low latency traffic patterns. Members of my senior staff love this platform. We're happy to have them onboard. This has also led to the winning of a social media-based shopping application that is rapidly growing, leveraging our expertise in that space as well.

Alongside social media, we added to our list of logos with one of the premier dating apps and are excited to pursue other dynamic traffic opportunities in similar mobile applications. We continue to penetrate new sub-verticals in e-commerce. For example, in live auctions, we recently won Phillips Auctioneers, which was a follow-on win to Sotheby's, making us a strong partner for live auctioning and its unique e-commerce website content requirements.

In the travel and leisure space, we continue to penetrate the gaming sub-vertical. In addition to Bally's, we added another major player in the space. And these newer verticals serve more than just grow our top line. They diversify our traffic load and provide Fastly with a smoother network and compute demand. This leads to higher infrastructure utilization and ultimately gross margin improvement.

We continue to see a tailwind from vendors who exited the space. MoxiWorks, a tech platform for real estate agents and brokers, is a great example of how we capitalize on this disruptive environment. We recently published our new annual global cybersecurity report, The Race to Adapt, uncovering the impacts of cyberattack on leading businesses across the globe and how 76% of businesses surveyed are planning to increase their

cybersecurity budget in 2024. We continue to expand our security offerings to help customers counter these new threats and meet this growing demand.

Fastly was also named a leader in The Forrester Wave: Edge Development Platforms, Q4 2023 report, highlighted by Fastly's Compute platform receiving the highest possible of five out of five in 22 criteria, including vision, innovation, road map, pricing flexibility and transparency. It warms my heart that Forrester state in its report, Fastly is an excellent fit for enterprises seeking to extend their capabilities from the public cloud with a highly performant and secure edge platform. This is exactly what Fastly can deliver. And if any enterprises out there are listening and want to extend their capability to the edge, please give us a call.

We continue to make strong improvements in our gross margins, which was 56.9% in 2023, up 330 basis points over 2022. In the fourth quarter, our gross margin was 59.2%, a 220 basis point increase year-over-year. And note that we recognized a one-time \$2.8 million true-up payment that benefited the quarter. Ron will share more details with you in a minute. But I'm extremely pleased with this result as our gross margin with or without the true-up payment hasn't been this high in almost three years. And while we were within striking distance of 60% in the quarter, we do hope to produce direct hits above 60% in 2024.

Our team executed on controlling our variable cost of revenue, especially with lower bandwidth costs compared to the third quarter on a relatively healthy traffic mix. Our operating loss was \$37 million in 2023, less than half of the \$76 million operating loss in 2022 and better than the original \$53 million to \$47 million our operating loss guidance provided a year ago. In the fourth quarter, our operating loss was only \$2.3 million coming in better than our guidance of \$10 million to \$6 million.

Additionally, we posted positive net income in the fourth quarter for the first time since Q2 2020. Financial discipline and rigor continues at Fastly and this quarter showcases what is possible as we stay focused on this. Ron will explain our outlook and guidance in more detail, but as you can tell from our OpEx spend, we are readying our model to leverage revenue growth and improve our cash flow in 2024.

At the end of the fourth quarter, we brought on Kip Compton, our new Chief Product Officer. Kip brings to Fastly 25 years of senior leadership experience driving innovation, most recently as the SVP of Strategy at Cisco Networking. In his various roles, Kip has directed strategy, technology and investment, and has even, at a prior company, built a CDN for a large media organization. Under Kip's leadership, we will continue to move our product road map towards a more complete platform strategy focusing on unifying, strengthening, simplifying, and always expanding Fastly's edge platform.

In the fourth quarter, we introduced multiple new features on our WAF, including agent auto-update, a simulator for debugging and testing, and Anomaly Signal to detect out-of-band domain requests and Simplified Attack Signal Thresholds.

One feature I want to highlight is our plug-in for Hashicorp Vault. Specifically, the plug-in allows customers to seamlessly access Hashicorp's Vault to store keys for customers' sites and rotate or replace from vault when needed.

We released our observability page, which allows customers to monitor Fastly Delivery and Compute services via collections of metrics and logs. All of this can be viewed in customizable dashboard to give our customers more insight into their inventory of products and features with Fastly, and those that are available for them to buy.

We introduced our Bot Mitigation solution in limited availability to select customers and we're very encouraged by the response and the potential. We'll discuss this further with the investment community next quarter.

Our new packaging motion gained momentum in 2023 and sets us up well for customer acquisition in 2024. I'm pleased to share with you that more customers purchased packages from Fastly in the fourth quarter than the first nine months of 2023 combined. The success of packages gives customers reliable billing and shows their confidence in Fastly by signing up for longer term commitments.

Moving on to our channel partner development, our growth continues. In 2023, deal registration more than tripled that of 2022 and we grew our partner engagement by over 65%. These partners include WWT, Presidio, GuidePoint Security and FHI.

