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Cloudflare, Inc. (NET)

Q1 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. My name is Jay, and I'll be your conference operator today. At this time, I would like to welcome everyone to the Cloudflare First Quarter 2026 Earnings 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 Phil Winslow. You may begin.

Philip Winslow

Vice President-Strategic Finance, Treasury & Investor Relations, Cloudflare, Inc.

Thank you for joining us today to discuss Cloudflare's financial results for the first quarter of 2026. With me on the call, we have Matthew Prince, Co-Founder and CEO; Michelle Zatlyn, Co-Founder and President; 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 on our Investor Relations website.

As a reminder, we'll be making forward-looking statements during today's discussion, including, but not limited to, our customers, vendors and partners, operations and future financial performance, our anticipated product launches and the timing and market potential of those products, our anticipated future financial and operating performance, and our expectations regarding future macroeconomic conditions. These statements and other

comments are not guarantees of future performance and are subject to risks and uncertainties, much of which is beyond our control. Our actual results may differ significantly from those projected or suggested in any of our 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 take 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 SEC as well as in today's earnings press release.

Unless otherwise noted, all financial numbers we talk about today other than revenue will be on an adjusted non-GAAP basis. You may find a reconciliation of GAAP to non-GAAP financial measures that are included 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.

We would also like to inform you that we will be hosting our Annual Investor Day on Tuesday, June 9.

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

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

Thank you, Phil. We had a very strong start to 2026. We achieved revenue of \$639.8 million, up 34% year-over-year. We now have 4,416 customers paying us more than \$100,000 per year, a 25% increase year-over-year. Revenue contribution from these large customers grew 38% year-over-year, contributing to 72% of revenue during the quarter, up from 69% in the first quarter last year. Our dollar-based net retention was 118%, down 2% quarter-over-quarter and up 7% year-over-year. Our gross profit margin was 72.8%. We delivered an operating profit of \$73.1 million, representing an operating margin of 11.4%. And we generated strong free cash flow of \$84.1 million during the quarter, again exceeding expectations.

The strong momentum we've seen in our business continued to build through the first quarter. Some highlights. Sales productivity increased year-over-year for the ninth consecutive quarter. Growth in hiring sales force capacity also accelerated in the first quarter, increasing at the fastest pace since 2023. Deals over \$1 million were up 73% year-over-year, the fastest growth rate since 2024. We added a record number of our largest customers in the quarter, those spending more than \$5 million with us annually. In fact, we added as many \$5 million-plus customers in Q1 as we did in all of last year.

Bookings from new customers increased at the highest rate since 2023. New pipeline generation grew sequentially at the fastest pace in five years, and we exceeded our planned target by more than any other first quarter since 2021. Our quarterly gross retention reached its highest level in four years, reinforcing that customers understand Cloudflare is a must-have rather than a nice-to-have. We are a significant beneficiary of many of the most powerful trends across the economy. To give you some sense, we added 1 million new developers in just the last quarter. Our products were made for this moment, and we are helping our customers build the future on our platform.

That's a good segue to talk about some of our customer wins in the quarter. A leading technology platform expanded their relationship with Cloudflare, signing a two-year \$10 million pool of funds contract with initial use cases for application services and our Workers developer platform. With our full portfolio now unlocked under a single rate card, we won workloads from both a hyperscaler as well as point solution competitors. Looking ahead, we are also in discussions on AI pay per crawl to control and help monetize AI bot traffic.

A rapidly growing technology company in APAC expanded their relationship with Cloudflare, signing a two-year \$8.7 million contract for application services and our Workers developer platform. Driven by the boom in AI-powered vite coding, this company has seen explosive growth and Cloudflare has become core to their infrastructure, intelligently routing billions of daily requests across the globe. This customer chose Cloudflare over a competitive bid from a hyperscaler due to the strength of our unified platform and our seamless low-latency security.

A Fortune 100 technology company expanded their relationship with Cloudflare, signing a two-year \$8 million contract for our Privacy Proxy solution, the fifth privacy engagement with this customer, solidifying Cloudflare as their go-to privacy partner. They approached us with an urgent need to handle massive scale with precise geolocation accuracy for user-initiated agentic traffic. We delivered a fully operational solution within one week, demonstrating the speed, trust, and engineering depth that continues to set us apart.

A leading insurance company in EMEA expanded their relationship with Cloudflare, signing a five-year \$5.1 million contract for application services and our full SASE portfolio. Driven by years of acquisitions, this customer's IT environment had bloated to over 600 vendors, with some employees literally juggling up to four laptops to access essential applications. By standardizing on Cloudflare, they displace six legacy vendors at signing, with 10 more displacements already underway, targeting over \$1.3 million in annual savings. Their CTO put it simply. He wanted a high-performance "Formula 1" level architecture with Cloudflare as the engine.

A Fortune 500 aerospace and defense company expanded their relationship with Cloudflare, signing a three-year \$5 million contract for our Zero Trust products, including Browser Isolation, Access and Gateway. After a major security breach forced this customer to move from on-premise hardware to the cloud, they discovered that their first-generation Zero Trust vendor's browser isolation solution could not meet critical government compliance requirements, putting \$5.5 billion in government revenue at risk. Cloudflare delivered a fully compliant solution in a matter of weeks where the incumbent could not.

