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# Cloudflare, Inc. (NET)

Q4 2020 Earnings Call

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Ladies and gentlemen, thank you for standing by and welcome to the Cloudflare Q4 2020 Earnings Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Jayson Noland, Head of Investor Relations. Thank you. Please go ahead, sir.

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**Jayson Noland**

*Head of Investor Relations, Cloudflare, Inc.*

Thank you for joining us to discuss Cloudflare's financial results for the fourth quarter 2020. With me on the call, we have Matthew Prince, Co-Founder and CEO; Michelle Zatlyn, Co-Founder, President and COO; and Thomas Seifert, CFO. By now, everyone should have access to our earnings announcement. This announcement as well as our supplemental financial information may be found in our Investor Relations website.

As a reminder, we'll be making forward-looking statements during today's discussion including, but not limited to, the impact of the COVID-19 pandemic on our and our customers', vendors' and partners' operations and future financial performance; anticipated product launches and the time and market potential of those products; the company's anticipated future revenue, financial performance, operating performance, non-GAAP gross margin,

non-GAAP net loss from operations, non-GAAP net loss per share, shares outstanding, non-GAAP operating expenses, free cash flow, non-GAAP effective tax rate, dollar net retention rate, free and paying customers and large customers.

These statements and other comments are not guarantees of future performance, but rather are subject to risks and uncertainties, some of which are beyond our control, including but not limited to, the extent and duration of the impact of the COVID-19 pandemic and adverse conditions in the general domestic and global economic markets. Our actual results may differ significantly from those projected or suggested in any forward-looking statements. These forward-looking statements apply as of today and you should not rely on them as representing our views in the future. We undertake no obligation to update these statements after this call.

For a more complete discussion of the risks and uncertainties that could impact our future operating results and financial condition, please see our filings with the Securities and Exchange Commission, as well as in today's earnings press release. Unless otherwise noted, all numbers we talk about today other than revenue will be on an adjusted non-GAAP basis. All current and prior period financials discussed are reflected under ASC-606. You may find a reconciliation of GAAP to non-GAAP financial measures in our earnings release on our Investor Relations website. For historical periods, a GAAP to non-GAAP reconciliation can be found in the supplemental financial information referenced a few moments ago.

Before finishing up, I'd like to invite you to our Virtual Investor Day tomorrow, starting at noon Pacific Time. We have an exciting agenda planned. Matthew will start things off with a focus on our culture of innovation. Michelle will be hosting a customer panel, including NCR, Garmin and Common Spirit Health. Jim Taylor, our Chief Product Officer, will host a panel of Cloudflare product leaders. And finally, Thomas will provide a financial update, before we finish with Q&A. You'll find a registration page on our IR site. Additionally, we'll be virtually participating in the JMT Tech Conference on March 1 and the Morgan Stanley TMT Conference on March 2.

Now, I'd like to turn the call over to Matthew.

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## Matthew Prince

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

Thank you, Jayson. We had an excellent quarter that topped off a remarkable year. We achieved \$125.9 million in revenue, up 50% year-over-year. For the year, our revenue was a bit over \$430 million, up 50% over 2019. I wanted to pause and thank all our team at Cloudflare for the hard work that resulted in another year of extraordinary growth. Beyond revenue, our other business metrics in the quarter were very strong. Our paying customer count grew to over 111,000, up 10% quarter-over-quarter and our strongest quarterly growth in several years.

Large customers, those that spend over \$100,000 per year with us, continue to be our strongest growth area, adding 92 new customers in Q4 and bringing our total large customer count to 828. Revenue from these large customers increased sequentially to 49%, up from 47% in Q3 as our sales team continues to close larger and larger enterprise accounts. As you look across customer segments by size, our large customer segment is growing the fastest. This is because of new logo wins and also because our land-and-expand motion is picking up steam. We saw initial evidence of this earlier in the year, but are now seeing it reflected in lagging indicators like dollar-based net retention, which increased 300 basis points sequentially to 119% in Q4. While there may be some volatility in that number going forward, I'm encouraged that when you dig into what's behind that improvement, it's being driven primarily by customer adoption of our expanding product portfolio. In particular, we're seeing more of our existing customers adopt Cloudflare for Teams, our Zero Trust network security solution, as well as Magic Transit. Customers see that they can use the full range of Cloudflare's products to achieve the

Corporate Network of the Future. This is the vision we articulated with Cloudflare One and it's resonating with customers. In other words, our sales team is more successful in part because our R&D teams keep delivering more products and features our customers need. Innovation is the energy that fuels Cloudflare.

One thing that kept coming up over the course of the quarter was how our pace of innovation is catnip for developers. This is something I plan to talk more about tomorrow at our Investor Day. But to give you a preview, from our earliest days, developers were our core audience. We made it easy for them to sign up and get started using our services without having to go through a traditional sales process. If a feature did not work exactly how they wanted, we let them have full control through our Workers development platform and while we augment our developer-first signup process with a terrific sales team, every product we launch is designed to be adopted by developers first.

One way of measuring this is the rate at which developers are adopting our Cloudflare Workers edge computing platform. In Q4, more than 50,000 new developers wrote and deployed their first Cloudflare Worker. That rate of new developers building on Workers for the first time in a quarter has more than doubled since we last reported it in Q2.

But it's not just Workers that brings developers to Cloudflare's platform. That's why one of my favorite stories from the quarter was not one of our biggest wins on a dollar basis, but rather one that I think evidences how developers see the broader Cloudflare platform. The engineering team at one of the leading software companies themselves building tools for developers approached us about better securing their own development environment. This project wasn't imposed by the IT organization from the top down, but instead led by developers at the company from the bottom up.

They knew having seen increasing threats and attacks like the one that impacted SolarWinds, they needed better access controls. They led the process to find the best solution and they chose Cloudflare Access, part of our Cloudflare for Teams suite.