I'm very pleased with the 2023 results and even more excited about the opportunities in 2024. We established our annual guidance of 16% growth to incorporate macro uncertainties, but are, of course, targeting to outperform that guidance with continued financial rigor, strong innovation velocity, strategically lowering the friction of our go-to-market efforts and streamlining both our employee experience and our customer experience.

Organizations around the world invest incredible amounts of time and resources building best-in-class digital experiences only to see the value of them lost by having to compromise between performance, safety and personalization. The solution to this has to be built on the edge and it has to leverage all of the benefits that a best-in-class edge cloud platform brings.

At Fastly, we deliver that platform. We partner with our customers to deliver the best possible end user experience: fast, safe and engaging without compromise.

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'll first discuss some housekeeping items, then I'll discuss our business metrics and financial results, and lastly, I will review our forward guidance.

Note, that unless otherwise stated, all financial results in my discussion are non-GAAP based. We are always focused on providing the most useful business metrics that help investors understand the fundamentals of our business and our progress toward our goal.

Beginning with the first quarter of 2024, we will discontinue disclosing quarterly NRR and DBNER as well as our market, countries and bandwidth statistics. We believe these were used infrequently by the investment community and candidly weren't particularly helpful in understanding our business.

Finally, we will begin disclosing revenue by product area, split between core, growth and emerging products. Specifically, the core segment includes our delivery and network services. The growth segment includes our security offering, and the emerging segment includes our compute and observability offerings. Again, these will commence with our next quarter earnings release and we'll provide further details at that time.

Turning to our financial results. Revenue for the fourth quarter increased 15% year-over-year to \$137.8 million, coming in at the lower end of our guidance range of \$137 million to \$141 million. Revenue from Signal Sciences products was 13% of revenue, a 25% year-over-year increase or 24% increase, excluding the impact of purchase

price adjustments related to deferred revenue. Also, note that we calculate growth rates off the actual result with the percentage of revenue rounded to the nearest whole percent.

In the fourth quarter, we saw traffic expansion at our major customers, coupled with healthy upsell and cross-selling activity. However, we saw weaker international traffic in the fourth quarter, a reversal from what we saw in the third quarter, resulting in lower revenue growth, but higher gross margins, which I'll touch on in a moment.

Our annual revenue was \$506 million, representing 17% growth over 2022 and coming in above our original guidance range of \$495 million to \$505 million provided one year ago. For the fourth quarter, RPO was \$245 million, down 1% from \$248 million in the third quarter of 2023 and up 24% from \$198 million in the fourth quarter of 2022. As our consumption-based revenue model is now being augmented with predictable revenue packages, we believe that RPO will become a more meaningful indicator to the health of our business in 2024.

As Todd shared earlier, we had 3,243 customers at the end of the fourth quarter, of which 578 were classified as enterprise, a net increase of 31 compared to a decrease of four in the third quarter and an increase of 22 in the fourth quarter of 2022. Our trailing 12-month net retention rate was 113%, down from 114% in the prior quarter and 119% in the year ago quarter.

Our annual revenue retention rate, which we reported fiscal year end, was 99.2% for 2023, up from 98.9% in 2022. These figures continue to reflect our very low churn and healthy customer retention dynamic.

Enterprise customers accounted for 92% of total revenue on an annualized basis in both Q4 and Q3, with average enterprise customer spend of \$880,000, up 3% from \$858,000 in the previous quarter and up 7% from \$822,000 in Q4 of last year.

Our top 10 customers comprise 40% of our total revenues in the fourth quarter of 2023, flat with their contribution in Q3, reflecting in part the impact of vendor consolidation and expansion of traffic at some of our largest customers, which also drove one customer to account for more than 10% of revenue in the fourth quarter.

I will now turn to the rest of our financial results for the fourth quarter. Our gross margin was 59.2% in Q4 compared to 55.9% in Q3 of 2023, well above our expectations of a 100 basis point sequential increase.

As I noted in my discussion of fourth quarter revenue, we saw weaker international traffic in the fourth quarter, a reversal from the stronger international traffic we saw in the third quarter, which resulted in lower revenue growth, but had a positive impact on our gross margins.

Our team also executed on controlling our variable cost of revenue, especially with lower transit costs with successful renegotiation of our transit rate in several international markets. As Todd explained, we recognized the one-time \$2.8 million take or pay true-up payment that benefited gross margins in the quarter. Had this benefit not been reflected, gross margin would have been 58.3% in the fourth quarter.

Our 2023 annual gross margin was 56.9%, up 330 basis point over 2022's gross margin of 53.6%. Discounting the benefit of the \$2.8 million true-up in the fourth quarter of 2023 and the \$3.3 million true-up in the fourth quarter of 2022, the gross margin improvement would have been 350 basis points year-over-year.

