Corrected Transcript

01-May-2024

Fastly, Inc. (FSLY)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, good afternoon. My name is Abby, and I will be your conference operator today. At this time, I would like to welcome everyone to the Fastly First Quarter 2024 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. And after the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

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

Vernon P. Essi

Vice President-Investor Relations, Fastly, Inc.

Thank you, and welcome everyone to our first quarter 2024 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 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 risks factors for our business, please refer to our filings with the SEC, including our most recent annual report filed on Form 10-K and Quarterly Report filed on Form 10-Q, filed with the SEC and our first quarter 2024 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, and 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. Reconciliation 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.

Now I will turn the call over to Todd. Todd?

Todd Nightingale

Chief Executive Officer & Director, Fastly, Inc.

Thanks, Vern. Hi, everyone, and thanks so much for joining us today. First, I'd like to give a quick summary of our first quarter financial results and related highlights. I'll then discuss our revised revenue outlook and provide an update to our go-to-market initiatives and customer acquisition as it relates to our path forward to drive revenue growth. I will then hand the call over to Ron to discuss the changes in our metrics, our first quarter financial results and our guidance in detail.

I'm pleased that we reported revenue of $133.5 million in the first quarter, representing a 14% year-over-year growth and coming in above the midpoint of our $131 million to $135 million guidance range. Our customer growth and retention efforts showed improvement in the first quarter with our LTM NRR at 114%, up slightly from Q4's level of 113% and reversing quarterly declines in this metric since the end of 2022. Our total customer count in the fourth quarter was 3,290, which increased by 47 customers compared to Q4 and by 109 year-over-year. Enterprise customers totaled 577 in the quarter, a decrease of one from Q4. We brought in 18 net new enterprise customers at the $100,000 annual revenue threshold in the quarter. This was mostly offset by customers that dropped below this threshold due to seasonality. On a year-over-year basis, we grew our enterprise customer count by 37.

Our gross margin continues to improve and was 58.8% in the first quarter, up 320 basis points year-over-year and ahead of our expectations. Our operating loss was $9.7 million in the first quarter compared to an operating loss of $14.1 million in the first quarter of 2023. I'm very pleased with this result as our loss was materially better than our guidance of $14 million to $10 million. The upside was roughly split between higher gross margins and better OpEx cost control. And Ron will share more details with you in a moment. Lastly, we posted positive $3.7 million in adjusted EBITDA and importantly, an $11.1 million positive cash flow from operations. I'm pleased with the continued momentum on operational execution here, especially as it helps us fuel growth moving forward.

Now, let me discuss the highlights of the quarter. In the first quarter, we continue our success in diversifying our logo wins and penetrating new and existing customer verticals. We had amazing wins in the healthcare sector during the first quarter with a leading health solutions company, a major government research agency and a leading imaging provider. These key lighthouse accounts will help us accelerate more customer acquisition in healthcare, drive growth in an important sector and deliver better vertical differentiation to our business. The healthcare industry has always been focused on reliability and performance, making Fastly a perfect fit. We continue to penetrate the mobile app market in high tech. In the first quarter, we won Bending Spoons, a leading mobile app developer serving over a half billion people across the globe.

In France, we are now supporting MWM a top app publisher which selected Fastly's content delivery and image optimization services to support its AI-driven model. In the business services vertical, we're proud to announce that a leading customer data platform will be onboarding with Fastly. We also won one of the world's largest realtor companies with over 100,000 agents in over 100 countries. It's a great example of how we landed in the real estate vertical with MoxiWorks, which we discussed last quarter. And we're able to build upon that vertical expertise with this new real estate win.

In the first quarter, we introduced Fastly Xcelerate, a series of in-person global events developed exclusively for Fastly's customer network of developers, security professional and business leaders. The first event was held at our headquarters in San Francisco on April 4 and was widely attended. We will be following up with similar events worldwide in 2024 with London, New York and Sydney to follow.

Lastly, I'm pleased to announce that Fastly's [ph] OHTTP Private Relay (00:06:54) won the 2024 DEVIES award for best innovation in services: application development. Our solution is widely used in the top web browsers on the Internet to help extend privacy to millions of users and beginning to find other use cases in privacy and security.

In the first quarter, we continue to drive focus and investment into platform unification and expansion. We enabled self-service adoption with a universal login feature across our solutions and improved product trials and upgrades platform wide. Expanding our platform is key to our platform strategy, and that's why I'm so excited for Bot Management becoming generally available in Q1. Our Bot Management Solutions combat automated bot attacks at the edge and significantly reduces the risk of fraud, distributed DDoS attacks, account takeovers and other online abuse.