In our conversations with them, one theme kept coming up. Cloudflare is the only company with a Zero Trust solution that really understands and is built for the needs of developers. It's a \$70,000 annual deal to start and we expect we'll be able to grow with this customer. But I think it's an indication of something more important: Developers are the future of IT and having won their trust, we expect will help us win, retain and expand more and more customers over time. To that end, here are some of our more traditional big wins for the quarter.

A Fortune 500 oil and gas conglomerate signed a three-year \$1 million deal to implement a portion of our Cloudflare One architecture, including Magic Transit, DDoS mitigation, firewall and DNS. We replaced spend they had with legacy telecom providers. They had faced serious technical challenges trying to integrate the telecom's network services with third-party offerings. We also beat out a number of point-cloud solutions. The customer appreciated our ease of use, technical innovation and the way multiple products fit together into a unified solution. A Fortune 500 US financial provider signed a three-year \$1.6 million deal to replace legacy telecom spend and move towards the Cloudflare One architecture. They were particularly impressed with our product roadmap and our pace of innovation.

Sticking with Financial Services for a second, a Fortune 500 Asian financial services company signed a four-year \$8.5 million deal with us. They too are implementing our Cloudflare One architecture to modernize their corporate network. While we often win deals that are driven by developer teams, this is an example of a classic IT-led RFP. Our sales team engaged with the customer, built the relationship and won the business. As part of the win, our Solutions Engineering team was able to use our Cloudflare Workers platform to seamlessly migrate the customer

from their previous provider. A Fortune 500 pharmaceutical company leaned into their Cloudflare implementation, further adopting the Cloudflare One architecture. They signed a \$450,000 per year deal to add our Magic Transit service. The company had received a threat from a hacker targeting their network. We received the call from the customer on a Friday and had them onboarded over the weekend. I think this speaks both to the nimbleness of our solution and also to the fact that when existing customers have security needs, Cloudflare is increasingly their first call.

A Fortune 500 semiconductor provider signed a three-year \$1.4 million deal to replace a legacy network provider. The buyer appreciated our technical innovation, the way our products seamlessly work together and our performance. They said their previous vendor solution "works, but it's clunky and slow with bolted-on parts." As for Cloudflare, he described that as "much more agile" and the "Company of the Future." That really made me smile.

A Fortune 1000 enterprise software provider signed a three-year \$2.6 million deal to implement Cloudflare across their organization. They initially came to us in order to improve their performance in China, something they struggle to be able to do with any other provider. They were also impressed with our Workers edge computing platform, they're a fast growing, technically savvy organization and we look forward to growing with them on their path to joining our other Fortune 500 customers.

Before I hand it over to Thomas, I wanted to take a second to reflect back on 2020. It was a remarkable year for Cloudflare, for the Internet and for all of humanity. We were proud to be there when the world needed the Internet more than ever before. Helping our customers shift to remote work, ensuring the network itself could scale to handle a massive increase in traffic, providing the Athenian projects and Cloudflare for Campaigns to ensure cyberattacks didn't disrupt the 2020 election and most recently launching Project Fair Shot to help governments, municipalities, hospitals, clinics and pharmacies around the world more fairly distribute the COVID-19 vaccine.

As one of the hundreds of organizations that has reached out to implement Project Fair Shot said the other day, "Cloudflare has literally helped save lives." It was incredible to watch our team rapidly build the technology behind Project Fair Shot on our Workers platform and deploy it at tremendous scale in a matter of weeks. We're incredibly proud of how our technology and expertise helped make a challenging year a little bit better. But it wasn't easy. We had to shift to working remotely while continuing to recruit, hire, innovate, deliver, scale and sell our services. While there were some tailwinds, there were a lot of headwinds too. In April, for instance, traffic grew across our network more in two weeks than we had expected it to over two years. That put pressure on our business. Less than 5% of our revenue comes from usage-based products. So in traffic spikes, our associated costs spike, but our revenue doesn't automatically follow.

Now customers love the predictability of this. The last thing anyone wanted in 2020 was a surprise bill. And our consistent pricing is one of the things that differentiates us. But that means our team has to do the hard work, renegotiating the bandwidth agreement, inventing new technologies and continuing to wring out every penny of efficiency. That's why I was particularly impressed that our gross margin was 78.1% in Q4; it's actually down 60 basis points year-over-year. I'm proud of the fact, however, that we could do all the things to keep the Internet working the way it needed to in 2020 and it only costs us 60 basis points. We didn't raise prices on our customers when they needed us most. We didn't sacrifice the quality of our service. We did what we do, invented new technology and got more efficient and going into 2021, look out, we're a lean, mean innovation machine and we have no intention of slowing down.

With that, I'll turn it over to Thomas.

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## Thomas J. Seifert

*Chief Financial Officer, Cloudflare, Inc.*

Thank you, Matthew and thank you to everyone for joining us. While it has been a year of challenges, I'm extremely proud of our team's performance and unrelenting execution and serving our customers and global communities with an outstanding fourth quarter where we again exceeded the high end of our guidance, wrapping up an exceptional year across the board. Total revenue for the fourth quarter increased 50% year-over-year to \$125.9 million. Total revenue forecast for 2020 also increased 50% year-over-year to \$431.1 million.

Since 2016, we've grown at a compound annual growth rate of 50%, demonstrating our continued growth at scale. From a geographic perspective, we saw noteworthy strength in the US and EMEA. The US represented 53% of revenue and increased 54% year-over-year. EMEA represented 26% of revenue and increased 60% year-over-year. Asia-Pacific represented 16% of revenue and increased 33% year-over-year. As you know, JD signed a three-year deal last year to build out 150 points of presence in China and we are excited to say that the relationship is off to an excellent start. Baidu renewed its contract in the fourth quarter for the next six months. We're in the process of transitioning from Baidu to JD as our primary partner in China. This transition might result in temporary short-term headwinds to growth in that region.

Expanding internationally remains a priority. We opened three new international offices in 2020, the first in Tokyo, followed by Paris and Toronto. With our inverted go-to-market strategy, we invest behind the demand we're seeing and the success of the customers we acquire, helping to remove risks as we continue to expand internationally.