I'm very pleased with the cross-functional work that took place in aligning our network capacity investments with expected traffic demand, our cost control efforts in bandwidth transit cost and our progress in pursuing beneficial peering relationships. While we have made significant gains in our cost of sales, there's still room for further

improvement as we scale, and we remain committed to demonstrating an 80% incremental gross margin in our financial model going forward. Moreover, the 330 basis point improvement in gross margin year-over-year, coupled with 17% revenue growth, resulted in gross profit growing by \$56 million or 24% over 2022.

Operating expenses were \$84 million in the fourth quarter, a 5% increase compared to Q4 2022 and sequentially flat with the third quarter. Our operating expenses were lower than expected due to continued cost management efforts, and fourth quarter hiring coming in slightly below our expectations.

Recall that our sales and marketing expenses in the third quarter were impacted by one-time marketing expenses related to events and fees, which benefited the sequential comparisons in OpEx. This favorability, combined with gross profit ahead of expectations, resulted in an operating loss of \$2.3 million in the fourth quarter, exceeding the high end of our operating loss guidance range of \$10 million to \$6 million.

For 2023, our total operating expenses were \$325 million, up 5% from \$308 million in 2022. Given our revenue and gross profit growth rates of 17% and 24%, respectively, we were able to leverage our lower OpEx growth to reduce our operating loss margins by more than half, from 17.7% in 2022 to 7.2%. The majority of our OpEx progress was due to companywide financial rigor we've discussed over the course of the year, including notable larger items such as reducing duplicative or unnecessary SaaS and IT tool in our organization.

In the fourth quarter, we reported a net profit of \$1.7 million or \$0.01 per diluted share compared to a net loss of \$9.5 million or an \$0.08 loss per basic and diluted share in Q4 2022, demonstrating our ability to drive towards sustainable profit in our business.

Our adjusted EBITDA was positive in the fourth quarter, coming in at \$11.5 million compared to negative \$0.1 million in Q4 2022. I'm pleased to report that our 2023 full year EBITDA was positive \$15.5 million compared to negative \$32.9 million in 2022.

Turning to the balance sheet. We ended the quarter with approximately \$329 million in cash equivalents, marketable securities and investments, including those classified as long term. We continued our repurchase of convertible debt principal in the fourth quarter, resulting in a reduction of our convertible debt principal balance by more than 50% from \$713.8 million at the end of 2022 to \$346.5 million at the end of 2023.

And specifically, in the fourth quarter, we repurchased \$130.9 million in principal amount of our convertible notes for \$113.6 million in cash or approximately \$0.87 on the dollar. Coupled with a larger repurchase back in May, our 2023 repurchases totaled \$367.3 million in principal for \$310.5 million in cash or approximately \$0.85 on the dollar.

Our free cash flow for the fourth quarter was negative \$21.9 million, a \$2 million sequential decline from negative \$19.7 million in the third quarter. This decline was primarily driven by an increase in our capital expenditures compared to the third quarter.

Our 2023 free cash flow improved by \$113 million over the prior year to negative \$59 million from negative \$172 million in 2022. This year-over-year improvement was driven by approximately a \$70 million increase in cash from operations and a \$42 million reduction in advanced payments for equipment.

Our cash capital expenditures were approximately 11% of revenue in the fourth quarter and totaled 8% for 2023 coming in at the high end of our guidance of 6% to 8% of revenue. As we shared on our Q3 call, we accelerated certain 2024 deployments into late 2023.

As a reminder, our cash capital expenditures include capitalized internal-use software. For 2024, we anticipate our cash CapEx will be in the 6% to 8% range with deployments to be weighted toward the first half of the year.

I will now discuss our outlook for the first quarter and full year 2024. 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 and we undertake no obligation to update these forward-looking statements in the future, except as required by law.

Our first quarter and full year 2024 outlook reflect our continued ability to deliver strong top line growth via improved customer acquisition and upsell and cross-sell expansion in our existing customers, driven, in part, by new and enhanced products. Our revenue guidance is based on the visibility that we have today.

Similar to Q1 2023, we expect revenues to decline sequentially from our seasonally high Q4 results due to lower traffic patterns and the absence of the \$2.8 million take-or-pay true-up recognized in the fourth quarter. For the first quarter, we expect revenue in the range of \$131 million to \$135 million, representing 13% annual growth at the midpoint.

We continue to be very disciplined in our network investment and cost of revenues, which contributed to our fourth quarter gross margins being approximately 200 basis points better than we initially expected. We typically see a seasonal decline in gross margins in the first quarter with improvement in the second half as we build capacity for peak traffic. For the first quarter, we anticipate our gross margins will decrease approximately 100 basis points relative to the fourth quarter, plus or minus 50 basis points.

As we mentioned previously, our Q4 operating loss was moderately better than our earlier expectations on continued cost management and slightly slower hiring. Our first quarter operating results will reflect the impact of the seasonal decrease in gross margin and the impact to our operating expenses of first half employer payroll tax increases. As a result, for the first quarter, we expect our non-GAAP operating loss to increase to a loss of \$14 million to \$10 million and our non-GAAP net loss to be \$0.09 to \$0.05 per share.