A leading AI company expanded their relationship with Cloudflare, signing a one-year \$4.1 million contract for application services. As one of the most visible targets for cyberattacks globally, this customer needed a security layer to protect their massive infrastructure build-out. Despite a strong build-over-buy mentality, they chose Cloudflare, trusting a battle-tested network that has proven its resilience against the largest attacks. This is a customer that moves fast and pushes boundaries. And they're already testing our AI Gateway for their AI workloads.

Another leading AI company expanded their relationship with Cloudflare, signing a 10-month \$2 million contract for Argo Smart Routing, coming just one quarter after signing a Workers developer platform deal. This customer wants to be the fastest and most reliable AI provider in the market, and Cloudflare is delivering. After deploying Argo, they immediately reduced their average global latency by 30%. In the AI space, that kind of speed is a real advantage that our hyperscaler competitors simply can't match.

In nearly every customer conversation, it's clear, the emergence of generative and agentic AI is not just redefining the economics of the Internet and software companies, they are redefining the business models of all companies, fundamentally reshaping how organizations are structured, operate and create value. At Cloudflare, we don't just build and sell AI tools and platforms. We are our own most demanding customer. AI and agents are no longer pilot projects at Cloudflare. They are now core parts of our workforce.

It's been an interesting journey. We've been selling picks and shovels in the AI gold rush for the last four years, but we ourselves were cautious users, wanting to ensure there was real ROI before making significant investment. We avoided a lot of the performative AI some companies engaged in. Internally, the tipping point was last November. At that point, across our teams, we began to see massive productivity gains, team members that were 2, 10, even 100 times more productive than they had been before. It was like going from a manual to an electric screwdriver. Cloudflare's usage of AI has increased by more than 600% in the last three months alone.

For team members in R&D, 97% use AI coding tools powered by the same Workers developer platform we ship to our customers, and 100% of their contributions to our production code bases are now reviewed by autonomous AI agents. I think across the industry, you're about to see a massive uptick in reliability as every code or configuration change can now have a tireless and uncorrelated set of eyes trained on every incident from the last 10 years, checking to avoid problems. At the same time, the impact on developer velocity is clear. We've never seen a quarter-to-quarter increase in new code generated, bugs squashed, and technical backlog burned down like we did last quarter. It's been wild.

Beyond the product and engineering, employees across Cloudflare from HR to marketing run thousands of AI sessions each day to get their work time. Those agentic workflows rely on dozens of MCP servers to reach data in systems of record and use hundreds of centrally managed skill files, as well as many more that have been created and shared within individual teams. The harness that we've built, which we call Cloudflare OS, allows teams across the company to quickly get up and running. We've asked our team to think what the fundamental job to be done is and then reimagine how we can make the work to achieve it more efficient, reliable and joyous.

At Cloudflare, the way work is done has fundamentally changed. That means being intentional in how we architect our company for the agentic AI era in order to supercharge the value we deliver to our customers and honor our mission to help build a better Internet for everyone, everywhere. As a result, we announced significant actions this afternoon to further accelerate our evolution to an agentic AI-first operating model. That unfortunately means saying goodbye to teammates who have contributed to building Cloudflare to where we are today, resulting in a reduction of the size of our team by more than 1,100 people.

This decision is not a reflection of the individual work or talent of those leaving us. They were critical in getting us to where we are today. Instead, we are reimagining every internal process from engineering to finance to sales to run on an agentic AI backbone on our Workers platform. This isn't a cost-cutting exercise or an assessment of the individual's performance. It's about defining how a world-class, high-growth company operates and creates value in the agentic AI era.

Deciding to part ways with teammates is the hardest part of this decision, and it's a responsibility the entire senior leadership team at Cloudflare takes personally. We believe that acting with empathy isn't about avoiding hard decisions, but rather about how you treat people when those decisions are made. If we are asking our team to be world-class, we have a reciprocal obligation to be world-class in how we treat them.

By taking decisive action now, we provide immediate clarity to those departing and protect the stability of the team that remains. We are also pairing the directness of these measures with severance packages that lead the industry, because we want to ensure that those who have invested their time and talents in Cloudflare's mission are taken care of as we move into the next phase. It's the right thing to do, it's the honest thing to do, and it reflects the values of the company we are continuing to build.

On a personal note, this has been a hard day. A number of friends will no longer be colleagues. But I'm confident they will land at other great places and bring with them a set of skills they learned building Cloudflare to where we

are today. The group leaving us will build many future great companies. And I'm confident that our reshaped organization will be even more nimble and innovative as we continue to build the future. Not an easy day, but the right decision.

With that, I'll turn it over to Thomas to walk through the numbers. Thomas, take it away.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

Thank you, Matthew, and thank you to everyone for joining us. Before I begin my customary remarks on our results for the first quarter, I would like to provide additional details on the actions we announced this afternoon to accelerate Cloudflare's evolution to an agentic AI-first operating model.

Cloudflare's history proves our business model innovation is as important as our technical innovation. These two forces don't sit side-by-side at Cloudflare. Rather, they compound on each other in ways that provide us with meaningful competitive advantages and create significant value for both our customers and Cloudflare.

AI is driving a fundamental re-platforming of the Internet, as well as a paradigm shift in how software is created and consumed, and it's shaping up to be the biggest tailwind for both our network and our Workers developer platform that we've ever seen in Cloudflare's history. From this position of strength, we are again applying the same winning formula of compounding technology innovation with business model innovation. By fully embracing an agentic AI-first organizational structure and operating model, as Cloudflare's revenue scales, our efficiency and productivity will scale even faster.