Turning to our customer metrics, we exited the quarter with more than 3.5 million total free and paying customers, representing an increase of 38% year-over-year. In Q4, we had a record quarter of paying customer additions, adding over 10,000 paying customers sequentially and over 27,000 paying customers year-over-year. We ended the quarter with 111,183 paying customers, representing an increase of 32% year-over-year. The acceleration in paying customer growth was primarily driven by increased new product adoption from free to paying customers. We ended the quarter with 828 large customers, which we define as paying customers with greater than \$100,000 in annualized revenue, representing an increase of 57% year-over-year. We added 92 large customers sequentially and over 300 in 2020. We saw significant expansion from our large enterprise customers, which helped to drive a dollar-based net retention rate of 119%, representing a 3 point increase sequentially.

Our enterprise go-to-market efforts generated significant ROI, which we look forward to providing additional insight on during our Investor Day tomorrow. Efficiency remains at the core of our business and is demonstrated in the consistently high gross margin we generate from growing revenue and in the low CapEx we need to deploy and build out the footprint and capacity of our network. Fourth quarter gross margin was 78.1%, representing an increase of 80 basis points sequentially. Network CapEx represented 9% of revenue in the fourth quarter and 12% for the year, in line with the guidance shared last quarter. We expect to see continued variability in how we deploy Network CapEx over the year, but we expect that will continue to trend down as a percentage of revenue.

Turning to the operating expenses, fourth quarter operating expenses as a percentage of revenue increased 1% sequentially and decreased 18% year-over-year to 82%. We had another strong hiring quarter with an increase of 41% year-over-year, bringing our total number of employees to 1,788 at the end of the quarter.

Sales and marketing expenses were \$58.2 million for the quarter. Sales and marketing as a percentage of revenue increased 1% sequentially and decreased to 46% from 52% in the same quarter last year. We continue to invest in our go-to-market efforts to add sales capacity and expand our global footprint.

Research and development expenses were \$25.7 million in the quarter. R&D as a percentage of revenue decreased 1% sequentially and decreased to 20% from 26% in the same quarter last year. General and administrative expenses were \$19.9 million for the quarter. G&A as a percentage of revenue was flat sequentially and decreased to 16% from 22% in the same quarter last year.

Scaling our business efficiently remains a top priority and we continue to see strong operating leverage in the fourth quarter, with operating margin improving 1,750 basis points year-over-year. Operating loss was \$5.5 million compared to \$18.3 million in the same period last year. Net loss in the quarter was \$7.4 million to a net loss per share of \$0.02. Our effective tax rate for Q4 was negative 28%.

Turning to the balance sheet, we ended the fourth quarter with \$1 billion in cash, cash equivalents and available-for-sale securities. Free cash flow was negative \$23.5 million or 19% of revenue compared to negative \$23.5 million or 28% of revenue in the same period last year.

Operating cash flow was negative \$8.8 million in the fourth quarter or 7% of revenue, which decreased \$10.8 million sequentially and a slight decrease of roughly \$200,000 year-over-year. The Q4 decrease in operating cash flow was driven primarily by an increase in DSOs due to seasonality. Collections, however, have come in strong in January. We expect to see some level of variability in cash flow margins due to ongoing fluctuations in working capital, the growth in our large enterprise business and seasonal factors. Additionally, we expect to see cash flow impacts due to investments in leasehold improvement as we think towards the future of how we use our offices and reinvent our spaces to support a new hybrid work environment.

Before moving to guidance for the first quarter and full year, I would like to provide a brief update on COVID-related impacts and associated provisions we shared last quarter. Throughout 2020, we've disclosed the percentage of revenue represented by customers in COVID macro sensitive industries such as transportation, hospitality and retail. This cohort represented 8% of revenue in the first quarter, 7% in the second and third quarter and we are pleased to share that this percentage remained consistent at 7% in the fourth quarter. Customer concessions in bad debt also came in well below expectations again in this quarter and therefore remain consistent with historical levels. In Q4, we saw another strong quarter of new ACV growth, increasing average customer spend and high sales productivity. Remaining performance obligations or RPO remained strong in Q4, coming in at \$384 million, representing an increase of 12% sequentially and 75% year-over-year. Current RPO was 75% of total RPO.

Given the strong growth and momentum we are seeing, we remain optimistic about the demand for our product and confident in the continued growth of our business. As such, we are pleased to again raise our outlook for both the quarter and the full year. For the first quarter, we expect revenue in the range of \$130 million to \$131 million, representing an increase of 42% to 44% year-over-year. We expect operating loss in the range of \$9 million to \$8 million and we expect net loss per share in the range of \$0.03 to \$0.02, assuming approximately 306 million common shares outstanding. We expect an effective tax rate of negative 20%. For the full year 2021, we expect revenue in the range of \$589 million to \$593 million, representing an increase of 37% to 38% year-over-year. We expect operating loss for the full year in the range of \$25 million to \$21 million and we expect net loss per share over that period in the range of \$0.09 to \$0.08, assuming approximately 309 million common shares outstanding. We expect an effective tax rate for 2021 of negative 60%.

In closing, it was another very strong quarter closing out an extraordinary year. I again want to thank our employees for delivering these great results and for their continued dedication. We hope to see many of you tomorrow as we'll be hosting our first Investor Day where we look forward to sharing a deep dive on our products and platform as well as providing an update on our financial progress and targets.

And with that, I'd like to open it up for questions. Operator, please poll for questions.

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Your first question comes from the line of Philip Winslow from Wells Fargo. Your line is open.

**Philip Winslow**

*Analyst, Wells Fargo Securities LLC*

Q

Hey. Thanks guys for taking my question and congrats on a great close there, really it is a great year. In a quarter where a lot of numbers obviously jumped off the page, the one that really stood out to us was the customer count boost, the 10,000 plus that were added quarter-to-quarter in Q4. I mean that's almost as many as you added in all of 2019. Wondering if you could run us – just some more color on what's driving that. Is it some new products like Teams? Is it sort of – sort of area of your products there like security driving that? Just more color on that would be awesome and I just had one follow-up.