This is an important cybersecurity milestone for the company, significantly expanding our security offering. Our DDoS services best-in-class WAF and Bot Management Solution make up an incredibly tight, complete security offering in the web application and API security space. We've already seen significant uptick here and it's great to see both customer expansion and acquisition leveraging this new capability so quickly.

Security is a great example of innovation velocity of Fastly. Our WAF continues to be highly differentiated with low false positives and a predominance of customers operating in full blocking mode. Our Bot Management Solution was 100% developed in-house and is already competing well against the most mature products on the market. And there is significant innovation and product enhancement to come. We set up a very strong foundation in 2023 with our newly introduced packaging motion that gained momentum throughout the year. In the first quarter of 2024, we updated Fastly packages by launching observability SKUs, fixed price add-ons and enhancements to our packages, especially in security to continue delivering simplicity, value and choice for our customers. I'm excited to share with you that in the first quarter we already exceeded all the customer packaging purchases sold in the first half of 2023.

Our packaging motion gives customers reliable billing and shows their confidence in Fastly by signing up for longer-term commitments. Package billing provides predictable pricing for our customers and predictable reliable revenue for Fastly. Additionally, our channel program continues to grow and mature. In the first quarter, deal registrations and revenue contribution more than doubled year-over-year. In fact, for the first time, the largest deal in a quarter closed through a channel relationship. Our channel partners continue to have strategic importance in our go-to-market efforts.

Our CRO search has been a key focus this quarter. I'm happy with the progress we've made as we're now in the final stages. We've interviewed numerous candidates to find the right expertise and the balance of operational expertise and the strategic ability to grow and scale. I'm pleased that we've narrowed our candidates down to just a handful, and we should have a selection finalized within a few weeks. I expect to announce a new Chief Revenue Officer in the second quarter.

Now, let me turn to address our outlook going forward. Our second quarter guidance of 6% to 9% year-over-year growth and modified 2024 annual guidance of 12% year-over-year growth are not where we expected our business to perform and of course are disappointing. Ron will discuss the financial details of this forecast in a moment. But let me first address this outlook and our path forward. There are a few factors that contributed to a challenging short-term environment. The biggest factor is a reduction of revenue from a small number of our largest customers. The first quarter revenue from our top 10 customers dropped from 40% to 38%. Many of the top 10 accounts were on a multi-vendor strategy, and we did see significant volatility here. And there are few reasons for this.

Firstly, historically, Fastly has gradually won greater traffic share on our largest accounts. But with the timing of rate and volume changes, we saw increased volatility this quarter. To be clear, we have not been removed from any of our largest customers and we remain in a strong strategic position with each of them long-term. Secondly, in some accounts, we did see an addition of CDN vendors, a reversal of the vendor consolidation we saw last year. And thirdly, we are seeing a slight uptick on the typical level of rerates with our largest customers, but we have not yet seen the commence or a traffic expansion usually associated with this motion.

Very positively, we are seeing continued success with the new customer acquisition motions and notably added two very large new logos in Q1, one of which will move into the top 10 over the course of the year. We aim to see the long-term results of our new customer acquisition motion having an increasing effect on our revenue as the year goes on.

Going forward, we strongly believe our strategy is correct and we will remain committed to our focus on growth. We will continue to invest in our customer acquisition and go-to-market motions. We are shifting the way we engage with our largest multi-vendor customers to focus on improving our visibility and driving traffic and revenue share in those accounts. We remain committed to platform unification and expansion, helping us drive cross-sell and growth. We will continue to drive engineering investment in this effort, coupled with the expansion of our security portfolio with Bot Management to drive stickiness and wallet share with our customers. As a backdrop to these investments, we will continue to drive discipline in managing our spend with a clear focus on efforts leading to long-term growth.

In summary, we are pleased with our first quarter performance, but we are not satisfied with our Q2 outlook and 2024 guidance. We're laser-focused on revenue growth initiatives, innovation, velocity and customer acquisition. And now to discuss the financial details of the quarter and guidance, I will turn the call over to Ron. Ron?

Ronald Wayne Kisling

Chief Financial Officer, Fastly, Inc.

Thank you, Todd, and thanks everyone for joining us today. I'll first discuss changes to our metrics disclosures before turning to our financial results and business metrics. I will then review our forward guidance. Note that unless otherwise stated, all financial results in my discussion are non-GAAP based. We continue to focus on sharing the business metrics that provide the most useful information to understand and monitor the progress of our business. Beginning with this first quarter 2024 release, we have discontinued the disclosure of quarterly

NRR, DBNER, the number of markets and countries and our bandwidth statistics. Conversely, we are now disclosing our revenue by product line between network services, which is our core delivery products offering; security, which is our growth offering; and other, our emerging products offering, which includes compute and observability products.