For calendar year 2024, we expect revenue in the range of \$580 million to \$590 million, an annual growth rate of 16% at the midpoint. This guidance reflects our expectation for quarter-on-quarter acceleration in revenue growth through the year, driven by new customer acquisition and continued expansion of existing customers.

We expect to continue to see gross margin improvement in 2024 and to continue our spending discipline while increasing our investment in go-to-market and product development. We anticipate our 2024 gross margins will improve by approximately 200 basis points, plus or minus 100 basis points relative to 2023, and to exit the year with gross margins at 60% or better.

As a result, we expect our non-GAAP operating loss to improve to a range of \$20 million to \$14 million, reflecting an operating margin of negative 3% at the midpoint, an improvement of over 50% over 2023's operating loss margin of 7.2% and by over 80% over 2022's operating loss of 17.7%.

We expect our non-GAAP net loss per share to improve to \$0.06 to breakeven, reflecting the improvement in our operating loss expectations. And we expect free cash flow to be breakeven in 2024 compared to negative \$59 million in 2023.

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

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. [Operator Instructions] Your first question comes from the line of Fatima Boolani from Citi. Please ahead.

**Fatima Boolani**

*Analyst, Citigroup Global Markets, Inc.*

Q

Good afternoon. Thank you for taking my questions. I wanted to ask about the backlog performance in the quarter. You did have some prepared remarks around it, but it really isn't typical to see a sequential decline in backlog. And certainly, we couldn't find an instance of this in our model going back several years. So I was hoping if you could unpack with a little bit more detail as to that sequential decline. And to the extent some of the package momentum, how is that really going to help blunt some of these impacts? And then I have a quick follow-up as well, please. Thank you.

**Ronald Wayne Kislring**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah. On the RPO, what we have seen at the beginning of the year was a pretty big increase as we've been focusing on building multiyear commitments. What that drove was, when you do a one or two-year commitment, larger amounts, and so those were with some of our largest customers. And so as those burn down, you're going to see a little more, quarter-to-quarter, I guess, fluctuation as they come down.

And over time, I think looking at it on a year-over-year basis, is probably going to be important, particularly given the Q4 being our highest quarter, you're going to see some of the biggest usage of those commitments during the fourth quarter.

**Todd Nightingale**

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

A

Yeah. Fatima, I think it's a great question. I think the point on RPO is right. I think we're going to see – we are going to see some choppiness in that number, but the package momentum has been great. That's the packaging is just one way so that we drive RPO, large annual contracts with a annual commit like the one that we had a true-up payment for in Q4. That's the other way that we see RPO driven up.

But on packaging, it really – it was an amazing result in Q4, which gives us a ton of confidence, not just in the mid-market side of the house but even in large enterprise accounts. And I think that really demonstrates that there's a desire in the market for reliable pricing and a simpler all-in construct for edge cloud that resonates up and down the market. So we're going to continue to invest there for sure.

**Fatima Boolani**

*Analyst, Citigroup Global Markets, Inc.*

Q

I appreciate that. And Todd, since I have you, can you speak to any succession planning or any updated thought processes in place with regards to the Chief Revenue Officer seat? I understand that Brett left the company later in the quarter. So just wanted to get a sense of where the management team is at with respect to filling that

vacancy. And to the extent that maybe had an impact on the quarter as well, if you can speak to that. Thank you very much.

**Todd Nightingale**

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

A

Sure. I absolutely. I really don't think it had any impact on the quarter. Remembering that Brett left the company very late in the quarter, and to be honest, he left an extremely strong sales team, both on the regional and account side, but also on the sales ops front. So we've been super happy with the team operating as it is.

That being said, we realize this is an incredibly important role for the company, especially as we run a true CRO model at Fastly, both on – as the role covers both the sales side of the house as well as the customer success side of the house. We're going to be very, very methodical in choosing the absolute best candidate for that role. To that end, we're in the process of retaining one of the top recruiting agencies in the world for CRO roles. And we've already, even before that, begun discussions with key candidates, as we speak.

**Fatima Boolani**

*Analyst, Citigroup Global Markets, Inc.*

Q

Thank you.

**Operator:** Your next question comes from the line of Madeline Brooks from Bank of America. Please go ahead. Madeline, your line is open.

**Madeline Brooks**

*Analyst, BofA Securities, Inc.*

Q

Hey, team. Can you hear me?

**Todd Nightingale**

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

A

Yeah.

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah.

**Madeline Brooks**

*Analyst, BofA Securities, Inc.*

Q

Okay. Perfect. Sorry about that. I guess I just want to dig a little bit into expectations and visibility for next year. I think, candidly, the guidance came in a little bit light versus Street expectations. So just want to hear where you're seeing both strength for this coming year. Is that in security, compute? And maybe where is the weakness coming from, of course, outside of the macro comments and just more specific to Fastly?

**Todd Nightingale**

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

A

Yeah, totally. From a portfolio point of view, pretty happy actually. The way the mix is evolving and the excitement around compute continues to build. And so from that point of view, we've been pretty steady and I think the progress is really good.

