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Fastly, Inc. (FSLY)

Q4 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

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 fourth quarter 2024 earnings conference call. We have Fastly 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.

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 annual report filed on Form 10-K, and quarterly reports filed on Form 10-Q filed with the SEC and our fourth 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. 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 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 during the fourth quarter, we will be attending the Oppenheimer 10th Annual Emerging Growth Conference held virtually on February 25, the Raymond James 46th Annual Institutional Investors Conference in Orlando on March 3, and the Morgan Stanley Technology, Media and Telecom Conference in San Francisco on March 4.

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

Todd Nightingale

Chief Executive Officer & Director, Fastly, Inc.

Thanks, Vern. Hi, everyone, and thank you so much for joining us. Today, I will cover our fourth quarter results and recap 2024, and then move on to our strategy for 2025. I will then hand the call over to Ron to discuss our fourth quarter results and our guidance in detail.

We closed out 2024 reporting record fourth quarter revenue of $140.6 million. This exceeded our guidance range of $136 million to $140 million, and represented 2% growth both year-over-year and quarter-over-quarter. Revenue strength was attributed to better-than-expected seasonal traffic coupled with share gains at the year-end.

We closed out 2024 with revenue of $544 million, representing 7% year-over-year growth. As we have discussed in prior quarters, we faced demand headwinds with a few of our largest customers. I'm happy to say we persevered and resumed strength with these larger customers into year-end as we will discuss today. We were also able to grow in other areas to offset these headwinds, and we look to build momentum as we head into 2025.

A key component to building lasting, predictable growth at Fastly is diversifying our revenue base. Fastly's top 10 customers dropped from 33% of our revenue in the third quarter to 32% in the fourth. This is down from 40% at the end of 2023. Moreover, the revenue outside of our top 10 customers grew 16% year-over-year in the fourth quarter. We are now approaching a healthy mix of our largest customers relative to the rest of our business. Our go-to-market strategy will continue to emphasize logo acquisition to grow the enterprise customer mix outside of our top 10. I'll talk more about this in a minute, but the opportunity to drive a greater cross-sell motion through the long tail of our customer base gives us potentially much more upside with our existing customers. And the broadening and unification of our platform gives us the opportunity to bring on a significant number of new enterprise customers.

We reported an operating loss of $4.2 million in the fourth quarter, within the guidance range of $1 million to $5 million. We continued our financial rigor through 2024 and made opportunistic investments, when appropriate, as seen in fourth quarter operating expenses. This opportunistic spend was mostly in sales and marketing as we brought on new seasoned leaders, and ramped up new sales incentives and compensation plans for our business. And we've been continuing to find savings in the R&D and G&A lines as seen in the quarter and throughout 2024.

This discipline produced respectable bottom line annual results despite the revenue headwinds in prior quarters. In 2024, our cash from operations increased from $400,000 in 2023 to $16 million in 2024. And we reduced our cash flow burn from $59 million in 2023 to $36 million in 2024. Along with our convertible debt refinancing, which Ron will discuss in detail, these efforts have set a strong financial foundation at year-end to drive growth for Fastly in 2025.

Our enterprise customer count returned to growth in the fourth quarter with 596 enterprise customers growing 3% year-over-year and quarter-over-quarter. I'm especially excited about the new customer pipeline momentum we saw in the fourth quarter. Our growth strategy in 2025 is grounded in our ability to introduce new products and features to the platform, but is driven by our go-to-market efforts. Under the leadership of our new CRO, Scott Lovett, we're transforming our sales and go-to-market motions to drive efficient customer acquisition and long-term revenue growth.

First, we are expanding our geographic presence with a focus on Latin America and India while we remain committed to the EMEA market, and see opportunities to expand our presence there, long term. Additionally, we are making our first move to hire a leader, a dedicated leader for the APAC region as we expect to strengthen our presence in those markets as well. Cross-selling remains a key lever, particularly by offering our entire portfolio, such as Security solutions, object storage and bot protection to our existing customer base. To support this, we are investing in specialized resources, strengthening the SE community, and building a technology specialist organization.

We continue to refine our segmentation strategy, further segmenting mid-market velocity motions from the enterprise segment. Two dedicated leaders in North America will help streamline this approach. Simultaneously, our media and gaming segment has been successful in serving high-touch accounts in the US, and is being globalized to drive a more unified industry-specific motion for media worldwide.