Unfortunately, this decision means parting ways with colleagues who have helped build a strong foundation Cloudflare stands on today, resulting in a reduction of the size of our team by approximately 20%. These reductions are across all functions and geographies and reflect how broadly AI is accelerating our operational velocity. Importantly, however, we continue to expect growth in the net capacity of our quota-carrying sales force to accelerate in 2026, with today's actions compounding productivity to fuel our growth.

These actions will result in severance and other restructuring charges of \$140 million to \$150 million for full year 2026, approximately \$40 million of which is non-cash, with the majority concentrated in the second quarter. Our expectations for free cash flow for 2026, however, remain unchanged, with approximately 25% to 30% of full-year cash generation in the second and third quarters. By decoupling our ability to scale from the traditional dependencies of the past, Cloudflare will be structurally faster, more innovative, more productive and more efficient.

Now turning to our results. The first quarter was a strong start to 2026, with momentum building across multiple areas of our business. We continue to see rapid growth from AI and agentic workloads across our network, strength in our largest customer cohorts, continuing returns from our go-to-market transformation, and rapid adoption of our Workers developer platform.

Total revenue for the first quarter increased 34% year-over-year to \$639.8 million. From a geographic perspective, the US represented 49% of revenue and increased 34% year-over-year. EMEA represented 28% of revenue and increased 31% year-over-year. APAC represented 15% of revenue and increased 34% year-over-year.

Turning to our customer metrics. We ended the quarter with roughly 4,400 large customers, representing an increase of 25% year-over-year. Revenue contribution from our largest customers was 72% of revenue during the

quarter, up from 69% in the first quarter last year. We again saw significant strength in our largest customer cohorts, including those that spend over \$5 million with Cloudflare annually, which grew 50% year-over-year and added a record number of additions both quarter-over-quarter and year-over-year.

Our dollar-based net retention was 118% during the first quarter, down 2% sequentially and up 7% year-over-year. As we've noted previously, there can be some variability in this metric quarter-to-quarter, with growth this quarter driven by a meaningful acceleration in business from new customers, which grew at the highest rate since 2023.

Moving to gross margin. First quarter gross margin was 72.8%, representing a decrease of 210 basis points sequentially and a decrease of 130 basis points year-over-year. Paid versus free traffic on our network continued to grow both year-over-year and quarter-to-quarter, again, driving additional allocation of network costs from sales and marketing into cost of revenue.

Our Workers developer platform products, which currently carry a lower gross margin than our corporate average, delivered another quarter of significant growth. In fact, developers on our platform increased to more than 5.5 million at the end of the first quarter, an increase of 1 million developers in a single quarter as compared to an increase of 1.5 million in all of 2025.

While our developer products are not yet as optimized on gross margin, they also have a lower cost to book. And we will continue to focus on driving further efficiency improvements as our developer products scale. While gross margin may continue to trend down in the near term from these dynamics, the scalability and efficiency of our network remain intact, and we expect our unit economic margin will continue to increase.

Network CapEx represented 9% of revenue in the first quarter. As a reminder, there can be some variability in this metric quarter-to-quarter, and we expect network CapEx to be 14% to 15% of revenue for full year 2026.

Turning to operating expenses. First quarter operating expenses as a percentage of revenue decreased 3% year-over-year to 62%. Our total head count ended the quarter at approximately 5,500. The majority of new hires during the first quarter were in sales, with a particular focus on continuing to add quota-carrying account executives.

Sales and marketing expenses were \$227.5 million for the quarter. Sales and marketing as a percentage of revenue decreased to 36% from 38% in the same quarter last year. Research and development expenses were \$101.5 million in the quarter. R&D as a percentage of revenue remained consistent at 16% compared to the same quarter last year. General and administrative expenses were \$63.6 million for the quarter. G&A as a percentage of revenue decreased to 10% from 11% in the same quarter last year.

Operating income was \$73.1 million, an increase of 31% year-over-year compared to \$56 million in the same period last year. First quarter operating margin was 11.4%, a decrease of 30 basis points year-over-year.

Turning to net income in the balance sheet. Our net income in the quarter was \$94 million, or diluted net income per share of \$0.25. Free cash flow was \$84.1 million in the quarter or 13% of revenue, compared to \$52.9 million or 11% of revenue in the same period last year. We ended the first quarter with \$4.2 billion in cash, cash equivalents and available-for-sale securities.

Remaining performance obligations, or RPO, came in at \$2.543 billion, representing an increase of 2% sequentially and 36% year-over-year. Current RPO was 64% of total RPO and grew 34% year-over-year.

Moving to guidance for the second quarter and full year 2026. For the second quarter, we expect revenue in the range of \$664 million to \$665 million, representing an increase of 30% year-over-year. We expect operating income in the range of \$90 million to \$91 million. We expect an effective tax rate of 21.5%. We expect diluted net income per share of \$0.27, assuming approximately 377 million shares outstanding.

For the full year 2026, we expect revenue in the range of \$2.805 billion to \$2.813 billion, representing an increase of 30% year-over-year at the midpoint. We expect operating income for the full year in the range of \$418 million to \$421 million. We expect an effective tax rate of 20.5%. We expect diluted net income per share over the period to be in the range of \$1.19 to \$1.20. We expect approximately 375 million shares outstanding.

In closing, the first quarter has set a strong tone for the year. Our strategic position heading into this paradigm shift of the agentic Internet has never been stronger, and the opportunity ahead of us is larger and more defined than at any point in our history. We remain committed to capturing it with disciplined execution, durable growth and long-term focus.