We have provided a trended eight quarter history of this revenue in our investor supplement because we are now providing revenue from our full security portfolio. We will no longer be reporting Signal Sciences revenue on a standalone basis. Signal Sciences acquired Firewall Solution has been integrated with Fastly's legacy firewall, which we now refer to as our Next-Gen WAF. Our legacy firewall revenue has largely transitioned into the Signal Sciences WAF or Next-Gen WAF. Note, that our combined security revenue reflects the impact of the decline in our Legacy WAF revenue taking place during that integration. Lastly, as our supplement only includes the trailing eight quarters, I will provide the revenue breakout for the first quarter of 2022 here in my prepared comments.

Network services revenue was $83.9 million. Security revenue was $18.2 million. And other revenue totaled $0.3 million. Turning to our financial results, revenue for the first quarter increased 14% year-over-year to $133.5 million, coming in slightly ahead of the midpoint of our guidance range of $131 million to $135 million. Specifically on our two largest product lines, network services grew 12% year-over-year to $106 million. And security revenue grew 16% year-over-year to $24.6 million.

In the first quarter, we experienced normal seasonal traffic pattern. This resulted in a sequential decline in revenue highlighted by expansion in some areas, particularly gaming, offset to a lesser degree by e-commerce-related traffic and lower traffic at our largest customers. Our top 10 customers comprised 38% of our total revenues in the first quarter of 2024, compared to 40% in Q4 2023, reflecting the impact of lower traffic at our largest customers. Also, no customer accounted for over 10% of revenue in the first quarter.

Our trailing 12 months net retention rate was 114%, up from 113% in the prior quarter and down from 116% in the year ago quarter. These figures continue to demonstrate our very low churn and healthy customer retention dynamics. At the end of the first quarter, our RPO was $227 million, down 4% from $236 million in the fourth quarter of 2023. And down 6% from $242 million in the first quarter of 2023. This decline is primarily due to our largest customers working through the remaining obligations over their contract term.

As Todd shared earlier, we had 3,290 customers at the end of Q1, of which 577 were classified as enterprise. A net decrease of one compared to an increase of 31 in the fourth quarter. Enterprise customers accounted for 91% of total revenue on an annualized basis in Q1, compared to 92% in Q4. And enterprise customer average spend was $846,000, down 4% from $880,000 in the previous quarter, and up 6% from $795,000 in Q1 of last year.

I will now turn to the rest of our financial results for the first quarter. Our gross margin was 58.8% compared to 59.2% in the fourth quarter of 2023. Recall that fourth quarter gross margins were 58.3% after adjusting for the onetime $2.8 million take or pay true-up payment, reflecting a 50 basis point quarter-over-quarter improvement. Our gross margin improvement was a result of continued cost control efforts in bandwidth transit costs and related services costs.

Operating expenses were $88.2 million in the first quarter, an 11% increase compared to Q1 2023 and up 5% sequentially from the fourth quarter. While our operating expenses were better than expected due to our continued management of cost. Remember that we do see a seasonal increase in our employee costs in the first half of the calendar year the increased employer payroll taxes. This favorability in our operating expenses combined with slightly better than expected gross profit, resulted in an operating loss of $9.7 million in the first quarter, exceeding the high end of our operating loss guidance range of $14 million to $10 million.

In the first quarter, we reported a net loss of $6.5 million or $0.05 loss per basic and diluted share compared to a loss of $10.8 million or $0.09 loss per basic and diluted share in Q1 2023. Our adjusted EBITDA was positive in the first quarter, coming in at $3.7 million compared to negative $1.9 million in Q1 2023.

Turning to the balance sheet, we ended the quarter with approximately $331 million in cash, cash equivalent marketable securities and investments, including those classified as long-term, up from $329 million at the end of Q4 2023. Our free cash flow for the first quarter was negative $2.2 million, a $19.7 million sequential increase from negative $21.9 million in the fourth quarter. This increase was primarily driven by an increase in our cash from operations to positive $11.1 million, compared to negative $7.4 million in the fourth quarter.

Our cash capital expenditures were approximately 9% of revenue in the first quarter coming in just above the high end of our guidance of 6% to 8% of revenue we shared on our Q4 call. 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 second quarter and full year 2024. I'd like to remind everyone again that the following statements are based on current expectations as of today 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.