To support these growth initiatives, we are evolving our compensation and incentive structures. We're making significant investments in sales leadership, including hiring a new global lead for presales engineering and a dedicated VP for North American Enterprise. We're also evolving our compensation and incentive structures designed to encourage both new logo acquisition and cross-selling motions. Additionally, our focus on segmentation aims to enhance efficiency and cost of sale gains through more self-service options, dedicated mid-market motions and support, and a new team of hunting only resources designed to drive new logo acquisition. We won several new streaming delivery logos in the fourth quarter, including Deezer, a music streaming service, and Mediaset Italia, a leading mass media company.

We also won other logos in the insurance, health care and related fields, including Insurance Auto Auctions, which selected Fastly's network service offerings. Both Instructure, an educational technology company, and Hacomono, a management system for wellness services selected Fastly Next-Gen WAF. Our biggest logo win is with a global Fortune 25 financial institution that we are extremely excited to work with, and with whom we hope to expand our business for years to come.

We continue our focus on the customer acquisition motion and reducing the onboarding friction at Fastly. Our packaging strategy, which focuses on the simplicity in pricing and ease of implementation, underscores this effort. In the fourth quarter, customer package sales grew over 60% year-over-year, and those involving new logos grew 70%. Package sales grew over 150% in 2024, with 40% of those sales to new logos.

As we look to 2025, we can expect continued growth and penetration of predictable package revenue as demonstrated by our RPO coming off its lows about a year ago, and growing 4% quarter-over-quarter. We've continued to build our channel presence, and our 2024 deal registrations grew 28% year-over-year. I believe that we have far more opportunity here to drive a greater outcome, especially in customer acquisition through deal registration, and we plan to do exactly that with greater focus in 2025.

Moving to technology, Fastly's software-driven edge cloud platform provides top-tier delivery, Network Services, Security, Compute and Observability. Our ongoing investment in leading technology and innovation not only strengthens our edge platform, but also continues to expand its feature set to support the future of edge computing. By offering this functionality, we enable our customers to globally deploy their applications closest to their users, providing exceptional, resilient user experiences.

We are confident that our unified platform approach will build upon our leadership in customer satisfaction, and continue to drive customer retention and success. Underscoring this effort in the fourth quarter, Fastly was once again named a leader in the IDC MarketScape: Worldwide Edge Delivery Services. Throughout 2024, we made further investments to improve our development processes and organization to accelerate our roadmap.

I've been pleased to see an increase in feature velocity, especially in Security and Compute. In the third quarter, we rounded out our Security offering with the general availability of DDoS protection in addition to our Next-Gen WAF and bot mitigation solutions. We've capitalized on our long heritage of DDoS protection at Fastly, coupled with unparalleled ease of use, partnering with some of the largest, most sophisticated customers, and productizing this technology to address the entire market so that our broader customer base can benefit.

In the fourth quarter, I was excited that we announced the general availability of AI Accelerator, a semantic caching solution created to address the critical performance and cost challenges with LLM/generative AI applications. By employing semantic caching of common queries on our edge network, we deliver up to a 9x faster response time, while offering substantial cost savings to our customers. Our solution also drives improvements in our customers' sustainability efforts, addressing common consumer concerns about AI's environmental impacts. We now support ChatGPT and additional platforms like Google Gemini, Microsoft Azure Foundry, and of course, we're always looking to expand.

In the fourth quarter, we also unveiled Fastly's Object Storage, which allows direct access to all of our customers' data at the edge with zero egress fees. This solution is designed to reduce our customers' origin costs, and drive performance to their users. I'm very excited about our product development initiatives, resulting in improved feature velocity and improved time to value for our customers. We are optimistic that this product roadmap will drive accelerated revenue growth, especially in cross-selling opportunities.

Now, let me discuss our 2025 outlook. We've taken measures as 2024 came to a close to ensure that Fastly has a solid financial foundation and growth strategy. This strategy includes increased revenue diversity, which mitigates our concentration risk, improvements to our go-to-market team and motions to drive faster revenue growth, and a unified platform fueling increased product velocity designed to drive more customer value. This has resulted in a strong customer acquisition pipeline, and this momentum positions us well to return the business to double-digit growth. While we are optimistic regarding our prospects, our 7% annual revenue growth guidance for 2025 reflects our visibility today, and incorporates the potential risks we've seen over the last year.

I want to be clear that our goal is to outperform this guidance. However, we need to see how our new strategic motions are evolving, and allow us room to maneuver as 2025 progresses. I appreciate the support of our employees and of all of our investors as we move into 2025, well-prepared and ready to execute.

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

Ronald Wayne Kisling

Chief Financial Officer, Fastly, Inc.

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

Revenue for the fourth quarter increased 2% year-over-year to $140.6 million, coming in above the guidance range of $136 million to $140 million. There were no unusual true-up payments in the fourth quarter. Excluding the $2.8 million true-up payment from last year, our fourth quarter revenue growth would have been 4% over the fourth quarter of 2023.