I think the macro is a big deal for us, for sure, and we want to make sure that we are being conservative and taking into account that uncertainty. We, of course, have a desire to overachieve on that guide, but we – yeah, we know that there is macro risk, just like all of you do.

That being said, the new customer acquisition motion and the engine that we've been building here, not just with packaging but with the efforts in channel, the focus on demand gen and especially, really creative demand gen engine being built right now in marketing team, we are really happy to see the indicator that that trajectory is changing. And I believe that is the real key to moving the needle and driving up that guidance in future reports. So that's what we'll be focusing.

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**Madeline Brooks**

*Analyst, BofA Securities, Inc.*

Q

And just one follow-up question for you, Todd. On the macro commentary, did anything get worse in the last quarter versus 3Q? I mean, is that 3Q is really kind of the first quarter we heard from you guys macro, a lot of your competitors and the rest of software started talking about macro much earlier. So just wondering if we should view this as hitting Fastly a little bit behind the ball compared to the industry or if something has materially changed from your perspective?

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**Todd Nightingale**

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

A

No, I think it was pretty much as we saw it last quarter. A handful of deals maybe taking a little longer than we thought, a little bit of deals elongation. But now that we are seeing some of it, just like we saw last quarter, we saw it this quarter again, we wanted to make sure we built it into the guide and not get ahead of our skis for 2024.

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**Madeline Brooks**

*Analyst, BofA Securities, Inc.*

Q

Got it. Thank you so much.

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**Todd Nightingale**

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

A

Sure.

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**Operator:** Your next question comes from the line of Frank Louthan from Raymond Stanley – I'm sorry, Raymond James. Please go ahead.

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**Frank G. Louthan**

*Analyst, Raymond James & Associates, Inc.*

Q

New firm, be a household name any day. Great. So you've talked about bringing on some products that are more recurring revenue in nature. Maybe walk us through those and how that's going to fit the – fit in into the revenue mix going forward? And then kind of a follow-up, where are you with sort of the converged ability – ability to sell the converged, both delivery and Signal Sciences with the sales team? Thanks.

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**Todd Nightingale**

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

A

Yeah. Great. We should mention all of our portfolio is recurring revenue. It's just on a utility billing motion largely and – or it has traditionally been on a utility billed motion, which is I think amazing for large, and especially, particularly sophisticated users who want to lean in and control their usage byte for byte. But for folks who are looking for a more turnkey solution and perhaps a more holistic strategic partner, it can help, it can be a great opportunity just to buy edge solutions, like ours as a SaaS product, a straight SaaS style, billed with predictable, regular recurring revenue. And that's what our packages are. So all of the – all the discussion, all the mention in the report here on the new packaging model, it's built around that model, predictable billing, monthly commit, regular recurring revenue.

It gives our sales team the opportunity to easily cross-sell from one product line to the next to continue to land and expand and grow the customer over time, but it gives the customer the sort of ease of use financially of knowing what their bill will be every month. And so that's been very successful for us so far. They've been in the market for about a year and we're pretty happy with that result.

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**Frank G. Louthan**

*Analyst, Raymond James & Associates, Inc.*

Q

All right. Great. Thank you.

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**Todd Nightingale**

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

A

Sorry, Frank. Did I miss the second part of your question? I just want to make sure I got the second part.

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**Operator:** Frank, can you press star one again, please?

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**Todd Nightingale**

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

A

Sorry, [ph] ma'am (00:39:11).

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**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Being able to sell the consolidated security.

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**Todd Nightingale**

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

A

Oh, sorry. You asked about product unification and being able to sell Signal Science and the traditional Fastly portfolio as well. We've made amazing progress actually and our customers are seeing that. There's amazing unification in the UI and a panel that allows you to simply flip between the two.

We're not done yet. We've got a full single sign-on offering that's going live this week or next week, rather. And then a new navigation, which will be really a super seamless user experience, which will be coming out at the end of the quarter, which I'm super excited about. And I think at that point, we'll have a really best-in-class unified edge platform for delivery, network services, compute, security and observability, which to me is really where we want to be. That's a cutting-edge edge cloud platform with a suite of solution that allows just about any organization to move to a Fastly edge for the best possible user experience.

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**Operator:** Your next question comes from the line of Jonathan Ho from William Blair. Please go ahead.

**Jonathan Ho**

*Analyst, William Blair*

Q

Hi. Good afternoon. I just wanted to get a little bit of additional color on what happened with international. And can you maybe help us understand what changed relative to your expectations and what do you sort of expect to persist? I know there were some macro commentary, but would you expect to persist on international into 2024?

**Todd Nightingale**

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

A

Yeah. It's important to note the difference between the mix of international business versus what shows up as international traffic on our platform. So our mix of international business was pretty much as we predicted.