As Todd shared in his remarks, we are facing a challenging environment of revenue declines in our largest customers, overshadowing the impact of new customer acquisition and product pipeline. Our guidance reflects these dynamics in our business and the visibility that we have today. We expect a flattish to modest sequential decline in Q2 revenues compared to our Q1 results due to lower traffic, specifically at our largest customers. We also will not benefit in 2024 from the favorable impact of the CDN consolidation that occurred in early 2023 that drove favorable sequential growth in the prior year same period.

For the second quarter, we expect revenue in the range of $130 million to $134 million, representing 6% to 9% annual growth. We continue to be very disciplined in our network investment and cost of revenues, which contributed to our first quarter gross margins being approximately 60 basis points better than we had initially expected. We typically see a seasonal decline in gross margins in the first half with improvement in the second half as we build capacity for peak traffic.

For the second quarter, we anticipate our gross margins will decrease approximately 130 basis points relative to the first quarter, plus or minus 50 basis points. As we mentioned previously, our Q1 operating loss was moderately better than our earlier expectations by continued cost management and slightly slower hiring. Our second quarter operating results reflect the impact of the seasonal decrease in gross margins and the impact to our operating expenses of higher first half employer payroll expenses. As a result, for the second quarter, we expect our non-GAAP operating loss to increase to $16 million to $12 million and our non-GAAP loss to be $0.10 to $0.06 per share. For calendar year 2024, we expect revenue in the range of $555 million to $565 million, reflecting annual growth of 11% at the midpoint. 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. As a result, we expect our non-GAAP operating loss to increase to a range of $28 million to $22 million. Reflecting an operating margin of negative 4.5% at the midpoint, an improvement of over 35% over 2023 operating loss margin of 7.2% and by over 70% over 2022's operating loss of 17.7%. We expect our non-

GAAP loss per share to improve to $0.12 to $0.06, reflecting the improvement in our operating loss expectations. And we expect our free cash flow to be close to breakeven in 2024 compared to negative $59 million in 2023.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question-and-answer session. [Operator Instructions] And your first question comes from Rishi Jaluria with RBC. Your line is open.

Rishi Jaluria
Analyst, RBC Capital Markets LLC
Q

Oh, wonderful. Hey, Todd, hey, Ron, thanks so much for taking my questions. Todd, let me start with you. Last quarter after the kind of first guide down, you talked about the pricing environment being relatively kind of in line with how it's been historically. It sounds now like there's maybe a little bit more intensifying pricing pressure in spite of the fact that there is consolidation going on, as you pointed out, and vendors exiting the space. Can you speak to what is maybe changed in the past 90 days in terms of that? And what tools do you have in your arsenal to maybe start to counteract those headwinds? And I've got a quick follow up for Ron. Thanks.

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

Yeah, I appreciate the question. I think in the general market, I would say the pricing trend that we have been seeing sort of continues. But what we saw in our top 10, 15 largest accounts, we saw some or slightly more kind of pricing pressure than we're used to. And that's got an outsized impact for us. And we are trying to make sure that we're doing the right adjustments to our projection based on that. Usually, with these kinds of pricing changes, we see a commensurate volume increase as well, and we still hope to see that, especially in some of these key accounts. But it's really in that high, in the large, primarily media conferencing, a little bit more pricing pressure than normal. But rest of the market, I still feel pretty confident in the pricing. Trends have been pretty good. Anything you'd add there, Ron?

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

No, I think the period of more – we saw more modest rerates, historically, I think that continues across kind of the broad market, but we have seen a change in the largest accounts.

Rishi Jaluria
Analyst, RBC Capital Markets LLC
Q

Okay. Got it. That's helpful. And then, Ron, for you, when I look at the investor supplemental, you talk – you're highlighting now RPO as a metric. But, can you maybe speak to why this is now a more relevant leading indicator, especially given you still do have a good amount of the business on kind of consumption that isn't pre-committed and what we should be making of the fact that RPO declined sequentially? And then even more so year-over-year, what needs to happen for that to kind of return back to more healthy levels? Thank you.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, that's a good question. First and foremost, over time, as we start to see more and more of the business packages, see that momentum gain. As Todd mentioned on the call, we saw more packages in Q1 than we saw in the full first half of last year. Those will be additive. So over time, it'll be a better indicator of our business. And as it grows, it's also going to reduce some of the volatility that we've seen particularly in the first half of this year. In terms of the decline, first and foremost, we really look at it kind of on a year-over-year basis, a lot of our customers do have annual commit, but some of our largest customers do have two year contract. And so what you're really seeing is some of our largest customers who have multiyear contracts as they sort of burn through that ahead of their renewals is creating some headwinds or declines on a year-over-year basis in the RPO.