Network services revenue of $110.1 million was flat year-over-year, while Security revenue grew 4% year-over-year to $26.9 million. Normalized for the true-up payment from last year, which was Security-based revenue, our Security revenue would have grown 17%. Our other segment, which represents emerging products, grew 63% year-over-year to $3.6 million, driven primarily by Compute products. In the fourth quarter, we saw better-than-expected seasonal traffic coupled with share gains from customers ramping in Q4.

Our annual revenue was $544 million, representing 7% growth over 2023, coming in below our original guidance range of $580 million to $590 million provided one year ago. As we discussed in prior quarters, we experienced revenue headwinds from a few of our largest customers. We responded during the year with the change to our customer strategy to improve our visibility and engagement, and in the second half, we realigned our costs to be in line with our revised revenue outlook.

Our top 10 customers comprised 32% of our total revenue in the fourth quarter of 2024, compared to 33% in Q3 2024 and 40% in the year ago quarter, reflecting the impact of the revenue declines from a few of our largest customers and our strategy to grow our overall customer base. We anticipate revenue from our top 10 customers will remain in the low- to mid-30% range throughout 2025, representing a healthy customer concentration. Also, no customer accounted for more than 10% of revenue in the fourth quarter.

As I mentioned, our strategy to grow our overall customer base and focus on customer acquisition has resulted in revenue expansion outside our top 10 customers, expanding our wallet share into the broader enterprise customer segment. Our trailing 12-month net retention rate was 102%, down from 105% in the prior quarter and down from 113% in the year ago quarter. The decline is primarily due to the revenue declines from a few of our largest customers in prior quarters and closely follows our overall revenue growth rate trends.

We anticipate this LTM NRR benchmark will remain flattish near term, followed by expansion in the second half of 2025. For the fourth quarter, our RPO was $244 million, up 4% from $235 million in the third quarter of 2024 and up 4% from $236 million in the fourth quarter of 2023. This increase is the result of our efforts to increase the number of customers with revenue commitments move toward higher commitments with our largest customers, coupled with an increasing share of predictable revenue packages as a proportion of our revenue.

We believe that RPO will continue to become a more meaningful indicator to the health of our business in 2025. As Todd mentioned, we had 596 customers at the end of Q4, a net increase of 20, compared to a decrease of 25 in the third quarter. On a year-over-year basis, enterprise customer count increased 3%. Enterprise customers accounted for 93% of total revenue on an annualized basis in Q4, compared to 92% in Q3. Enterprise customer average spend was $873,000, down 1% from $880,000 in both the previous quarter and Q4 of last year.

In the fourth quarter, we performed a complete review of our customer data for consistency and accuracy. In reviewing the data, we noticed a number of small online self-service accounts that were previously identified as a customer that did not continue to qualify as ongoing customers. We remove these customers from our total customer account and reflected this adjustment in the fourth quarter as a one-time correction.

As a result, our total customer count was 3,061 in the fourth quarter, a net decrease of 182 year-over-year and 577 quarter-over-quarter, reflecting the corrections we made in the fourth quarter. Revenue from these customers was less than $100,000 for the quarter ended December 31, 2024. Due to this immateriality, we have not revised prior periods and for these reasons, we continue to suggest to investors that our enterprise customer count, those that represent over $100,000 in annualized revenue, is a better indicator of our customer acquisition progress and revenue growth drivers.

Our annual revenue retention rate, which we report at fiscal year-end, was 99% for 2024, down from 99.2% in 2023. These figures continue to reflect our very low churn and healthy customer retention dynamic. I will now turn to the rest of our financial results for the fourth quarter.

Our gross margin was 56.5%, compared to 57.7% in the third quarter of 2024 and down 270 basis points from 59.2% in Q4 2023. And excluding the $2.8 million true-up payment from last year, our Q4 gross margin would have been down 180 basis points from Q4 2023. This decline was due to increased bandwidth costs and higher traffic and an increased mix of traffic outside the US and Europe, offset by better utilization of our fixed costs. Our incremental gross margin was 71% on a trailing 12-month basis, compared to 77% in the fourth quarter of 2023. Our 2024 annual gross margin was 57.8%, up 90 basis points over 2023 gross margin of 56.9%. Discounting the benefit of the $2.8 million true-up in the fourth quarter of 2023, the gross margin improvement would have been 120 basis points year-over-year. We had no material one-time true-ups in the fourth quarter and we will continue to highlight to our investors any true-ups that totaled more than 2% of revenue.