We ran 27% of our revenue international this year, up from 26% in 2022. We expect that trend to continue, a slow increase, a slow balancing of our revenue globally. But this particular quarter what happened was that some of our traffic mix from, really, to be honest, one particular country with a very high rate slowed down. That traffic wound up landing in other regions. And because of that traffic change, we wound up with a little bit of headwinds to revenue, as Ron said earlier, but a little bit of tailwind to gross margin.

And what I mean by that is traffic that lands in that particular country tends to be billed at a high rate, but it is less profitable for us. And so we see that in the numbers and that is a reality that showed up in our numbers this quarter. So you'll see better profitability because of that traffic shift, but a little headwind to the top line. Anything to add, Ron?

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

No.

**Todd Nightingale**

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

A

Great.

**Jonathan Ho**

*Analyst, William Blair*

Q

Great. Just one additional question in terms of net retention and the DBNER trends over time. Can you give us a sense of – you signed this large cohort of new enterprise customers. Are they fully contributing out of the gate or would you expect this group to maybe increase spend over time and maybe start helping those trends out? Thank you.

**Todd Nightingale**

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

A

Yeah. I 100% expect the new enterprise customers and really all new customers be helping that trend out over time. In fact – and this is sort of an interesting reality to Fastly's business and I think most SaaS utility billed businesses is LTM NRR, even DBNER, is actually highly dependent on new customer acquisition because customers ramp their spend pretty hard over the first 3 years, 2.5, 3 years and then that ramp tends to tail off. It continues to grow, but at a slower rate. And you could get pretty good data on those trends if you looked at our disclosures from Investor Day earlier in 2023. We presented a graph on exactly that phenomenon.

And so, yeah, I think your point – your question is the right one. Those – that surge in new customer acquisition will absolutely help us drive better LTM NRR rates in the next two years.

**Jonathan Ho**

*Analyst, William Blair*

Q

Thank you.

**Todd Nightingale**

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

A

Sure.

**Operator:** Your next question comes from the line of Tim Horan from Oppenheimer. Please go ahead.

**Timothy Horan**

*Analyst, Oppenheimer*

Q

Thanks, guys. Can you talk a little bit more about the distribution business? How does your kind of quality compare to your peers out there and maybe pricing? And are you thinking of more major sporting events because of the improvement in quality?

**Todd Nightingale**

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

A

When you say distribution, you mean like CDN content distribution, right?

**Timothy Horan**

*Analyst, Oppenheimer*

Q

Yes. Yes.

**Todd Nightingale**

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

A

Yeah. Yeah. Sorry about that. Sometimes we call it delivery distribution. Yeah. Look, I think this is an area where we believe we've got a very strong competitive advantage from a performance point of view, and in many major markets, a capacity point of view. The one [ph] hole (00:44:45) I think that we are continuing to grow into is that true, like, longest tail of global coverage. And we're continuing to evolve there, but competitively in major markets, we feel extremely strong about our performance advantage.

We also are extremely proud of the feature completeness, the fact that our security and our compute portfolio is available on every single node. That delivery is available on. Our customer never had to trade those things off. Our edge is fully capable everywhere that it exists around the world, and that gives us a boost when it comes to content delivery as well.

So we are feeling pretty good about that. Live sporting events or any live events, we're starting to see some interest in other kinds of live events as well is, I think, a huge win for us, and that continued trend towards more live events can only help Fastly. It's an area where our differentiation just continues to be [ph] very strong (00:45:49).

**Timothy Horan**

*Analyst, Oppenheimer*

Q

And is your offering improving over the last couple of years in terms of lower latency, more capacity, low jitter, et cetera?

**Todd Nightingale**

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

A

Absolutely. But both performance, like you said, lower latency, greater capacity, closer – distributing our nodes closer and closer to the user, but also just the completeness of the platform, the feature set, the flexibility that it gives. One thing I think we're going to start to see in live events is an increase in broadcasters trying to combat piracy and advanced feature set at the edge really matters there and advanced focused on more personalization, not just on the ad flow, but other parts of the experience. Again, advanced feature set is going to matter there. We're very proud of the performance of our infrastructure, especially in terms of live of events, but the feature set is just as important.

**Timothy Horan**

*Analyst, Oppenheimer*

Q

Very helpful. Thank you.

**Operator:** Your next question comes from the line of Jeff Van Rhee from Craig-Hallum. Please go ahead.

**Jeff Van Rhee**

*Analyst, Craig-Hallum Capital Group LLC*

Q

Great. Thanks for taking the questions. I've got a few. Just on the new customer numbers, good to see the enterprise capture number strong. It didn't transition or translate to the RPO acceleration. Were the initial landing size of these customers as large as expected? Were they potentially smaller deals? That's one. And two, just in terms of the pipeline, have you turned the corner? And is this a new repeatable level of enterprise adds quarterly?