Before opening the floor for questions, I want to again acknowledge our colleagues who will be departing Cloudflare as we move into our next chapter. They will always be part of the Cloudflare story, and we are sincerely grateful for their service to our customers and their commitment to our mission.

With that, operator, please poll for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. The floor is now open for questions. [Operator Instructions] Your first question comes from the line of Matthew Hedberg of RBC Capital Markets. Your line is open.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my questions, guys. Matthew, first, on your strong Q1 results, I find it interesting that some of your Act 1 competitors don't seem to be benefiting from monetizing agentic traffic the same way you are. I guess, first of all, why are you seeing such strong tailwinds there?

And then as a follow-up regarding the announced restructuring, really in light of these strong Q1 results, it seems to really be coming from a position of strength. I guess, the question is why now? How is it going to make Cloudflare stronger? And Thomas, have you embedded any conservatism in the guide for this action?

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

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Yeah, Matt. So, thanks. And maybe I'll start with the second because, again, I think it's I think sort of the honorable thing to do. This wasn't an easy decision, but it's the right decision. We've just seen that there are roles at Cloudflare that just aren't the roles that we need for the future. I think just because you're fit doesn't mean you can't get fitter.

And so I think that what we've seen over, especially though, of course, the last six months, is just the productivity that we've been able to gain from the people who are directly talking to customers and people who are directly

creating code. That has been just such an incredible efficiency gain. And a lot of the support, people that have provided support behind them, those roles aren't going to be the roles that drive companies going forward.

I think we've always looked a little bit in the future. And I think that you're going to see companies around every industry starting to realize the gains that they can get from these tools. And in the process, I think that that's going to change companies pretty dramatically. We are, I think, early beneficiaries of that. I think that we will continue to – we believe in people. I think that we will continue to hire people and we'll continue to invest in them because the people that are embracing these tools are just so much more productive than we'd ever seen before.

And I would guess that in 2027, we'll have more employees than we did at any point in 2026. But the roles are changing dramatically, and you've got to do something dramatic in order to make that shift, and that's why this was the right time. In other words, we're the fittest we've ever been, but we're going to get even fitter to win the next chapter.

To your first question about traffic, I think the key here is something that we've always understood, but I'm not sure the market has understood as well, which is not all traffic is created equal. A lot of the times, if you were sort of a traditional CDN customer or company, what you're trying to chase was things that drove lots of bandwidth, so video streaming of live events and things like – and things like that. And again, that was an okay business. I think it had a lot of pressure. It was largely a commodity. But that was kind of the game of being a CDN.

We never saw ourselves that way. We thought what we wanted to get in front of was the most essential traffic that was out there, not bandwidth and video streaming, but APIs and applications and seeing that. And I think that in this new world of agentic commerce and agentic transactions, our approach is showing kind of the wisdom and durability of that.

So today, literally, we're seeing hundreds of billions of agentic requests per month, and that number is growing exponentially. They are interacting with us, and we are setting what the rails and the guardrails are for that, and that's driving our Act 1 business. And then on the other side, in our Workers platform, we have built a platform that allows you to build agents that are just significantly more efficient than anyone had before.

And so across all of the parts of our business, because even in the Zero Trust and SASE space, it turns out that having more fine-grained controls about data is exactly what you need if you have kind of these somewhat new agents running around doing things. You want to make sure that they only have access to the things they should.

It's – I wish I could say that we saw all this years ago and built Cloudflare for it. But I think that the reality is that we happen to have built exactly the right set of tools for this moment. And I think that's what's separating us from some of the people that we sometimes get compared to.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Thanks, Matthew.

Q

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

Yeah. Let me take your second part regarding guidance and how this action is reflected. First of all, I would say we've been rather thoughtful. And you heard in my prepared remarks that while this action pretty much affects all teams at Cloudflare, the only exception really is our AE and quota-carrying capacity that is sitting in front of the customers. We hardly touch that. And I think we've been careful trying to reflect whatever residual risk remains in

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the guidance that we provided for the remainder of the year. So I think we – as usual, we've tried to be thoughtful and prudent in how we think about what is in front of us.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Q

Thank you.

Operator: Your next question comes from the line of Adam Borg of Stifel. Your line is open.

Adam C. Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Awesome. And so much for taking the question. Maybe, Matthew, for you, one of the things that we keep on hearing about is just how AI costs internally are really expensive, especially around R&D coding agents use internally. And so how do you think about balancing R&D agentic coding adoption with the cost? What AI efficiencies are you looking to see across the organization? And of course, how much of this risk is to offset some of what I just mentioned? Thanks.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

Yeah. So, first of all, we have seen, as usage has gone up 600% in the last quarter, we have seen costs go up, but I don't think it's gone up nearly as much as some others. And I think that's driven by a number of things. I think the least important is, it turns out that most of the big AI labs are Cloudflare customers. And so we have very good relationships with them. We work with them. We have ways of making sure that we can get the best pricing and the best models from them.

I think more importantly, though, is a lot of times we're able to run those models instead of on their infrastructure, on our own infrastructure. And so we have a fleet of GPUs and we have all of the tools with Cloudflare Workers and Workers AI to be able to build and use those tools themselves. And so, most of the use of various AI coding tools isn't even leaving our network. It's running on our infrastructure because we're very good at routing to wherever there's capacity, we're able to get a lot out of that. And so I think that's one of the reasons why we see a significantly higher utilization across our GPU resources than some of – than any of the hyperscalers and than any even of the AI labs are able to drive.