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

A

I'll just add that I think the reason I do believe that's a good metric for us to start looking at and they'll become more and more relevant over time is that for the packaging transition we'll start to hit. We're seeing more and more of our large enterprise and even midsize enterprise accounts engaging on packaging. And that impacts can be shown on that line as we move forward.

Rishi Jaluria
Analyst, RBC Capital Markets LLC

Q

All right. Wonderful. Thank you, guys.

Operator: We will take our next question from Frank Louthan with Raymond James. Your line is open.

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

Q

Great. Thank you. First, just to kind of clarify on the guide, last year at the Analyst Day, you guided to free cash flow breakeven for the year, that's still attainable. And then, Todd, you mentioned the shift in the engagement approach to customers. How long is it going to take to train the sales team on this engagement shift? And when can we see that turn into higher growth and net retention rate? And then, what gives us the confidence in the strategy here versus where you were in mid-February and the market clearly was different? And what have you learned in that last few weeks [indiscernible] (00:29:47) and the guide are going the right direction?

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Frank, yeah, on the free cash flow, I think, we have continued commitment to managing our expenses in line with our revenue outlook. As I mentioned in the prepared remarks, it does create some headwinds, but we expect to be very close to breakeven for 2024 on our free cash flow.

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

A

Yeah, as far as the large account management and large account engagement, look, I think that's incredibly important question for us right now. And I believe you have to react to the realities of the market and you have to react with real conviction and real speed. And that's what we're doing right now. The top 15 or 20 accounts at Fastly, they carry a lot of our revenue and the way that we engage with them, the way that we drive platform like product line penetration, the way we drive price control and discount control, the way that we optimize their performance and driving more significant and complete technology solution, I believe we have an opportunity in all of those categories to improve the way that we engage and dedicate more resources and more focus to it. And that's exactly what we're doing right now.

We have already launched a new engagement model. We're driving a far higher touch across all of those major accounts. We've been running it for a couple of weeks now, and we're – I'm pretty happy with the progress so far. But just looking at the – where our projection is for those accounts and how much it's changed in just one quarter, like you said, [ph] since last (00:31:38) February, I think decisive change in our engagement model was warranted. And that's exactly the transition that we're undergoing right now.

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

And you've been doing this for two weeks. And that's – and now – and you think that you have right formula? Or it's just going to take a little longer to evolve? How should we think about it?

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

I mean, look, I think we're going to be evolving that formula for quite a while, but I think we have the right resourcing on it now. We have deployed a lot of resources, a lot of the most significant resources into that effort, very quickly. And I'm happy with the progress so far.

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

Okay, thanks.

Operator: We will take our next question from Madeline Brooks with Bank of America. Your line is open.

Madeline Brooks
Analyst, BofA Securities, Inc. Q

Hi, team. Thanks so much for taking the question. Todd, I guess, this is more so for you. If we look at the back half of the year and if we look at your guide, right, going down to 7.5% growth for second quarter and then there's a re-acceleration in the back half of the year to 12% growth, what's giving you the confidence in that right now? And additionally too, if we look into second quarter, what about second quarter is driving so much of the volatility?

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

Yeah. As I look at the second half projection and Ron can add color on this as well. We've got ramping customers and new customer acquisition has been strong. We have been able to move the needle there. We're seeing those revenues ramp and new customers being added to the platform. And so I think we've got pretty high conviction that we're going to see that revenue materialize in the second half. The weakness and the shift in the projection from last quarter this quarter is really in those large accounts, and that's why we've changed our engagement model with them so significantly. But the reason really comes down to that. We've seen a little bit of a pullback in the vendor consolidation trend. And that's reversed and we see some folks even adding a additional vendor here and there and we see a little more pricing pressure up there. And that has – those are large accounts for us and have a large impact.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah. The only thing I would add on the acceleration – go ahead.

Madeline Brooks
Analyst, BofA Securities, Inc.

Q

No, go ahead.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

The only thing I would add on the second half acceleration is, typically, we do have seasonality in the business that we historically have about – second half tends to be up about 10% or 11%. So when we took a look at the second half, we looked at where the business was in Q2. And, as Todd mentioned, the number of new customers that we've signed and we believe that seasonality that we've seen is intact coming off of the dynamics we're seeing in the second quarter.

Madeline Brooks
Analyst, BofA Securities, Inc.

Q

And then maybe just a quick follow-up too. As those customers ramp, understand what's going on with customer acquisition, but if we just stayed in those 15 large customer accounts, do you see those accounts stabilizing after the second quarter [indiscernible] (00:34:51) or do you think we should expect and model declines in that cohort through the end of the year, just given the trends that you're seeing in the market now?