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah, Phil thanks for the question. We were excited to see that the paying customer count was up as strong as it was and that's our strongest quarter-over-quarter growth that we've had in some time. I think there's not one specific thing that I would point to. I think that we've built what is a strong machine, sort of a strong horse plowing through a snowfield [indiscernible] (00:25:28) if you will. But I think that we're always looking for ways that we can get either our existing customers that are on the free version of our service to pay us or to get more people to come into the funnel. And so I think there are three different areas that I would point out. The first is that our total customer count had a really strong performance as we saw people just adopting Cloudflare as a whole. A lot of those customers start out as free customers and migrate up, but some percentage will start as paying customers from day one. And so as the total customer count grows and with the strongest quarter-over-quarter growth we had in all of the – all of 2020 last quarter as well and that total customer count, that feeds that.

I think the second thing was we launched a new feature which we call Automatic Platform Optimization or APO, that had real appeal for a lot of our existing free customers, where they could, with one click of a button and a payment to us, get substantial improvement on – especially WordPress-driven sites. And so I think that that drove some potential additional attention and additional usage. And then we also saw some of the customers that were using the free versions of our Teams products. And if you remember at the beginning of the pandemic, we made Cloudflare for Teams a free product. A lot, we had very good and very strong conversion of that and that that translated into paying customers, some of which showed up in the quarter. So I think it was those three things, plus us just continuing to execute and again, I'm really proud of our team.

**Philip Winslow**

*Analyst, Wells Fargo Securities LLC*

Q

Great. And then just to follow up on that. Both Thomas and you highlighted gross margin not just this quarter, but this year and really kind of a case study so to speak of converting variable cost to fixed or no cost. But I kind of want to take the other side of that, sort of using it as the competitive weapon versus other players in the space that might charge on a variable basis. Do you think about using that in 2021 and beyond sort of as a way to think about displacements, talking to folks to maybe have these variable spikes and then had – obviously variable

change in their cost – to their provider. How do you think about using sort of your fixed or no cost model as sort of a weapon in terms of competitive displacement?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. We've seen for quite some time that there is a lot of angst over the surprise bill that variable based billing leads to. And I think that especially as you're trying to sell a service like a security service, if you get a cyber-attack, and all of a sudden you get a bigger bill from your provider, then the provider's not that much different than the attacker themselves. Both of them are costing you. And so from the beginning, we really believed that it was important to keep our core services on a fixed, predictable basis. And so a theme that we're hearing already in Q4 and coming through now into Q1 is that companies, after the craziness of 2020, are looking for a real level of predictability and we definitely see our ability to use our strong gross margin performance to potentially displace some of those providers that really surprised customers over the course of 2020.

**Philip Winslow**

*Analyst, Wells Fargo Securities LLC*

Q

Great.

**Thomas J. Seifert**

*Chief Financial Officer, Cloudflare, Inc.*

A

What I would add is I mean there are two really good examples that always come to my mind, where you can see how we can use our margin as a strategic weapon. One was certainly when the unmet [indiscernible] (00:29:09) for the very first time. You saw it last year when we gave our Teams product away for free, for pretty much most of the year and then we added other products when we supported the election platform. So we've done that in the past and we'll stay with that strategy moving forward.

**Philip Winslow**

*Analyst, Wells Fargo Securities LLC*

Q

Great, thank you for the extra color there.

**Operator:** Your next question comes from the line of James Fish from Piper Sandler. Your line is open.

**James E. Fish**

*Analyst, Piper Sandler & Co.*

Q

Hey guys, congrats on the quarter and thanks for the question. Matthew, you actually just mentioned the free-to-pay conversion of Teams is strong. Can you guys provide any more color as to really how much of that free base you've now converted versus what's left to go chase in 2021 and any other new kind of pipeline you got in Q4 for Teams?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yes, so I think that we have two different ways that we look at that. So first of all there have been companies that started out on a small portion of their team using that Teams product and so the Teams product grows naturally with the number of seats that adopt it and so our team right now is focused on a lot of – we had a lot of success which we've talked about last quarter in converting those free customers to being paying customers. And now I

think what we're trying to do largely for those is take them from being small customers and grow them into larger and larger customers over time and so that's one bit of focus.

I think we have continued to try to be really empathetic to the customers that continue to be in either industries or segments that are tough and so we have continued to extend for those businesses that are still being hampered by the pandemic, their payment terms and continue to extend that free offer. We want to be focused on the long term and we think we're building our relationship with those customers. The feedback is that they're very positive and while that's a small percentage of that overall base, that's something which we do think there's opportunity around. But the bigger one is we think that once an organization starts using the Teams product and we make that super easy for them to use for a small part of their organization, that gives us an opportunity to really expand that product over time and that's really where our team is focused.

**James E. Fish**

*Analyst, Piper Sandler & Co.*

Q

Makes sense. And on the go-to-market side, you listed off a lot of wins especially with Cloudflare One this quarter. Are reps leading with this or the individual solutions that still kind of comprise it, just any sense of how much of new bookings that really drove this quarter?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. I think that it depends. I think that the usual motion to adopting the full Cloudflare One suite remains that a customer will come to us with a very specific need. They'll need to put in new access controls around some of their applications or services. They'll need to defend against a new vulnerability or cyber threat that they become aware of. But once we get into the selling motion, what we see is that customers really care about the overall platform and how it fits together. And that's what Cloudflare One represents. And one of the things that Thomas will be talking about tomorrow during our Investor Day is how we have continued to see real strength in getting customers not just to adopt any one solution of – or any one product of ours, but to adopt that overall solution. And as we talked about in our IPO, what we think about is that once the customer is using four or more of our products, it's very, very difficult to compete with us because of the broad suite. And so we are definitely working with customers to try to get them to that four or more number and Thomas will talk about tomorrow a little bit more of the success we've had doing that.