And then when we built what we call Cloudflare OS, we've paired that with our AI Gateway product. And that AI Gateway product allows you to route different requests based on what's the right model for the right task. And so that means that if we have a task which we can evaluate as being relatively simple, then we can route that to a model that might be running on our own infrastructure and be able to be delivered at essentially no marginal cost to us. Whereas if we have something that is more important, we might send that off to one of the frontier models and pay more for that.

I think that that model, again, I feel like we're living a little bit in the future. I think that's what you're going to see a number of companies doing. And as we demo Cloudflare OS to other companies, what we're seeing over and over again by CIO after CIO after CIO is, wow, we want that too. And so we already have kind of the stripped down version of that with Cloudflare as AI Gateway. But I think you might see us increasingly take some of the tools that we've built internally and actually make those available to other companies. And that's actually very normal for Cloudflare. Almost every product we've had that's been successful starts as something that we needed ourselves, and then it turns out that what we've built for ourselves is valuable to others as well.

Adam C. Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's really helpful. And maybe as my follow-up, Fortinet last night talked a lot about this opportunity that they're seeing in [indiscernible] (00:34:01) SASE. And when I think about Cloudflare and just your global network and your reach and data residency requirements globally, how do you think about the data localization opportunity, sovereign opportunity, not just in Act 2, but across the Acts? Thanks so much.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

Yeah. I mean, I think that we're uniquely positioned for a world where they're increasing regulatory or even just practical requirements around keeping data in particular jurisdictions. We're present in more than 120 countries worldwide, more than 350 cities. And we're designing all of Cloudflare's systems in order to really think of data as being able to just stay wherever your permissions are.

So if you're a customer that really cares about, I need to make sure that all my data stays in Germany because I'm a German, I don't know, a health care provider, then we can actually set that up now where your data can actually stay resident in Berlin, Frankfurt, Munich, the various data centers that we have inside of Germany. And we can do that with a level of granularity that no hyperscaler can match.

And so I think that we've – that will increasingly become an advantage of Cloudflare's network because of what we're doing. And then if you layer on top of that, the Zero Trust and SASE tooling, that's going to allow us to make sure that agents can only get access to the things that they have permission to get access to. And I think that that's actually going to be a bigger tailwind to that space. And again, we won't be the only winners there.

But I think across the board, you're going to see a lot of these principles that sort of the most forward-leaning companies had adopted previously, that those will become much more standard with what people are doing with things like OpenClaw. I mean, it's amazing how many – how the fact that we have a self-service version of our Zero Trust products, as people are experimenting with things like OpenClaw, they need to have that fine-grained data control, and we're basically the only game in town to deliver it.

Operator: Your next question comes from line of Saket Kalia of Barclays. Your line is open.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Hey, guys. Thanks for taking my questions here and nice start to the year. Thomas, maybe for you. I know the growth in different Acts, of course, has different impacts on gross margin. And of course, we spoke about sort of the proactive optimization here in the business as well. As we get through those changes here, I think you said by the end of Q3, how do you think about sort of the net impact to OpEx? And how should we sort of think about gross margins as those other Acts continue to grow?

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

Yeah. You know what, it's a topic we've been talking about for a while that the margin structure is different. The gross margin structure is different across the various Acts, with Cloudflare – with the developer products being the gross margin weakest. But we also said that despite this fact, all products are pretty much equal when we look beyond gross margin and look at performance from a unit economic value. And I think this will be a transition that

we will get you ready for on Investor Day that our operating margin becomes a better measure for competitiveness of products than gross margin.

Just keep in mind that one of the biggest moves in gross margin the last quarter was free traffic moving to paid traffic and cost moving into cost of revenue. While that is decreasing the gross margin, it's literally a wash from an overall P&L perspective. And I think you'll see more movements like that. It will be up to us to give you the right insight. But what is clear to us across all products with the opportunity in front of us that the unique economic margin and value is going to increase over time.

We – with the guidance that is in place already today, we are getting north of 46% from a Rule of 40 perspective. And we think we have visibility to reaching north of 50% next year. So that all shows you how much potential is, and we just need to give better insight in how the various parts are coming together and provide force in that direction.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

Yeah. The one thing I would add to what – sorry, I was just going to say, the one thing I would add to what Thomas said is just to put a finer point on what I think is the most important part there, which is for – since our founding, Cloudflare's always had a free version of our service, and that provided a lot of different benefits. One of the largest was it gave us data to provide – build the security models and do everything we did. And we haven't actually worked that hard to convert free customers into paying customers. And so the traffic that was associated with those free customers went into as a marketing cost.

What's been fascinating though is that that giant pool of free customers, turns out a lot of them are developers. And so as we've now built incredibly compelling developer tools, most of our developer tools aren't free. They require at least some payment. And so you're seeing a lot of that free traffic turning into paid traffic. And so it actually might be that the cost of customer acquisition that we have for those really high-growth products like our developer platform are really fueled by what we've built over the beginning of Cloudflare and some of those Act 1 products.