Operating expenses were $83.6 million in the fourth quarter, primarily due to increased sales and marketing expenses, as we invested in our sales transformation leading into 2025. On a year-over-year basis, operating expenses were flat compared to Q4 2023, increasing 5% sequentially from the third quarter. Higher operating expenses combined with better than expected gross profit resulted in an operating loss of $4.2 million in the fourth quarter, coming in at the lower end of our operating loss guidance of $5 million to $1 million.

For 2024, our operating expenses grew 5% to $342 million from $325 million in 2023, reflecting our mid-year restructuring and expense reduction that allowed us to grow our spend below our annual revenue growth rate and improve our operating margins. Combined with our 7% revenue growth and gross profit increase of 9%, we improved our operating loss margin from 7.2% in 2023 to 5% in 2024. Improved our free cash flow by 39% and our adjusted EBITDA by 78% to $27.5 million from $15.5 million in 2023.

In the fourth quarter, we reported a net loss of $3.8 million or $0.03 loss per diluted share, compared to net income of $1.7 million or $0.01 income per basic and diluted share in Q4 2023. Our adjusted EBITDA was positive in the fourth quarter, coming in at $9.7 million, compared to $11.5 million in Q4 2023.

Turning to the balance sheet, we ended the quarter with approximately [ph] $296 million (00:23:07) in cash, cash equivalents, marketable securities and investments, including those classified as long term. In the fourth quarter, we refinanced a portion of our outstanding convertible debt, raising $150 million of 7.75% convertible notes with a 100% conversion premium due in 2028.

As a result, we repurchased $158 million in principal amount of our existing 0% convertible notes due in 2026 for approximately $0.95 on the dollar, leaving approximately $189 million of those notes outstanding. As a result, our total convertible debt balance declined to $339 million in the fourth quarter from $346 million in the third quarter. Moreover, this extra two years of runway against our cash and cash equivalents balance of [ph] $296 million (00:23:59) and our progress in reducing our cash burn has substantially mitigated any liquidity concerns for the company.

Our free cash flow for the fourth quarter was $7.9 million, a $0.8 million sequential decline from the negative $7.1 million in the third quarter. This decline was primarily driven by an increase in our purchase of property, plant and equipment. It was offset by improved cash from operations of positive $5.2 million, lower capitalization of internal-use software and repayment of finance lease liabilities. Our 2024 free cash flow improved by $23 million over the prior year to negative $36 million from negative $59 million in 2023. This year-over-year improvement was driven by approximately a $16 million increase in cash from operations and a $12 million reduction in payments of finance lease liabilities, offset by a $5 million increase in capitalization of internal-use software.

Our cash capital expenditure [ph] were approximately 9% (00:25:08) of revenue in the fourth quarter, coming in below the midpoint of our guidance of 9% to 10% of revenue, we shared on our Q3 call. As a reminder, our cash capital expenditures include capitalized internal-use software. For 2025, we anticipate our cash capital expenditures will again be in the range of 9% to 10% of revenue with our medium to long term cash capital expenditures declining closer to our previous 6% to 8% of revenue expectation.

I will now discuss our outlook for the first quarter and full year 2025. 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. As Todd shared in his remarks, as 2024 progressed, we continued to diversify our revenue, increase our product velocity and ramp investment in our go-to-market.

We believe these measures will best position Fastly to execute on our 2025 growth strategy and goals. Our revenue guidance reflects these dynamics in our business and is based on the visibility that we have today. I'd like to note that TikTok, one of our larger customers has been the subject of much scrutiny given current legislation addressing their US operations. Globally, ByteDance, the parent company of TikTok, represented less than 10% of our revenue in 2024, and their United States traffic represented less than 2% of revenue.

We do not know the full outcome of this legislation. So, as a prudent measure, our 2025 forward guidance excludes revenue from US traffic with this customer. Due to improving revenue at some of our largest customers and incremental traffic ramps from new customers, we expect to see better than our typical sequential seasonal growth in the first quarter. As a result for the first quarter, we expect revenue in the range of $136 million to $140 million, representing 3% 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 30 basis points better than we initially expected. Beginning in 2025, we will be excluding the amortization of stock-based compensation in our internal-use software costs and our non-GAAP gross margins to improve the comparability of our non-GAAP measures with our peers. This change would have added approximately 100 basis points to our 2024 non-GAAP gross margins.

As a result, for the first quarter, we anticipate our gross margins will increase approximately 30 basis points relative to the fourth quarter plus or minus 50 basis points. We anticipate our first quarter operating expenses will increase in the fourth quarter levels by $3 million to $5 million, reflecting the impact of increased employer payroll taxes and benefits at the beginning of the year of approximately $5 million plus expenses from annual sales events held in the first quarter.