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

A

Yeah, I mean, we're – I think our projection is relatively conservative. I believe we're going to see traffic levels come up and we're going to find some success in recovering revenue in those large accounts. We're signaling the guide here because, obviously, there's certain new projection and we want to reflect that. But, look, I believe there's an opportunity for us to beat that projection and reverse, not just stop the declined, but really reverse the trend in the second half.

Madeline Brooks
Analyst, BofA Securities, Inc.

Q

Great. Thanks so much.

Operator: We will take our next question from Fatima Boolani with Citigroup. Your line is open.

Q

Hi. Good afternoon, guys. This is [ph] Mark (00:35:53) on for Fatima. Thanks for taking our question. Maybe just to kick off, on the package and bundling uptake, can you maybe just give us a sense of penetration in these currently and the impact on from a new logo acquisition pipeline build point? And then understand that packaging [indiscernible] (00:36:12) variability and improving on the visibility on revenues. Can you maybe just quantify in any way how [indiscernible] (00:36:18) going up in the revenue predictability today? Thanks.

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

A

Yeah, look, I think in the long run, the channel engagement will help us drive customer acquisition through deal registration and we're starting to see some effect of that broadening significantly beyond where our channel was strong a year-and-a-half ago, which was really just in the security portfolio. We're seeing the channel engaging across the board. This past quarter, our largest deal closed – our largest new booking closed not just through the partner, but also on the packaging solution. And so, I think both of these trends are helping not just in the midsize and small accounts, but in large accounts as well.

So we've had, I think, some real success on the channel growth and the importance of the channel on the go-to-market. The packaging has, I think, in large part, helped us move more quickly, bringing new customers to the platform, especially midsize and large traditional enterprise into the platform. It has a very kind of attractive feature of sort of a no overages model for those customers that give them very predictable billing. And it really gives us much more predictable revenue, which has been a great – has had great impact so far. I'm pretty happy with both of those, and I think it – we're doubling down on both of those initiatives and really that's – a big part of this kind of initiative across the board where our biggest focus is on revenue growth and driving that revenue growth back up into the 20s where it really should be.

Q

Got it. Okay. Thank you for that. Maybe just a quick follow-up. Can you just touch on some of the recent regulatory [indiscernible] (00:38:14) one of your large social media customers is seeing [indiscernible] (00:38:21) how you're [indiscernible] (00:38:20) of the logo and the impact on the business overall. And is this also reflected in your updated guidance?

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

A

I'm sorry you broke up a little bit. Yeah. Could you repeat that, [ph] Mark (00:38:33), I think you asked about a restructuring of the social media customers [indiscernible] (00:38:39)?

Q

Oh, no. Can you hear me now?

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

A

Yes, much better.

Q

Okay, great. No, I just wanted to touch on some of the recent regulatory scrutiny that one of your largest social media customers is seeing. Just want to get a sense of how you're thinking of that logo and the impact on the business? And is it also reflected in updated guidance? Thanks.

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

A

Yeah, completely. And thanks for repeating the question. For sure, I think, first and foremost, we are fully committed to supporting all of our media customers through any sort of transition they happen to be having, in this case, that you're referring to, should be -- should there be any sort of transition or significant transition there, we're doubling down on being able to support them and support them through that transition, however, it may come to light. But our engagement with that account has been super strong and we're pretty positive on the way that will shake out any way you sliced it. We are, of course, modeling some risk in here, but I'm pretty confident in the path forward.

Operator: And we will take our next question from James Fish with Piper Sandler. Your line is open.

James E. Fish
Analyst, Piper Sandler & Co.

Q

Hey, guys. [indiscernible] (00:40:04) maybe the best way to ask this one [indiscernible] (00:40:09) to the minimum contract levels you guys [ph] have increased (00:40:15). What are you assuming for those customers that you're seeing the issues with? And per our discussions, you said you really weren't seeing any large renewals like a competitor – your main competitor was this year. Are you just seeing that earlier now just because you saw more volumes than anticipated and so that moved up? Or walk me through that?

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

So I think if you look at each customer, I think you look at the large customers, there are different dynamics in each one. And within their multiyear commit, the amount of traffic that they're running, in some instances, as Todd spoke about, we did see some pricing changes that were not accompanied with traffic increases. Our renewals sort of spread across the year. And then, secondly, we did see some of our largest customers where they added in an additional CDN that reduced some of our traffic levels at those customers. So those were the dynamics, which was a little bit different, but it was really a combination of some pricing changes, your traffic share with increasing the number of CDNs at some of our largest customers.

James E. Fish
Analyst, Piper Sandler & Co.