And so while that shows up somewhat funnily in gross margin, it actually is a sign that more and more people are adopting the paid products, including the developer platform products, which is the part of our business which I think I am certainly among the most excited about.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

It's a great reminder and certainly a geography shift, to your point. Matthew, maybe for you for my follow-up. I'd love to hit on Act 4 a little bit and Cloudflare's ability to sort of manage that relationship between AI tools, scraping type of tools and content owners. Maybe the question is, what are some of the milestones that you need to see in order to see that business inflect? Is it big lighthouse accounts? Do you need industry consortiums? It's just such an uncharted territory, I'm curious how you think about it.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

Yeah. I think the way that we think about Act 4 is that the business model of the Internet, which has historically been advertising and subscriptions, is about to change dramatically over the next five years. And exactly what it

changes to, I think, is still an open question. And I think it might not be one thing. I think it might be several things. Because of how much of the Internet sits behind Cloudflare, we have a seat at the table of defining that.

And so I think there are a number of different things that I'm watching. So one of them is I think that some part of this is going to be some kind of micro transactions for any request that agents are making to websites. It might be fractions of fractions of pennies. But if you think about, I don't know, the \$500 billion requests that pass through Cloudflare in any given second, that – some percentage of those, we think that there's going to be some ability to have some micro payment that is made for that, because somebody has to pay for the infrastructure. And if you look at the growth in agentic traffic, if you look at the growth in sort of non-human traffic on the Internet, somewhere in 2027, we think it's going to surpass human traffic, and it's not going to slow down. And so we've got to figure out something else to build it.

And so I think one of the milestones we'll look for is how do we figure out what that sort of micro payment infrastructure looks like. And the challenge is, like, nobody can handle the volumes right now. And so we're looking around to partner with people. We're looking around for everything. But at right now, the sort of transaction volumes that people are excited about, like 1 million transactions per second, we need something that's significantly larger than that. So I think that's one thing.

I think on the other side, first of all, it's really important to be clear that the answer isn't that everyone wants to be blocked from AI or everyone wants them to be paid. For example, Cloudflare has a whole bunch of developer documents. We want those developer documents to be in every single LLM that's out there. And so we make it as easy as possible for LLMs to crawl our developer documents. On the other hand, if you're an ad-supported business, then your content being crawled is actually a threat. So I think we're trying to provide tools on both sides of that.

The side that you focused on was the folks that want to block it, the ad-supported folks that are out there. And I would say that the first milestone that we've seen is that we went from being relatively low in terms of our penetration in the media space to today dominating that space. And so I think that's the first sign. And what I hear from media company execs is they are signing better deals with AI companies because we've given them the tools be able to control who has their content. That's the early lighthouse signal.

I think the question is, how can we then take that down to the long tail? So, sure, the Condé Nasts or the Dotdash Merediths of the world can negotiate their own deals, but how do we make that available for everyone that's on the Internet? And I think that's going to be really some lighthouse sort of deals with some of the foundational model companies. And I don't know exactly when that will come. But I do – I will say that when we listed what our top six priorities were for 2026, one of the six was making sure that we make real progress and see the first revenue that we can then pass back to that long tail of the Internet in order to help make sure that we continue to create a healthy ecosystem for content creators. And I'm pretty confident we'll make that goal.

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

James E. Fish

Analyst, Piper Sandler & Co.



Hey, guys. Thomas, you just mentioned Rule of 50 there potentially. But given what you're seeing with the demand behind inferencing, I guess, what's the team's willingness to go after more of this opportunity and really drive more megawatts behind the network to host more of the inferencing use cases, like, what you're seeing out of some of your ed peers?

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

I can get started, but Matthew, for sure, has an opinion on this. I think you will see us leaning in, in this opportunity already with all the force that we have. This is the reason why you saw developer count go up by 1 million in the first quarter alone. We are continuing to optimize margin for these products, but we are not at all restricting growth, just the opposite, I would say. So this is not a – there's no restriction on leaning in into this opportunity.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

I think that, Jim, at risk of kind of saying – being critical, I think that people don't understand the difference in our business model versus the hyperscalers. The hyperscalers business is to buy a server and then to lease that server back ideally for five times or more of what they paid for it. And so if they don't have servers to lease then they can't grow their revenue. And so their CapEx has to invest ahead of whatever that demand is that's out there.

We focus on very different things. So the thing to watch for us is when you see us publish a blog post about how we figured out how to get more utilization across our fleet of GPUs or how to get more models loaded quickly across GPUs, that's real IP that we're inventing internally. And the metaphor to think about is, once upon a time when I was in college, I remember, this new thing called the web was starting and so we needed to have a web server. And so we literally – from Gateway, I remember ordering a box that came with, like, cow prints on the outside of it. And we bought a Gateway server and we plugged it in because there was no idea of virtualization. And then VMware came along. And after that, you had docker and containers, and that was sort of the journey that everyone went on.

We're still at the stage with GPUs of buying the physical server and needing to use that for most of the industry. And so across most of the hyperscalers, you're seeing utilization rates of their GPUs that are in the single digits, whereas we're slowly getting our GPU utilization to approach what our CPU utilization is, which is up in the 70% to 80% range.

And so as we do that, we can actually continue to, with the fleet we have, get – service the requests that come in and invest behind demand as opposed to investing ahead of demand. And so because our business model is different, that's allowing us to continue to keep up with the inference demand and also do a lot of experiments and trials and things to capture developer mindshare that is very different than if, again, what your business is essentially leasing a physical server that you bought and trying to get at least five turns out of that lease.

James E. Fish

Analyst, Piper Sandler & Co.