**James E. Fish**

*Analyst, Piper Sandler & Co.*

Q

That's very helpful. Thanks, guys. Congrats.

**Operator:** Your next question comes from the line of Brent Thill from Jefferies. Your line is open.

**Brent Thill**

*Analyst, Jefferies LLC*

Q

Matthew, you mentioned the largest customer segment is growing the fastest. I'm curious if you could shed a little more light on that topic. And for Thomas, just tying into that, when you look at the quota-carrying reps that you'll add to meet the demand you're seeing in this large enterprise build out into 2021, are you accelerating your growth? Are you adjusting some of the adds that you made last year to address this segment of the market? Thank you very much.

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. Thanks Brent. So I'll start and then Thomas can add some more color. So the first thing is and again not to keep plugging Thomas' segment tomorrow, but I was just looking over the slide and we're going to provide a lot more color on exactly how the various customer segments are working and how the growth at the strongest and the largest customers is the fastest growing portion of our business. I think that's driven by two different things. I think that half of that is coming from our increasing ability at landing big deals early. And so we are seeing more and more that when there is a sort of traditional multi-million dollar RFI or RFP which is submitted, that we have the team to be able to respond to that and win those deals and the product is in place and we're winning more of those deals at the very beginning and I think that's a really good sign. I think the other part that's a really good sign is that our land-and-expand motion continues to pick up steam and we're seeing more customers grow into those larger categories. And again tomorrow, Thomas will provide more clarity on that.

But I think that what we see across our entire organization is that we're adding the support in order to really make sure that those customers have a terrific experience and that means bringing on great salespeople. We're not one of the companies that believes that you can get away without having salespeople. If you have customers who are spending \$1 million to \$10 million with you, they want to have someone that they can really build a relationship with. And so tomorrow we'll outline a lot of some of those sales leaders who have joined our team and their really incredible kind of enterprise DNA that they're bringing with us and I think that's making us a better and better company.

**Thomas J. Seifert**

*Chief Financial Officer, Cloudflare, Inc.*

A

And addressing your second question, we've invested heavily in sales capacity last year in terms of quota-carrying reps, but also leadership and we've hired great talent. I think the real positive over the last year was that we've been able to keep our sales productivity extremely high both in terms of how fast we onboard people and how fast they run, but also in terms of how much flow that they retire once they are ramped on and we will continue to invest in sales capacity moving into this year.

I think we've always said that our commitment to spend on sales and marketing will continue as long as it returns those superior top line growth and it worked really well and successfully last year, the team has done an outstanding job and will continue to pursue this path for this year too.

**Brent Thill**

*Analyst, Jefferies LLC*

Q

Thank you.

**Operator:** Your next question comes from the line of Keith Weiss from Morgan Stanley. Your line is open.

**Keith Eric Weiss**

*Analyst, Morgan Stanley & Co. LLC*

Q

Congratulation and very, very nice quarter and very nice year, in fact. I'm going to disagree with my colleague Phil Winslow. I think the most impressive number I saw on the page was that expansion in net dollar expansion rate up to 119%. I think it really highlights both kind of your retention has remained rock solid and you've been expanding really well within particularly those large customers. Can you tell us just a little bit about maybe help us

sort of understand the quantification of when a customer is buying Cloudflare One and getting the whole platform, what kind of uplift do you see on a typical customer when they're kind of going online with the platform?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yes. Keith, I really appreciate it [Technical Difficulty] (00:38:15), but we're following carefully and we really appreciate the success. Dollar-based net retention is definitely a lagging indicator. And I think that we saw real success in our ability to sell more products to our customers over the course of the year. And so we expected that it would pick up and it's heading in the direction that we wanted to be. We're not satisfied yet. We think there's a lot of improvement left to go. And I think we're [indiscernible] (00:38:49) of ourselves. We use a pretty conservative dollar-based net retention definition. And I think that that's been something which we've grown into. What I think is important though is that it's a real indication of how our R&D team's ability to deliver new products really supplements the ability for our sales team to be able to sell more to our customers over time.

And so what we're seeing is that with Cloudflare for Teams and with a broader sort of definition of Cloudflare One that we are able to go to customers and get them to oftentimes significantly increase their spend with Cloudflare. And then over time [indiscernible] (00:39:36) products are sold based on a seat basis, we think that we will be able to continue to expand with them over time in a way that many of our traditional products haven't been. So we're excited about this. We do see some significant uplift from it. And I think that that's something that we're continuing to really track and are motivated by it.

**Keith Eric Weiss**

*Analyst, Morgan Stanley & Co. LLC*

Q

...a follow up. I made an assumption in that question that the retention rate was remaining solid. Can you give us some visibility in terms of that expansion in the net dollar expansion rate. Are you – is it only on the upsell portion or is there any change in the underlying kind of gross retention?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. We've had very strong numbers for quite some time and I don't think that there's anything – there hasn't been anything that has changed that underlying gross retention number; it's continued to trend very – at a very strong level. And so, most of the improvement in dollar-based retention is actually in our ability to better upsell to customers.

**Keith Eric Weiss**

*Analyst, Morgan Stanley & Co. LLC*

Q

Thank you so much.

**Operator:** Your next question comes from the line of Matt Hedberg from RBC Capital Markets. And as a reminder, please make sure that your lines are not on speaker phone when asking questions. Mr. Hedberg, your line is open.

**Matthew Hedberg**

*Analyst, RBC Capital Markets LLC*

Q

Great. Thanks so much guys and congrats on the quarter and really the year. I wanted to ask about the SolarWinds or SUNBURST breach. Kind of curious if you saw it impact pipeline, perhaps could it lead to more

free teams conversion? Just sort of curious on that aspect. I'd have to imagine you guys are in a pretty good spot to help a lot of your customers and potential future customers with those sorts of issues.