Q

Right, Ron. But my question is more – look, you guys tend to have – RPO doesn't reflect this to Rishi's earlier kind of question, where RPO [indiscernible] (00:41:42) include essentially, but the minimum contract levels that you guys have, I think, historically, you guys have had roughly 80% visibility to any given year just on those minimum contract level. So as we think about this kind of revised guide, I guess, how much above, like, the minimum contract level are you guys having that we're not going to be sitting here in another 90 days saying, why does that re-dropping guide again?

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, I guess two things to clarify. I mean, when you look at our largest customers, while some of them do have commitments, a significant portion of them are utility based, not commitment based. And so, that's – I guess, that's not reflected with in the RPO when there is not an underlying commitment on the customer contract. And so you're going to see a mix of customers that do have a commit and customers where they don't – even in the cases of commit, the customer maybe running traffic above that consistently. And so we are still predicting it or forecasting it based on a level of traffic or utility basis.

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

A

To look at that just from a slightly broader lens. I think it's fair to say that we've seen some more rerates in our largest 10 or 15 accounts in this past quarter. And I take your point on the competitive messaging we've heard. I think that is a fair point. Plus I've got high confidence in the adjusted guide here because I think we've shipped through that largely and we're really moving back to the path of growing those accounts and expanding not just the volume we see, but the product penetration in those accounts as well.

Operator: And we will take our next question from Tim Horan with Oppenheimer. Your line is open.

Timothy Horan
Analyst, Oppenheimer

Q

Thanks, guys. Sort of hammer on the same topic here. But – so, maybe when you mentioned like multiple products, like what else is in that network services revenue, like how many of those – how many different products do you have in there? And what are you typically selling to customers?

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

A

Yeah. So on the network services side of the house, we sell services around obviously content delivery which includes both video streaming and full-site delivery and replication around the world. We sell it different kinds of technology in terms of image optimization and live event and streaming and live event monitoring, rate reservations, et cetera. When I talk about product penetration across the platform, I'm talking about expansion into security, expansion into observability, and largely – and starting to really gain traction expansion into compute as well.

Timothy Horan
Analyst, Oppenheimer

Q

Well, and thanks for the revenue breakdown, but I mean, it looks like compute only 1% of revenue. And is observability and network services or is that in a different category?

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

A

Observability falls into other, correct.

Timothy Horan
Analyst, Oppenheimer

Q

Okay. And one of your largest competitors last quarter said they were going to bundle really aggressively with compute. They kind of implied they were going to use price on CDN to win customers back. I mean, are you seeing them pull back on that at this point? I mean, it would seem like that would last for a year or two if they're going to make comments like that and pursue that strategy. Are you seeing them pull back? Or do you think your quality at this point is such that your core customers are not going to be impacted by what they do on the pricing or bundling front?

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

A

The largest customers, I don't think they're going to be impacted on the pricing front there because it is – these are high tech customers that are deeply engaged in the performance service level for reliability especially. And there's – I think the customers are extremely mature. And there's only so much sort of pricing flexibility that you can deploy in an account like that. We are super aggressive, not just on the performance, but on the pricing as well in those top 10 accounts. And again, I think we're driving a new level of engagement in those accounts to really return that cohort back to growth. But I do think that bundling has real potential, stronger bundling down market. And if anything on the competitive front, that's where I've seen some success. We are also with our packaging solution getting more aggressive in bundling. And we've seen success there as well.

Timothy Horan
Analyst, Oppenheimer

Q

But, I guess, to be fair, I mean, Akamai has – they're going after basically legacy virtual machine workloads and legacy storage, which is a huge market. And if they could price that down. Would that impact customers decision on the core – on your, like, core network services business? Or do you think that's like not enough to make customers move back to Akamai or somebody else?

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

A

I think customers who are moving to Fastly are looking for sort of next-gen solutions, serverless compute, edge storage, the type of technology that we're delivering. Moving back to sort of legacy virtual machines, I don't see that as being compelling. I do think, though, there's real opportunity on the compute side. I wouldn't discount it because it's currently small, it's growing quickly. It has extreme – it drives extremely high stickiness with accounts. Our compute customers are very high customers are very high customer stack. We're pushing on that business very hard because it works so complementary with our CDN business, that helps drive both sides of our customer engagement there.

Operator: [Operator Instructions] And we will take our next question from Rudy Kessinger with D.A. Davidson. Your line is open.

Rudy Grayson Kessinger
Analyst, D.A. Davidson & Co.