Guidance for our first quarter operating results reflects the impact of the sequential increase in gross margin and the impact of the increases in operating expenses I described. As a result for the first quarter, we expect a non-GAAP operating loss of $11 million to $7 million and a non-GAAP loss of $0.09 to $0.05 per share. For calendar year 2025, we expect revenue in the range of $575 million to $585 million, reflecting annual growth of 7% at the midpoint. As a reminder, beginning in 2025, we will be excluding the amortization of stock-based compensation and our internal-use software costs and our non-GAAP gross margin, which has a favorable impact of approximately 100 basis points compared to 2024.

We anticipate our 2025 gross margins will be approximately flat plus or minus 50 basis points relative to 2024. This reflects the impact of excluding the amortization of stock-based compensation and an increased mix of traffic in emerging regions, which currently have lower margins. As a result, we expect our non-GAAP operating loss to be in the range of $15 million to $9 million, reflecting an operating margin of negative 2% at the midpoint, an improvement of approximately 56% in dollar terms over 2024's operating loss margin of 5%. For modeling purposes, this implies 2025 operating expenses in the range of $345 million to $350 million. We expect our non-GAAP net loss per share to be in the range of $0.15 to $0.09, and we expect our free cash flow to be in the range of negative $20 million to negative $10 million in 2025, compared to negative $36 million in 2024.

This assumes our current CapEx strategy. However, we may lease a portion of our 2025 capital expenditures to bring this figure closer to break even. Before we open the line for questions, we would like to thank you for your interest and your support of Fastly. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] . We'll take our first question from Frank Louthan at Raymond James.

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

Q

Great. Thank you. Can you give us an idea of what sort of investments in capital and in people you'll need for the Asia-Pac expansion? And when can we expect some of those changes to start impacting the top line trajectory? Thanks.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah. So, from a capital investment perspective, I would say a fairly nominal investments, probably very little on the capital side. We – our build-out reflects traffic on a global basis and the expanding traffic rates that we see. From a personnel perspective, we currently have largely the team in place and this is the leader. I'll let Todd add a little color on the management of that region.

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

A

Yeah, I think this is really a move to make our total system more efficient. We have the infrastructure in place largely because we're serving so many global customers, but by putting in dedicated APJ or APAC sales leader in place, we have a real opportunity to drive more local business in that market and really focus on that market because there's just so much potential there right now for us. And we are really under-penetrated. So, I think from a investment point of view, it's probably pretty small. We're really talking about just bringing on one high level leader.

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

Q

Okay. And looking at the group that you're going to hire in sales to focus on new logos, how is that going to change the current sales structure? And where you get new logos? How long will it be to have that team built out? And then how should we think about new logo expansion and when that will sort of hit its stride?

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

A

We've largely done this through refocusing existing resources, so largely that team is in place right now. Scott's done a great job sort of repositioning and refocusing the teams we have. I think the area where we are certainly still ramping up is in the Security specialization. We have a huge focus on Security right now, obviously bringing Scott in with his Security background, all of the R&D focus we put in and product launches that we saw through 2024, we will be bringing on Security expertise into that patch, but I think – into the sales team, but I think that will sort of continue organically throughout the year. Our sales leadership has – our new sales leadership has such a strong Security background, I think we feel pretty good about where we are in.

Operator: We'll take our next question from Fatima Boolani at Citigroup.

Q

Hey, good afternoon, guys. This is [ph] Mark (00:33:39) on Fatima. Thanks for taking our questions. So, maybe just [ph] to Todd first (00:33:42), it seems like you guys are gaining traction on the bundle initiative and diversification effort, but really the business mix has remained fairly consistent. Can you maybe just give an insight on, why aren't we seeing a more visible shift in the mix? And then what are some of the gating factors here? And then how should we think of the mix in the context of 2025 guide? Thanks.

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

A

Sure. When I think about the business mix, I think about it kind of in two dimensions. One is revenue diversification. And we – I think we have seen a pretty big shift here. The bundling and specifically the package motion is really designed and targets the mid-market and by swinging the – and to some degree enterprise accounts, but really not the top 10. And by really sharpening up our playbook there, we've been able to drive this revenue diversification and the strength in the rest of that market outside the top 10.

I think that's what we're seeing. We started 2024 with 40% revenue concentration in top 10. We're able to bring that number all the way down to 32%. As the other dimension I looked at when I think of the revenue diversification is along the product line areas and Ron gave you the normalized view there with the Security growth. Obviously, the one-time payment, a one-time take or pay payment from 2023 complicated that growth number a little bit. But generally speaking, we do see diversification towards Security, towards Compute and Observability, towards our growth and our expansion part of our portfolio. But I certainly believe we can do better. We can drive a far higher Security growth rate, which is why we are placing so much emphasis, which is why we did place so much emphasis in 2024. And the [ph] feature (00:35:43) velocity in the Security space, we're continuing to focus there for sure, and it's why we're investing and focus so much on the Security go-to-market.