---

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. Thanks, Matt. I think it's early for us to be able to indicate clearly whether that had a significant impact yet. I think that the first thing that was the question that we got from our customers was, were we impacted? And the answer was no, we weren't a SolarWind customer. I think the more important thing and a story that I think that the market is waking up to is how a Zero Trust approach to security like the one that Cloudflare can help with really acts as almost bulkheads in a ship. There are going to be flaws in software over time. And SolarWind was impacted this time. But the real challenge is that because an attacker was able to get in through SolarWinds, they were then able to, once they were in, move across the entire organization. And that is a symptom of the previous sort of castle-and-moat approach. Once you find one way across one moat, you'll have access to the entire castle and that's the challenge where I think that the real brilliance of a Zero Trust approach is that it puts those natural bulkheads in place so that if there is some sort of breach in one part of an organization that the attacker then can't move laterally across the rest of that.

And so that's something that we have implemented as our own security systems and it allowed us to very quickly not only verify that we weren't using SolarWinds anywhere at Cloudflare, but then also to really do an assessment that there was nothing else that created an issue for us. And I think also when we sell our Cloudflare for Teams products to customers, this idea of a much more modern Zero Trust approach to security is resonating. And so I think SolarWind is one instance where it's going to be a tailwind to sell more Zero Trust approaches and we think that our Zero Trust approach is not only the most developer-friendly and the most effective that's out there and I think over time that will lead to more and more customers for us.

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**Matthew Hedberg**

*Analyst, RBC Capital Markets LLC*

Q

That's great. Thank you. And then Thomas mentioned in the script that – it sounds like in six months, you're going to be migrating away from Baidu to JD.com. Sort of curious on the thought process there and I think he also mentioned that there could be a slight headwind. Just sort of wondering is there any more clarification on what that might mean and really what the rationale is ultimately at the end of the day on that decision? Thank you.

---

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. So we – one of the things I think that's unique about Cloudflare is that we provide a truly global network that extends around the entire world, including into China and so for our customers that care about performance in China, this is a way for us to be able to give them a unified platform and that was a pretty, it was a pretty ambitious goal for us to set out on and we set out on a journey with Baidu in 2014 to build that one unified network and for them to be our partner in China.

They have been a terrific partner to us over the course of the last six plus years and we appreciate everything that they have done in order to help us do that. We wanted to upgrade the network in China and really make it something that was going to be even more performance and dramatically increase the presence that we had. And so we went out looking to see whether it was Baidu or JD or who would be our partner for what we hope will be another six plus year relationship and the team at JD really impressed us both in terms of their technical acumen and their ability to help us really build out what is an extensive network across what is often a very complicated region for both technical and other reasons.

And so over the course of next three years, we're working with JD to build out over 150 points of presence in China alone. We'll be able to have our customers opt in to using that if they want and we can also generate revenue as JD sells the rest of our global network to customers elsewhere. As we transition off, there was a payment that was coming from Baidu in the past for us. That will diminish and we have a payment that comes from JD that picks some of that up. But in the meantime, that transition there may be some headwinds. We don't think it's going to be material and it's all baked into our existing guidance.

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**Matthew Hedberg**

*Analyst, RBC Capital Markets LLC*

Q

Thanks so much.

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**Operator:** Your next question comes from the line of Amit Daryanani from Evercore. Your line is open.

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**Amit Daryanani**

*Analyst, Evercore Group LLC*

Q

Yeah. Thanks for taking my question guys. I guess two for me as well. First off, I was hoping if you could maybe talk about how do you think about product deployment versus product development in calendar 2021 because if I think about the last 12 months, right, the velocity of new product launches is fairly impressive. I can't imagine how much the TAM has expanded since the IPO. But if you think about calendar 2021, should we think about this new product innovation to sustain the same cadence? Or do you think we spend more time perhaps scaling these products up to further increase your wallet share with customers?

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**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. Thanks for the question. And I think that our rate of innovation is something that Cloudflare was really designed for and it's something that I may be talking a lot about at the Investor Day tomorrow about how we do that. We have no intention of slowing down our rate of innovation. And so I think that you will see a series of product weeks that will be very similar to what you saw in 2020 with really great launches across that. That will include both taking products that we have announced and are currently in beta and moving them into GA. And so we're excited about some of the extensions to our Workers platform, being generally available, things like Durable Objects and making that something that people can sink their teeth into and really work on. And the early feedback from the beta users has been terrific, but it also means us thinking about and dreaming up new ways to take our network and deliver more value to that.

And so I think that 90% of our products and engineering organization is really focused on how do we take our existing products, take feedback from our users and continuously make those better, like a traditional product organization. But we have this one team which we call ETI for Emerging Technology and Incubation, which is about 10% of our R&D efforts, who are really thinking about how do we dream up what is over the horizon and they are not slowing down. And I think that a lot of the things that Cloudflare for Teams products and Cloudflare One, for example, are graduating out of ETI into our traditional products organization and that frees up some headroom for them to start thinking about what are the niche products that are going to shake the industry 18 months from now.

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**Amit Daryanani**

*Analyst, Evercore Group LLC*

Q

Thanks a lot for that. And if I could just follow up, as I think about the calendar 2021 revenue guide and I really appreciate you folks even giving us a guide at this point. We did 50%-plus revenue growth this year in calendar 2020. I think the midpoint of the guide implies 37% growth in 2021. What are the factors that are driving that sort of deceleration in 2021?

**Thomas J. Seifert**

*Chief Financial Officer, Cloudflare, Inc.*

A

Well, let me get started and Matthew jumps in. It served us well over the last year in times of uncertainty to be thoughtful and prudent about the guidance that we provided for the year. And I think we applied the same approach. We lean in more this year, if you compare the guidance we gave at the beginning of this year and compare it to last year. But we also have to recognize the numbers become bigger. There is a law of large numbers and there's still uncertainty out there that has not diminished making guidance an easier topic as last year. So I think it's a prudent and thoughtful approach, thinking through the opportunities, but also weighing the risk that undoubtedly are still out there.

**Amit Daryanani**

*Analyst, Evercore Group LLC*

Q

Perfect.