Q

Yes. Makes sense, Matthew and Thomas. Maybe just following up on the security side. Look, you guys have been aggressive about displacing the legacy hardware guys across security, firewalls, VPN and so forth. Are you seeing any compression in enterprise sales cycles for large-scale Zero Trust deployments or are macro approvals still kind of elongated? And really the crux of it is the supply chain issues, the component issues causing more customers on the enterprise side to start to evaluate more of the cloud opportunities out there for protecting their environments. Thanks, guys.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

I mean, the hardware companies seem to have nine lives, and I don't know how many more they have to use. But it's – I think that as you see that there are vulnerabilities in hardware, which some of the Palo Alto had issues with,

as you see, again, supply chain shortages, especially around memory right now, I do think all of those things are pushing more and more people to evaluate that they need at least some part of the cloud as part of their infrastructure.

But again, I have been impressed by how long the hardware players have continued to operate and hold out. So I'm not willing to call that this is the time that it's going to be a complete change. But I do think that there's – I do think that the cloud continues to show its resilience and that all of these things are tailwinds behind our business and other cloud-native businesses that are out there.

Operator: Your next question comes from the line of Gabriela Borges of Goldman Sachs. Your line is open.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good afternoon. Thank you. Matthew and Thomas, I wanted to get your observation on how the fleet mix may be changing between GPUs and CPUs. And specifically, Matthew, you're just talking about how GPU utilization is approaching CPU utilization. Are you also finding that there are some AI inference that you can now route to CPUs? And Thomas, I imagine that has an implication on the unit economics of how you're serving up the AI inference market.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

Yeah. I mean, so we want to make sure that for customers, we're just abstracting what the most optimum silicon is behind the scenes. And so for some models, CPUs work great. But for others, we want to make sure that GPUs are available. As we deploy a server, those servers today have – they sort of come with all of the various parts. And we – and so it's not you deploy a GPU server, you deploy a CPU server. When we deploy a server now, it's got a CPU, it's got a GPU, it's got a certain amount of memory, it's got a certain amount of storage, it's got a certain amount of capacity in the network. And those are all resources that we're constantly trying to both balance and then create opportunities around.

And so I think what we're – what's different about us is we are not renting an H100, but we'll have H100s across our network. And then we're trying to match the workload that makes the most sense with the silicon that's behind that and with what a customer is paying for. So if you're paying us more, then we're going to give you a faster and better experience than if you're paying us less. And so I think that that has always – like, at some level, Cloudflare has always been just a giant scheduler. And so what we're effectively doing is dispatching those jobs across this and then being able to drive it.

It's like the question earlier about, is our cost going up because our developers are using more AI tools? The answer is, yes, at the margins, but much less than we see from our peers because we can use that giant scheduler to essentially route those tasks to anywhere we have excess capacity across our network. And we can prioritize those based on what is more important or less important.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

[ph] Matthew (00:52:08) there is the data point intra-quarter on Anthropic announcing managed agents. I would just love to pick your brain on where you think that type of infrastructure intersecting with the LLM creates opportunity and/or risk for that Cloudflare business model.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

I mean, like I think that we are – so without talking about specific customers, I'll say that what we're seeing from the major AI labs is, first of all, that we're partnered with all of them and get access to all of their labs, and that they see our infrastructure is critical to being able to deliver this. And so they are actually looking for partners to be able to have that infrastructure run on.

And so like there are the examples of, in the case of – we launched something called Dynamic Workers, which allows you to very quickly stand up something, which is significantly more efficient than a container. Containers are too slow and too heavy that to actually be able to respond to these incredibly fast agentic workloads. And so what AI studios are doing is they're looking at this and they're seeing the opportunity. And so to give you a sense of with – I'm naming them, one of the large AI studios in just the last 15 days went from essentially zero Dynamic Workers to over 1 million Dynamic Workers running across the platform. And we're seeing almost everyone excited about the underlying tools and technologies that we build.

So I see what Anthropic is doing as being very positive to the infrastructure that we see. We see that as an opportunity to deliver incredible value across that. And we see ourselves as very differentiated in the space and able to provide significantly better performance and at a significantly lower cost than anyone else who's playing in the space today.

Operator: Your next question comes from line of Fatima Boolani of Citi. Your line is open.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Good afternoon. Thank you so much for taking my questions. Matthew, along those lines, with respect to the agentic edge and agentic AI systems moving into production, I wanted to harken back to a lot of the announcements that you made at Agents Week. It's very clear that there is a fundamental rewiring that you're working on to natively power agents to basically do their best work, to put it simplistically. And a lot of this does seem like it is a frontier monetization opportunity for you.

But I'm wondering if you can speak to what sort of halo the rise of production agentic systems could have on the more flagship established parts of your business, i.e., the revenue and monetization halo to Act 1, Act 2, and certainly Act 3 products? And then I have a follow-up for Thomas, if I may.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

A

Yeah. I mean, I think for the Act 3 products, the developer platform products, I think it's the most obvious, which is that we're just seeing more code being created. It needs an efficient place to run. It needs to have a set of primitives that can act as fast and as ephemerally as agents need to act.

So if you imagine that you're a company that's building something that's going to plan a vacation for someone, what you really need is the ability to essentially spin up an extremely lightweight sandbox that writes code, that assembles kind of all of the different parts of what that vacation may entail, puts it together, pulls it back and then blows the sandbox up very, very quickly. To do that with any other platform is extremely expensive and slow. And we've made it with some of the things that we've announced during Agents Week and otherwise, we've made that just drop-dead simple. And so that's driving a ton of use. And again, I think that the way to see that is the fact that

we added 1 million developers to our platform just the last quarter, almost as many as we did in all of last year is extraordinary.