Q

Okay, great. Thanks. And then just maybe a follow-up, just on the NRR trajectory from here, what's sort of giving the confidence of expansion in second half of 2025, especially given some of the sales changes and initiatives you guys are currently undertaking? Thanks.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, I think from a trajectory perspective, it closely follows kind of the revenue growth and being on an LTM basis. [ph] The only thing (00:36:27) it's going to lag some of the impact that we see from that expansion. We spoke about the efforts in the sales organization to really drive expansion in existing customers and exiting the year with the complete Security portfolio and improve platform unification, give us a real opportunity to grow that expansion. Reporting out on an LTM basis, though, it's going to lag kind of the impact that we see in a particular quarter. But we do expect that with that product portfolio and the change, as Todd spoke about on the sales team, that we should see that start to accelerate in the second half of 2025.

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

A

We're also putting a much, much greater focus on the sales team on the cross-sell. And I think this is something that Scott's done a great job bringing to Fastly, that's going to help us drive the Security opportunities that exist within our current customer base, and I think help us drive that recurring revenue growth overall.

Operator: [Operator Instructions] . And we'll go next to Rudy Kessinger at D. A. Davidson.

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

Q

Hey, great. Thanks for taking my questions, guys. I'm curious, just on the exclusion of the TikTok US revenue, just to be clear, like as of February 12 and year-to-date, like is that traffic still flowing at roughly the sub 2% of revenue rate that it's been flowing at or has it been cut off yet or any [ph] segregation (00:38:01) to it?

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

A

Yeah, it's a great question. It's an important one. We're very mindful of ensuring that we're always operating within the bounds of law. We've been in very close contact with authorities to ensure we do that. But yes, currently, it is running and yeah, and it's running under kind of normal load. We – just to be prudent, we know that there's very kind of increased uncertainty on what will happen to that US traffic after Q1. And so, we've just excluded any potential revenue from that US traffic beyond Q1. Sorry, we've excluded beyond Q1 in our guide – in our guidance.

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

Q

Beyond Q1. Okay. Got it. That's helpful.

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

A

Yeah.

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

Q

So, it's in the Q1 guide, but not beyond it. Okay. And then just with Edgio shutting the network down, just what benefit, if any, did you see in Q4 post their bankruptcy announcement? And I guess, the same question in Q1 and really, what is baked into the 2025 guide from share gains and traffic gains from the customers who were running sizable traffic on their network?

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

A

Yeah, there's been a handful of benefits and some for sure we predicted and some were a little bit of an upside. It's interesting we saw some new logos come to Fastly and I know that a lot of Edgio, mostly Edgio revenue is – was already on shared Fastly customers, so we did see more than 10 new logo wins from users that were using and leveraging Edgio and those folks coming over to Fastly. That's a significant chunk and it was really nice to see that momentum and those customers choosing Fastly across the market.

We also have been diligently working on bringing as much of that Edgio traffic onto the Fastly platform instead of other competitors. That is a sort of constant engagement with those customers. And it also is driving a lot of kind of capacity build that we're looking at in 2025 to ensure that we can backfill all of the Edgio traffic that we can possibly bring onto the platform. And we're trying to manage that with being careful in our capital spend and our gross margins. But for sure, we want to be a platform where all the traffic that's possible can come onto the Fastly platform.

But the last thing I'd say there is certainly the pricing environment, not just because of Edgio's shutdown, but a handful of these [ph] point (00:41:00) CDN providers shutting down. I think the pricing environment in 2025 certainly looks a lot better than it did in 2024 and we're trying to do our best to try to figure out how to quantify that. But it is for sure – it's for sure an upside for 2025.

Operator: We'll go next to Sanjit Singh at Morgan Stanley.

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

Q

Hi. Thank you for taking the questions. I wanted to get back to sort of the business mix shift dynamics going on between your top 10 customers and your non-top 10 customer. And it looks like the second derivative on growth improved on the top 10 customer side. And I think, Ron, correct me if I am wrong, that you're pointing to that mix stabilizing in the low to mid-30s. What sort of – what gives you confidence on that underlying stabilization and some of the improvement that you saw this quarter on a [ph] secondary (00:41:57) basis.