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

I think I would just echo what Thomas said and I think that we've tried to be very thoughtful throughout this year. I remember at the – when we were back in April or early May and after our Q1 guidance, I mean we didn't know what the world was in store. And I think there's a lot of uncertainty still out in the world. And while we've seen an enormous amount of success and we're excited, we want to be extremely prudent about how we think about the future.

**Operator:** Your next question comes from the line of Jonathan Ruykhaver from Baird. Your line is open.

**Jonathan B. Ruykhaver**

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

Q

Yeah. Thank you and congrats on the performance. So, I have a two-part question on security. First, can you talk about the opportunity you're seeing to cross-sell across the more traditional WAF [indiscernible] (00:51:12) service products and the newer offerings like Access Gateway and browser isolation? Just what kind of spreads are you seeing there.

Then the follow-on would be what is the impact to cost of goods when you sell both that security reverse and forward proxy use case? Is that a point of future leverage in the model?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah, thanks, Jonathan for the two questions. I can take a stab at both and then Thomas may have something to add. So I think that we've been very pleasantly surprised at the way that there is a cross-sell opportunity from different products. I think the two that seem to go together like peanut butter jelly for us have been our access products, which is all about how do we secure the access to applications which are exposed to internal users and

our WAF and DDoS products. I think other competitors in the market often think that sort of Access and Gateway fit naturally together and we see that as well.

But there is really an opportunity and what we're seeing is that as people are adopting a Zero Trust approach, that means exposing more applications to the Internet. And while access controls are important to that and Internet Gateways are important to that, when those things get exposed to the Internet, they have traditional Web application firewall concerns and they especially have DDoS mitigation concerns.

And so those different products end up fitting very nicely together and customers like that they can manage all of their security needs through one pane of glass and that's I think something that is very differentiated in our products versus other products that are in the marketplace or trying to cobble together a number of different solutions in order to get what Cloudflare offers out of the box.

Your second question I think is it really goes to what is the other side of the same advantage that we have, which is that early on in Cloudflare's history, we made a determination that every single server everywhere across our network would run every single bit of our software. And so that means that we can deploy as we need more capacity for one product or another that the network automatically adjusts to that and allows us to be able to adapt. What that also means is that for products that are sort of as, as you put it, forward versus reverse proxies which is just a direction that traffic is flowing. It turns out you only pay – when you're paying for bandwidth, you only pay for the larger kind of in versus out. And so it can often be – at least on a bandwidth basis, it can often be that we can add new products to a customer's overall bill without it significantly changing what our underlying cost infrastructure is. And I think that's part of the secret sauce of how Cloudflare works is our product team is always looking at what are the excess resources that we have on our network and how can we deploy products in order to take advantage of those excess resources. And so as we add – if we have a customer that's using our DDoS and WAF, if we get them to adopt Access and Gateway, it doesn't meaningfully change our cost basis. And that also means that we can be very competitive and especially on an ROI basis versus competitors and we can bundle products together in a very effective way.

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**Jonathan B. Ruykaver**

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

Q

Got it. That's very helpful. Thank you very much, Matthew.

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**Operator:** [Operator Instructions] Your next question comes from the line of James Breen from William Blair. Your line is open.

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**James Breen**

*Analyst, William Blair & Co. LLC*

Q

Thanks for taking the question. Can you just give us a little more color on sort of how the revenue mix is split out and the success you've had internationally relative to the US? And I know you've talked a lot about sort of the architecture network helping from a compliance standpoint as software's delivery. Can you just talk about that as well? Thanks.

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**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Sure. I think that we had a very strong year in both the US and Europe. Today, the US represents about 50% of our revenue and the rest of the world is the other 50%. I think that Europe has had very strong growth and has really been a standout for some time. We had some – we were watching carefully, especially as there were

concerns around adoption of some US technology companies and some of the privacy regulations. But what I think you'd see in Q4 was we really leaned into the fact that Cloudflare is a privacy-first organization and we saw that pay off in the results where more and more European customers are willing to adopt us. And we're actually seeing a number of European governments turning to Cloudflare as part of Project Fair Shot as they roll out the vaccine deployment and I think that is a good early indication of the trust that we've built in that market.

Asia throughout 2020 has been definitely in a transition year for us and we saw that its growth has not been as strong as we've seen in Europe. The reason for that and we've talked about this on previous calls that the reason for that is that it is a complicated market in terms of how – in terms of the multitude of various bandwidth providers and you have a bit of a chicken-and-egg problem where in order to get enough bandwidth to get great pricing from providers, you have to have a whole bunch of customers. But in order to get a whole bunch of customers, you have to have great pricing. And so we made what I think was a very smart and rational decision earlier in Cloudflare's history to take on customers that we knew we would be unlikely to have with us over the long term, but that we had – that would give us that initial bandwidth usage in the region in order to get the interconnectivity, the performance and the pricing that we needed. And so, I'm encouraged by one of the examples that we gave with the \$8.5 million contract for a large Asian financial institution which adopted us, they are going to be a real lighthouse customer for us. I think they're going to up-level the response there. We've also brought in a new Head of our Asian sales effort who came to us out of AWS and we're super excited for him to join and I think that Asia is really poised to be a – to kind of go from a rebuilding year in 2020 to a real position of strength in 2021.

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**James Breen**

*Analyst, William Blair & Co. LLC*

Q

Great, thank you.

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**Operator:** Your next question comes from the line of Gray Powell from BTIG. Your line is open.

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**Gray Powell**

*Analyst, BTIG LLC*

Q

Okay, great. Thanks for working me in here and congratulations on the good quarter. So yeah maybe some other follow-up questions on Cloudflare Access. In our fieldwork, we've heard that a lot of customers that bust out in March of last year to increase their legacy VPN capacity for work-from-home initiates that they're now looking for more modern solutions and I think you kind of hit on that earlier. But is that something you see today and do you see a potential for Cloudflare Access adoption to accelerate over the next six months?