And if you look at growth across the Workers platform, more than three-quarters of that is from new customers. And the growth rates are pretty extraordinary across that. That's also, again, to some extent, putting pressure on gross margin because those are less optimized for gross margin products. But we are confident that as we can continue to drive GPU utilization and all those things, that we'll be able to get more out of that.

I think to the other part of your question, just as more – every time an agent does something, like if you think about it, if you just – if you type something into ChatGPT or any of the things, like, to search, the number of sites that get searched, the amount of traffic that gets generated, if I'm looking for a digital camera as a human, I might visit five websites, if I really care about it. My agent's going to visit 5,000. And so that's going to just drive significantly more usage, which is the biggest driver of kind of our Act 1 revenue.

And again, I think unlike some of the pure-play CDNs that are out there, the agents aren't going to go watch reruns at the Super Bowl. They're going to drive things that actually drive real traffic to real e-commerce sites. And that's where Cloudflare and the huge swath of the Internet that sits in behind us is really valuable.

And then for Act 2, again, as we talked about already, I think being able to very narrowly define what data an agent has access to and what data they don't, we're just seeing more and more of that usage, especially in the self-service category, which there really isn't another sort of SASE, Zero Trust, self-serve competitor out there with any sort of scale.

And so that's with things like OpenClaw driving a lot of usage there. And what we've found time and time again is, as hobbyists or individuals adopt a technology, they inevitably start to bring that technology more and more to work. And that's what we're seeing as we win more of the enterprise accounts across Act 2.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Thomas, just on the pool of funds, you're sort of in year three in earnest of having this motion with your customers mature. I was wondering if you have any comments or observations on a pending renewal cycle from maybe your earliest vintage of pool of fund adopters? And maybe what trends you are seeing from a renewal and expansion of usage vectors as you re-engage with some of these customers that are coming back to the well, so to speak. Thank you.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

Yeah. Well, as we are now in our, I would say, sixth quarter of pool of funds, it becomes a much more standard tool in our go-to-market motion. Folks are familiar in how to deploy the tool, when to deploy it, when it makes sense. So I think we get efficiency in the process. From a renewal perspective, you heard this in Matthew's prepared remarks, we had our highest ever renewal rate in the last quarter, and that includes all the pool of funds deals that were up for renewal. So I would say, the hypothesis that this would be a tool that not only allows us to work expansion really well, but also becomes a very sticky tool from a customer engagement perspective, has turned out to be true.

Operator: And your last question comes from line of Shaul Eyal of TD Cowen. Your line is open.

Shaul Eyal

Analyst, TD Cowen



Thank you. Good Afternoon. Thank you for squeezing me in. Thomas, you've mentioned quota-carrying sales capacity continues to accelerate. Could you provide some more color on your expectations to continue to grow capacity relative to productivity? And I have another follow-up for Matthew.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.



Yeah. So when I said we are not touching quota-carrying AE sales capacity, what goes along with that is where we see significant productivity is in the support ratios for these AEs. So the ratio is going to change significantly, which means we are freeing up dollars. And within the same spend envelope now of dollars, you can deploy more quota-carrying AE capacity towards our market opportunity. And this, of course, then will allow us to continue to drive productivity from a go-to-market perspective.

Shaul Eyal

Analyst, TD Cowen



Got it. Matthew or Thomas, partners increased to 30% of revenue this quarter. What's driving this continued increase? And how much more channel mix would you expect going forward?

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.



Yeah. I'll start and Thomas might have more to add. I think that this really started with Mark Anderson laying out certain two years ago that we were going to have a motion that really included partners and made sure that they were able to deliver on that. I think that it has been an incredibly successful way for us to sell, especially our Act 2 products, which require a lot more of a consultative sale and a lot more of work, making sure that the integration is done extremely well. That, I think, will continue going forward.

I think the big question is going to be what partners are really able to leverage this new world of agentic AI in order to just get additional value and scale and velocity. And I think that's what we're evaluating across the partnership world. I think there's going to be a lot of change in that space. But I think that partners will continue to be an extremely important part of our strategy.

And just like, again, I think a lot of our businesses is changing, a lot of our partners' businesses are changing. And we're seeing that the ones that are delivering the most value to customers and are the best at getting success at selling our tools are the ones that are embracing new ways of selling and servicing and making sure that the customers are successful with our tools.

Operator: Thank you. That concludes our Q&A session. I'll now turn the conference back over to Matthew Prince for closing remarks.

Matthew Prince

Co-Chair, Co-Founder & Chief Executive Officer, Cloudflare, Inc.

So, again, just wanted to emphasize, this has been a hard day. We've never done something like this in Cloudflare's history, and we take it extremely seriously, and we know how much it has affected people who have been friends and colleagues. I am confident that those people who are leaving us today are going to go on to take

what they learned at Cloudflare and help build many more great companies. In fact, it's amazing to see how many people are already writing in saying, anyone who got traded at Cloudflare, we would be happy to interview.

We're going to make sure that we take care of those people, but we also want to make sure that we are hiring for the right roles. This isn't about us downsizing. This isn't about us saving costs. This is about making sure we have the right people in the right roles to build the future. Our mission is to help build a better Internet. That's an important mission. It's never been more important as the Internet goes through all of the transitions with AI and agents. And Cloudflare is going to lead the way.

I'm proud of everything that we're doing. I'm sorry that we had to take the action that we did today, but I believe it's going to make Cloudflare better for the future. Thank you. We'll see you back here next quarter.

Operator: This concludes today's conference call. You may now disconnect.

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