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

A

So, we've moved to a much higher touch customer engagement near customer success motion. We're leveraging a whole host of new analytics and statistics, both internal and external. We have a much tighter executive engagement. We're doing very, very high touch revenue projections for all of these accounts. And so, I think we have a much better view of sort of what is on horizon for each of those major customers. We've also been able to bring on new workloads in many of those customers.

And as we start – as we're starting to see them ramp, we're able to sort of project what the revenue will be like in 2025 there. Of course, we did have a pretty precipitous decline in that customer cohort in the middle or beginning and middle of 2024. And so, as we kind of shake past the year-over-year compares for that and the big growth rate, the year-over-year growth rates will start to improve.

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

Q

Understood. And then, on the Security business, excluding the true-up, 17% growth is a pretty nice number. It looks like an acceleration versus the past couple of quarters. You have a new DDoS service out. Just any sort of expectations on whether the growth rate that you're seeing, call it, sort of mid- to high-teens, [indiscernible] (00:43:28) sustainable going forward to 2025 and some of the drivers for that. Thank you.

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

A

Sure. It's a great question. On the Security front, I think the 17% growth rate is okay, but I certainly think we can do better than that. I think the market is actually growing at about that rate. And certainly, we're looking to pick up share here. The portfolio maturity, bringing on fully turnkey reactive DDoS, bringing on a fully capable homegrown bot solution has helped really complete the portfolio and be able – and put us in a position to be able to sell the entire Security offering, including a managed service offering there to pretty much every one of our accounts.

I don't think we felt the full acceleration of that yet. The go-to-market change, the Security specialization, our sales team, the cross-sell incentives, et cetera, are really just starting to take hold. And so certainly, I'm hoping that we'll be able to do better in 2025 than 2024.

Operator: We'll go next to Madeline Brooks at Bank of America.

Madeline Brooks
Analyst, BofA Securities, Inc.

Q

Hi, team. Thanks for taking the question today. I guess, I'm going to ask on the Security growth and segment mix a little bit different. If I take the segment contribution from 4Q and just apply it roughly to the fiscal year guide, I think the guide is calling for a majority of the revenues to actually be flat. But more importantly, Security growth still continues to look weak. And I'm just comparing that on a year-over-year comp, it's not that difficult. But more importantly, when I look at the space, the space is growing, and there're really only two other players in the space, and they're both larger than you, but also growing faster, which I guess just means that there's still a problem with growth. And I appreciate the packaging and the changes in go-to-market, but it feels like maybe there's other underlying issues as well. And I'm just wondering how you can do better just given your smaller size in the market. Thanks.

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

A

Yeah. Look, I think it's a good question. And I think for sure we can do better than we're doing. I think 17% year-over-year growth here is a good result. But I fully believe we can do better than that in 2025. I think the reality here is, number one, we may be smaller, but we are far more focused. We don't participate or build products for the entire market. We only focus on edge-delivered Security technology that is targeted to the web application and API protection space.

And that means we're selling to web developers, the cloud engineering, platform engineering teams, the same people who buy our observability, our delivery and our Compute product line. So, we have greater focus, and we have a great architectural platform to build on top of. We have the highest performing edge platform in the world. I think that gives us a real leg-up in how we can compete, even if we're smaller than some of those competitors. I believe the biggest lever in 2025 for Security growth is going to be on the go-to-market focus, expertise, specialization and leadership. We feel really comfortable with the way the portfolio has shaped up now, and we're leaning into that go-to-market motion in 2025.

Madeline Brooks
Analyst, BofA Securities, Inc.

Q

Got it. And on the Security piece as well, do you feel as though there are any additional talent hires you need to make to really drive differentiated change in strategy here to help you meet those goals?

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

A

Well, I'll tell you what, I think on the go-to-market side, bringing on great leadership like the new APJ position that we have that we're searching for right now, I think that will absolutely help us. And there's tons of Security opportunity in APJ it's just having been tapped yet. But we've made great leadership hires, the new head of our SE organization, new head of our US enterprise sales, both with Security background. I feel pretty good about the way the leadership, our go-to-market leadership is shaping up, especially looking at their Security background from Scott on down.

Operator: We'll move to our next question from Jeff Van Rhee at Craig-Hallum.

Jeff van Rhee
Analyst, Craig-Hallum Capital Group LLC

Q

Great. Thanks for taking the question. Just a couple. On the gross margin side, and as you look at the push in international markets on the delivery portion of the business, just talk about the vision for international and how long you would expect that to be a drag on the overall gross margins? Or asked differently, just a higher-level picture in terms of the push towards international markets, given the lower gross margins, you've called out.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, I mean, there's a couple of drivers going into that across the – and certainly exiting 2024 where we did see in a handful of our largest customers greater price declines than we've seen historically. We think that reverses in 2025, which will largely impact favorably 2026 margins.