**Todd Nightingale**

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

A

Yeah, great question. As far as the new customer adds and like their average size, I can't – we don't disclose the size of new enterprise customers, but the average enterprise customer size increased. And I think those new customer, enterprise customers I would call typical. Yeah. We don't have [indiscernible] (00:47:45)

**Jeff Van Rhee**

*Analyst, Craig-Hallum Capital Group LLC*

Q

I missed that. You'd call them what? What was that?

**Todd Nightingale**

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

A

They're typical of our other enterprise customers. They're not smaller, they're not bigger. As far as the trajectory goes, it's absolutely our intention to maintain that level. We'll be pushing hard to do so. I'm sure, of course, there'll be fluctuation as there always is, but I believe we have an opportunity to achieve levels like that moving forward and we're going to keep that.

**Jeff Van Rhee**

*Analyst, Craig-Hallum Capital Group LLC*

Okay. And then if I look at the...

Q

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

Jeff, I would add on...

A

**Jeff Van Rhee**

*Analyst, Craig-Hallum Capital Group LLC*

Go ahead.

Q

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

I was going to add on the RPO, the mix of which of those customers when we sign new enterprise customers that actually have a commit, not all of our customers have a commit. To the extent they do a consumption-based deal with no commit, it's not going to show up in the RPO. So that is also something to think about that there's not 100% translation for new customers into the RPO.

A

**Jeff Van Rhee**

*Analyst, Craig-Hallum Capital Group LLC*

Yeah, got it. And then if I look at the overall guide, just the acceleration that you're looking for throughout the year, the quarter's a bit below, Q1 looks a bit below, but the year kind of brackets the consensus on top line and it implies acceleration. What's the visibility to that? What do you have to assume there? What are you assuming in terms of like the international weakness thus far? Does that have to improve materially? Do you assume continued international weakness to hit that back half of the year? Just give us maybe a little more comfort where you're getting your conviction later in the year.

Q

**Todd Nightingale**

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

Yeah. Great question. And we look at that very carefully because I guess we knew we'd have this question. We project the revenue down to the account level for a very large number of accounts and look at the trend across the board. And this is the best projection we've got. I feel very, very confident in it.

A

As far as the international traffic goes, if we saw another surge in one of those more high-priced regions, you'd expect that to be a tailwind to revenue in any quarter that it happened. If we saw a particular large strategic new customer come onboard, we could again see a tailwind.

As far as the Q1 number versus the rest of the year number, our projection is for the full year and we're trying to track it very, very carefully. The biggest thing you're seeing in Q1, I think, is the step down from a one-time true-up payments from Q4 to Q1, which, yeah, our model obviously takes into account. So we see that. But the driving the continued growth, right, through the rest of the year, I think it is, in fact, sort of like the baseline for our projection.

**Jeff Van Rhee**

*Analyst, Craig-Hallum Capital Group LLC*

Q

Okay. And maybe, sorry, just to go back, if I could, one more on international, just to understand. It sounded like you were – I guess I'm a little confused. You're saying some of the revenue shifted from one country to another. It sounded like it might be very concentrated. I don't – were you suggesting it was concentrated to a specific customer? Just indulge me there and maybe just explain that one more time.

---

**Todd Nightingale**

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

A

Yeah. Some traffic moved out of one country. So there's a handful of countries in the world where delivery services are just very expensive because of the way Internet service providers and technology vendors operate in that country and the rate is very high, and we don't pass all of that cost onto our customers. So because of that, the margins tend to be very low. When we see a spike of traffic in a region like that, we see an increase in the top line, but a headwind to gross margin. And we saw that in Q3 and we saw it come down in Q4, which was the headwind on the top line and the tailwind on gross margin. We try our best to project that – to predict and project that, but that is what happened.

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**Operator:** Your next question comes from the line of Rudy Kessinger from D.A. Davidson. Please go ahead.

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**Rudy Grayson Kessinger**

*Analyst, D.A. Davidson & Co.*

Q

Hey. Thanks for taking my questions. Just to follow on to that. I mean, just with this traffic being lower in this one country, was that from your largest customer that's over 10%? And secondly, what was the reason for the lower traffic in that one country? Was – did they – did you lose share to another provider? What was the – was it not enough new content in the quarter? Was it live sporting event related and not as much viewership? What was the reason for the lower traffic in that one country?

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**Todd Nightingale**

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

A

Sure. I can't comment on which customer it was from, but it's just a natural variability like you said, how much new content or what types of content are being published in a particular region for streamers has volatility. When it comes down to the granularity of a single country in the world, you get volatility in that space. And so that's what we saw.

We tried to make sure that our 2024 projections are really the baseline traffic in countries like that. And if we see surges, then they'll show up as a tailwind moving forward.

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**Rudy Grayson Kessinger**

*Analyst, D.A. Davidson & Co.*

Q

Okay. Ron, and two just kind of housekeeping clarification questions. Revenue acceleration on a year-over-year growth basis every quarter, so Q2 growth should accelerate from Q1. And then on gross margins, you said Q1 down about 100 basis points versus Q4. Is that versus the reported 59.2% or the adjusted 58.3%?