Q

Hey, thanks for taking my question. So I just want to understand, I mean, you guys gave that guide halfway through Q1, when exactly in the quarter did these customers start repricing contracts in and adding other CDNs and moving share, et cetera? And with these repricings, I guess, you guys just have no control over it whatsoever. And they just asked for repricing, you guys do it within a couple of days. I mean, I just don't understand how, three months ago, you told us you didn't have any large repricing expected. And now it turns out you did within a six-week timeframe?

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, I think a couple of things. I think in terms of the dynamics that Todd spoke about, both in terms of the pricing, a lot of that arose really at the end of March and in early April when the – we saw, one, the motion of some of our customers kind of reversing their trend to consolidating on CDNs, which affected our traffic projections for the year. And then as we engaged in some of the rerates that we knew we're coming, those negotiations resulted in bigger discounts than we thought that did not come with the typical increase in traffic that we've seen historically. And so those were the big drivers. I would say the timeframe really was late March, early April, when we saw these different dynamics, but all affecting some of our largest customers that have an outsized impact on our revenue outlook and growth rate.

Rudy Grayson Kessinger
Analyst, D.A. Davidson & Co.

Q

Okay. And so is it the larger than expected pricing pressure? I guess, it would go against the conventional wisdom when several of the smaller low cost vendors have exited the space over the last six months. And so just any thoughts on why you had to concede so much on price with less profit growth than typical, given there's fewer competitors, fewer low cost competitors in the space? And then, lastly, Ron, just what level of visibility do you have to second half revenue? Like what percent of that second half – implied second half revenue guide is actually the minimum commitment?

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

A

Yeah. I'll take the first half, I think -- look, I think it's a fair question. We did see the pricing and traffic projections change a lot at the end of the quarter and the beginning of this quarter, Q2. But I think it's – I think, an important piece of this is look, there's a small number of accounts where we had – where our projection – our revenue projection has pulled back. And those are large accounts that are very significant swing and they need to be handled and managed and optimized very specifically. It's why we're changing our motion there. And look, I believe, we have an opportunity to move back to growth in those accounts, but our projection reflects where we currently are.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah. The only thing I would add on the second part is, again, a significant portion of our business is on a utility basis. The largest accounts had their pricing and/or these adjustments in traffic in March and April. And so our outlook reflects those activities that occurred in those largest accounts. And so the variability in the smaller accounts should have less volatility as we move through the year.

Operator: And we will take our next question from Jeff Van Rhee with Craig-Hallum. Your line is open.

Q

Thanks for taking my question. This is [ph] Daniel (00:51:43) on for Jeff. [indiscernible] (00:51:44) you referenced earlier the volatility with some of the larger customers. Can you just expand on that in terms of volatility? Volatility as a term referencing, some one-time changes or some quarterly changes, just into this quarter or just sort of what did you mean in terms of some of the volatility?

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

A

Yeah, we had a couple of accounts in that very large set that negotiated rerates in the past quarter. Usually, a rerate like that would come up – would come with like a commensurate volume increase. And we tried to model that very carefully, but our projections there was a little bit aggressive, I believe. And we have seen this trend towards -- which we saw a strong trend last year for vendor consolidation, as folks with five or six CDN vendors consolidate all the way down to two or three. We saw a little bit of pulling back there and people adding a vendor here or there. And those two trends caused some volatility which affected our projection.

Q

And then just a second for me on, I believe earlier when you were asked about the assumptions contemplated in the guidance and just with the top 15 customers, what sort of is baked in in terms of the traffic levels? Let me just read you back and see if I got that correct. With the notion that you expected you were modeling in for those traffic levels to stay flat from Q2 into Q3 and Q4, although you actually thought that was conservative, you thought you could actually tick up from Q2, is that correct? And what would you would drive those to actually go back up somewhat here in Q3 and Q4?

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

A

What we're modeling all the time is sort of the seasonality of our traffic patterns. But I believe we have an opportunity to increase the revenue and the wallet share at those large accounts by demonstrating superior performance, showing and demonstrating the ROI of using Fastly more clearly and expanding the product portfolio that those accounts use. And so, it's why I think it was so pertinent for us to really change our engagement model and move very quickly here to react to what we're seeing in the market, why we are pushing so hard on that right now.

Q

Thanks for taking my questions.

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

A

Thank you.

Operator: And ladies and gentlemen, that concludes our question-and-answer session. I will now turn the conference back to Mr. Todd Nightingale for closing remarks.

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

Thanks so much. I want to thank all our employees, our customers, our partners and our investors. We remain focused on execution, bringing lasting growth to our business and delivering value to all of our shareholders. Thank you so much for your time today.

Operator: Ladies and gentlemen, this concludes today's call and we thank you for your participation. You may now disconnect.