Todd touched on the fact that we have some incremental investments to rapidly bring on capacity to accommodate the Edgio traffic. And then, we do see the international traffic. As we grow, that becomes a bigger percentage. That headwind largely gets resolved. As that traffic grows, we continue to make improvements in the rates and efficiency of our cost structures internationally. And so, I think that works its way through largely in 2025 as that capacity grows.

Jeff van Rhee
Analyst, Craig-Hallum Capital Group LLC

Q

And on the delivery side, I think you'd called out you had your large media customers were unusually focused on profitability and not so much on growth. And that was why we were seeing very challenged bit growth. Just curious how you'd characterize their posture and approach right now?

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

A

Yeah. You know what, I don't think they've changed too much. I think we found a new normal, and maybe a healthier normal for the market in general. And we've taken the correction, and now we're sort of back to the growth path that we'd like to be on. What we're seeing in most of those large accounts is a real opportunity for us to expand the use cases, expand the areas in which they use Fastly, and that they bring workloads to our platform, not just in delivery but across the portfolio.

Operator: [Operator Instructions] We'll go next to Rishi Jaluria at RBC Capital Markets.

Christopher Fountain
Analyst, RBC Capital Markets LLC

Q

Hi. This is Chris Fountain on for Rishi Jaluria. Thanks for taking my question. Could you share some more details on what drove the decision to evolve the sales incentives, as you discussed? And does this decision have any impact on your 2025 guidance philosophy?

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

A

I'll leave the guidance philosophy to Ron. But we've spent – we know that the path forward here, the best and strongest path forward is to build a more diversified Fastly, not just in customer mix, but in portfolio mix, including the Security, Compute, Observability product lines. And so, by incentivizing the sales team to drive that, number one, we are incentivizing the cross-sell revenue, which tends to be more efficient for us to acquire, and it also builds – you need to build a stickier multi-portfolio, multi-product line customer relationship and a stronger, more diversified revenue base.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, on the overall guide, I would say philosophically we haven't made any real changes to how we look at it. There are a couple of important things, in 2025 though, the engagement we have with our largest customer gives us better visibility to their traffic profiles and expectations around those customers, which we think reduces some of the volatility that we saw last year. We spoke about how we've addressed some of the volatility around TikTok, particularly around the US. So, there are particular events that we've taken into account. But overall, philosophically, it hasn't changed. We provided guidance around what the visibility is we have today taking into account those dynamics.

Christopher Fountain
Analyst, RBC Capital Markets LLC

Q

Got it. Thank you.

Operator: And we'll take our next question from James Fish at Piper Sandler.

Q

Hey, guys. Thanks. This is [indiscernible] (00:52:11) for Jim Fish. Todd, maybe for you, the edge computing story seems to be a little bit lost here, even though I think as we talk about AI infancy, it's only increased across the space. So, maybe help us understand what you're doing from a go-to-market or messaging perspective to drive adoption of the Fastly Compute platform, and then how you're balancing kind of adoption with actual monetization of that platform.

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

A

Yeah. And I'm sorry if it seems lost, but I feel really bullish about the Compute trajectory here, especially the launch of AI Accelerator and our focus on those AI workloads, and how the edge really works in that AI architecture, driving cost savings, driving responsiveness, and a low latency, more organic feeling interaction. In 2025, I believe the big growth lever here is going to be on the Security side. And maybe that's why we've focused more about it. But I do feel pretty good about where that Compute portfolio is. We're seeing significantly increased workloads and demand on the system, and some very interesting use cases coming out of the customer base right now.

Q

Got it. That's helpful. And then, Ron, maybe for you, digging a little bit deeper into a prior question that was asked. With Edgio customers, where you've already had exposure, so kind of shared customers at this point, are you seeing those customers willing to accept a decrease in overall CDN exposure, or do you expect and have they messaged you that they will diversify over a kind of medium term? And so, this is more of like a near-term bump that may kind of be spread over the longer term. Thanks.

Ronald Wayne Kisling
Chief Financial Officer, Fastly, Inc.

A

Yeah, no, that's a good question. We have not seen any indications that the departure of Edgio means that they would be looking to sort of replace them with another party in terms of diversifying their overall traffic. I think most of these players are already multi-CDN, and they still have a healthy mix of [indiscernible] (00:54:25), but there is an opportunity for us to – that share that Edgio had to pick up a big piece of that.

Operator: And that concludes our Q&A session. I will now turn the conference back over to Todd for closing remarks.

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

Thanks so much. 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 all of our shareholders. Thank you so much for your time today.

Operator: And this concludes today's conference call. Thank you for your participation. You may now disconnect.