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**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah thanks, Greg, for the question. I think that the story of 2020 was really everybody kind of holding on for dear life in the IT world and hoping that they can hold things together. And that meant if you were relying on a bunch of legacy hardware VPNs, you put in a big order early in the year just to get whatever you could in the door to make sure that your team could continue to be productive. But what I'm hearing from the CTOs and CIOs and CISOs that I talk with is one phrase over and over again, which is never again. They, having lived through this and seen the pain that it caused, they never want to be in a position to have to manage something like that again. And I think also large enterprise organizations are waking up to the fact that the sort of workplace in the future is going to be more flexible about where and when and how people work.

And so we're definitely hearing from people who are – who – frankly for the last nine months were like, I'm too busy to even take your phone call. They're now starting to put their heads up and say, I don't want to keep

investing in what I know is the solution of the past. And so I think that that definitely, for both our Access and Gateway products, but really for the overall Cloudflare One solution is important. And so I don't think that – there – I don't think that we are at the sort of tail end of that wave of transformation. I think we're much, much, much earlier in that process and the story of 2020 was not CIOs sticking their heads up and saying, gosh, we got to go, sign up for Cloudflare. The story of 2020 was people were trying to figure out how to survive.

I think the story of 2021 might be that there is a much broader move away from what had been a traditional castle-and-moat, what had been a traditional hardware-based security approach to a much more modern Zero Trust approach and we're optimistic that Cloudflare can be one of the leaders as companies do make their way through that transition.

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**Gray Powell**

*Analyst, BTIG LLC*

Q

Understood. That makes perfect sense. Thank you very much.

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**Jayson Noland**

*Head of Investor Relations, Cloudflare, Inc.*

A

Operator, can we take one more question please?

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**Operator:** Certainly, your final question comes from the line of Alex Henderson from Needham. Your line is open.

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**Alex Henderson**

*Analyst, Needham & Co. LLC*

Q

Hello, sneaking in under the wire. Hey, I was hoping you could talk a little bit about the domain-to-domain traffic protection market, particularly as we see more and more adoption of Kubernetes and other modern micro service-based applications and that in turn drives more domain- to-domain application-to-application traffic. What are you seeing in terms of that contributing to your protection of data in-flight and how do you think that evolves as we go forward? We have seen other companies trying to get into that space, but it seems like a natural for you guys?

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**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah – I also think that's – it is I think a natural extension of both our Access and our Gateway products. And one of the things that we see a lot is that customers that have complicated network architectures, where they might be running some of their own applications on a AWS or a Microsoft Azure, they may be using some machine learning out of an IBM or a Google. They may be using other staff's vendors and really coordinating between that. What we're seeing is that we have really positioned ourselves I think well to be the network that connects those various pieces together. So one of the initiatives that we launched some time ago we call the Bandwidth Alliance and that is a way that if you're moving data between clouds or between SaaS applications that we can help you do so in both the most efficient way, but also then save you money. We connect to all the major public cloud providers over a private network interface and we don't pay to send them bandwidth and they don't pay to send us bandwidth. And so our argument to them was why should we be charging customers for exchanging that bandwidth themselves? And we've had a lot of success in getting a number of the large cloud providers to adopt this and that then means that not only can you get the real benefits of Cloudflare in terms of security, access controls, visibility, but you're going to actually save money on your underlying cloud spend as well. And so I think that that's definitely an area that us being that connective tissue between cloud and between applications is a very

natural point for us and it's part of why at our core, we think of Cloudflare as a network and we're a network that can help connect multiple applications even if they are across different providers together.

**Alex Henderson**

*Analyst, Needham & Co. LLC*

Q

I wanted to, for a second question, go back to the staffing commentary. I think you said in the quarter, you had a 41% increase in staffing and I assume that more than a disproportional piece of that went into the sales and marketing piece, particularly going after the large enterprise. As we look at CY 2021, can you give us any metrics around your expectations for the sales capacity growth in that space? Is it still up in the 50% plus range on a full-year basis or any other metrics along those lines that would help us gauge that capacity expansion?

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

A

Yeah. So I'll take a stab at the beginning of it and then Thomas can weigh in if he has anything to add. I think that 2020 was pretty remarkable for us. We had nearly 200,000 people apply to work at Cloudflare and we only accepted about 0.5% of the total applicants. Of those 200,000, about half were for either – were for sales and marketing roles within the company. So we saw very, very, very strong raw numbers of applicants. And we're seeing those applicants coming to us from really other enterprise sales organizations that we admire at every level, both from early in their career to very seasoned leaders that can lead that team. And so we've invested heavily in building out our sales capacity over the course of 2020 and we will continue to invest in that and we've got a great pipeline of candidates that are excited to join our team and I'm just really blown away by the caliber of the people who we're interviewing or onboarding on a weekly basis.

**Thomas J. Seifert**

*Chief Financial Officer, Cloudflare, Inc.*

A

What I would like add, Alex, is that we will continue to invest in our sales capacity, but it's a more sophisticated approach than just hiring people. We have to balance more levers and we are getting better at it and then expanding DNR is one example. A stronger focus on channel partners and from an international go-to-market perspective will be part of that. But overall sales capacity will continue to increase and we will invest heavily into it.

**Alex Henderson**

*Analyst, Needham & Co. LLC*

Q

Okay, thanks. I guess that's a wrap.

**Operator:** I'll now turn the call back to management for closing remarks.

**Matthew Prince**

*Chairman & Chief Executive Officer, Cloudflare, Inc.*

I appreciate first of all everyone at Cloudflare who worked incredibly hard this year to take what was a challenging year and be there for each other, for our customers and for the Internet as a whole. I am proud of the role that Cloudflare played in making sure that the Internet held together during what was a year that was really, really, really extraordinary.

I'm looking forward to talking with many of you tomorrow on our Investor Day. That kicks off right at 12 PM Pacific Time. It's open to anyone. You just need to register to at our Investor Relations page which is at cloudflare.net

and so until then, looking forward to giving you more of an update and hope to see many of you tomorrow. Thank you.

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**Operator:** That concludes today's conference call. Thank you everybody for joining. You may now disconnect.

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