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**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

A

Yeah. So I guess on the latter one, just to clarify, that's against the reported 59.2%, so it's 100 basis points plus or minus against what we actually reported.

In terms of the acceleration, I mean, I think you will see it across the course of the year. I think I expect that to be generally in line with what we've seen historically from a seasonality and some acceleration across the year.

**Operator:** Your next question comes from the line of Angie Song from Morgan Stanley. Please go ahead.

**Angie Song**

*Analyst, Morgan Stanley & Co. LLC*

Hi. Can you guys hear me?

Q

**Todd Nightingale**

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

Yes.

A

**Angie Song**

*Analyst, Morgan Stanley & Co. LLC*

Perfect. Thanks so much for taking my question today. So just wanted to dig in on gross margins. You mentioned that 80% incremental gross margin. Could you just speak to what drive this? And on the 60% margins, is it somewhat more aspirational or is this something that you have a line of sight on?

Q

**Ronald Wayne Kisling**

*Chief Financial Officer, Fastly, Inc.*

Yeah. I think on the latter question, in terms of our outlook for gross margins for 2024 and achieving, by year-end, margins at the 60% or a little above that is – it's really our plan. We have a line of sight to it. It is continued rigor and our investments in capacity. It's continuing to improve our bandwidth, our transit costs through both negotiations and increasing our peering. It's network efficiency.

A

And then, as we just continue to grow, it allows us, particularly international, to improve our cost structure. And so those are kind of the big drivers that give us line of sight to that improvement that we expect to continue to see that improvement across 2024. [indiscernible] (00:55:37)

**Operator:** Your next question comes from the line of Rishi Jaluria from RBC Capital Markets. Please go ahead.

**Rishi Jaluria**

*Analyst, RBC Capital Markets LLC*

Wonderful. That's a new way to pronounce my name. This is Rishi Jaluria from RBC. Thanks so much for taking my question.

Q

Maybe I want to start with just looking a little bit closer at Signal Sciences. We saw a little bit of a slowdown after a few quarters of acceleration. I know there is obviously comps and scale and everything like that. But just any color on what drove that and how we should be thinking about that growth going forward? And then I've got a quick follow-up.

**Todd Nightingale**

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

Yeah, it's a great question. We see a little bit of a – we always see a little bit of a surge in delivery in Q4. And so the security growth can tend to slow down a little bit. But I'll check into it, but it hasn't been a huge shift there. The

A

sales motion seems to be running pretty smoothly. There could be that we have a little bit of a backup on folks who are waiting for that unified experience coming out this quarter, which will be exciting. But we've been pretty confident in that security side of the business this quarter.

**Rishi Jaluria**

*Analyst, RBC Capital Markets LLC*

Q

Okay. Got it. That's helpful. And then maybe just sticking with security, as you have the new bot management product out there, what sort of early feedback have you gotten from select customers that are actively using it in production today? Thanks.

**Todd Nightingale**

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

A

Yeah. We've had some really solid feedback. In fact, we had a couple of customers actually make purchases in Q4, even though it was just an early availability. That was a nice confidence. I think it showed a maturity in our beta motion.

I'll tell you the biggest piece of feedback that I've heard is just a very broad interest in this technology, and that's been great, and a ton of interest in expanded feature sets. We are starting to look at productizing some private access tokens as part of that solution as well because we've gotten just so much interest in that side of the house. I think there's a ton of revenue opportunity here for our security portfolio on the bot side and we're going to be pushing that.

I think it's easy to imagine that the only people who would be super motivated around bot management might be like big, incredibly [indiscernible] (00:58:12) retailers that do big product drops, but it's not true. It's a pretty broad – broadly applicable product with a bunch of use cases, some as simple as customers who don't want their competitor scraping their data off the website – off their websites. And that's super interesting. And it's something we're going to be pushing hard at and continuing to invest in.

I think even as we go GA this quarter, we're going to continue to add functionality here for probably for years to come. There's a ton of interest and a ton of innovation here.

**Rishi Jaluria**

*Analyst, RBC Capital Markets LLC*

Q

Wonderful. Thank you so much.

**Todd Nightingale**

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

A

Welcome.

**Operator:** That concludes our question-and-answer session. I will now turn the call back to Chief Executive Officer, Todd Nightingale, for closing remarks.

**Todd Nightingale**

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

Thanks, everyone, for joining us on Valentine's Day. I want to thank our employees, customers, partners and investors. We remain focused on execution, bringing lasting growth to our business and delivering value to our shareholders.

Let me close by saying I believe digital experiences will drive the mission and define the success of almost every organization everywhere, and Fastly will have a significant impact on the way digital experiences are built and delivered around the world. Our customers have a real passion for Fastly solutions and our employees have real enthusiasm for Fastly's mission to make the Internet a better place, where all experiences are fast, safe and engaging.

Thank you so much.

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**Operator:** This concludes today's conference call. Thank you for your participation and you may now disconnect.

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