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Cloudflare, Inc. (NET)

Q3 2026 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome, ladies and gentlemen. Thank you for joining us and welcome to Cloudflare's Third Quarter 2026 Earnings Conference Call. After today's prepared remarks, we will host a question-and-answer session. [Operator Instructions]

I will now hand the conference over to Phil Winslow. Phil, please go ahead.

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 third 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 will 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.

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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 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 participating in RBC Capital Markets Global Technology, Internet, Media and Telecommunications Conference on November 18, and Barclays Global Technology Conference on December 9.

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

Matthew Prince

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

Thank you, Phil. There's no other way to say this, by nearly every metric, we had our best quarter ever. We again accelerated growth and became more profitable at the same time, delivering our fastest revenue growth in nearly four years and achieving our highest operating margin in the history of the company.

We crossed $3 billion in annualized revenue, generating $782 million in the third quarter, that's up 39% year-over-year. We now have more than 5,000 customers paying us more than $100,000 per year, a 25% increase year-over-year. Our dollar-based net retention was 122%, up 2% quarter-over-quarter and up 3% year-over-year.

Our gross margin was 72.4%. We delivered an operating profit of $137.1 million, representing an operating margin of 17.5%. And we generated free cash flow of $82.1 million during the quarter, again, exceeding expectations. But that's just the start of what was a monster quarter. The strong momentum we've been seeing in our business continued to accelerate in the third quarter. It's like the engine was firing on all cylinders and we found another gear.

Some highlights. Sales productivity reached a new record in the third quarter and increased year-over-year for the 11th consecutive quarter. In Q3, we delivered our highest ACV growth ever and highest quota attainment in more than five years. Bookings from new customers grew faster still, beating last quarter's five-year high. We added more than 158,000 paying customers this quarter, that's 110% growth in paying customers year-over-year and nearly double the previous record of more than 80,000 we added in Q2.

We also achieved record year-over-year net additions across all our large customer annualized revenue cohorts from $100,000 to $500,000 to $1 million to $5 million. Across every one of those, we grew at a new record pace. And as we already announced at our customer conference a few weeks ago, we passed 10 million active developers on our platform, more than doubling the number we had at the start of 2026.

As I said, we seem to have found a new gear. These results speak for themselves and are the cumulative effect of our relentless focus on innovation combined with disciplined execution. Much of that execution improvement has come from the transformation of our go-to-market engine to match our already world-class product and engineering teams. Mark Anderson deserves a huge amount of credit for shepherding us through that transition.

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With his well-earned retirement coming at the end of this year, we wanted to find a successor with a proven track record of scaling global sales organizations to turbocharge our already robust go-to-market momentum. I'm incredibly excited to welcome Christian Smith to Cloudflare as our new President of Revenue. No one will ever replace Mark, but Christian's skill set and experience building and enabling world-class go-to-market organization matched perfectly with the current stage of Cloudflare to further accelerate our next wave of growth at scale. I wanted to invite Christian to the call to say a few words. Christian?

Christian Smith

President of Revenue, Cloudflare, Inc.

Thank you, Matthew. I am thrilled to join the Cloudflare team. What Cloudflare has built, the sheer scale of its world-class network, the company's unparalleled product innovation and the clear vision for the future of the Internet, it is truly unique. But what gets me most excited is the massive generational opportunity that's still in front of us to go and capture. I have spent my entire career scaling enterprise go-to-market engines with operational rigor, building world-class partner ecosystems, and driving intense customer focus. Mark Anderson has built an incredible foundation over the past three years at Cloudflare. And my immediate priorities are to double down on go-to-market execution, further accelerate our enterprise momentum, and ensure our customers get even more rapid compounding time to value from our platform.

With the rise of the agentic Internet, Cloudflare was built for this moment. Now, it's about execution and scale, and I'm ready to go get to work with the team.

Matthew Prince

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

Thanks, Christian. Under your leadership, I know we will continue to deliver on our vision that has never just been about selling products, but rather about helping solve some of our customer's toughest challenges as only Cloudflare can and to ensure the smoothest transition, Mark Anderson has agreed to stay on as an advisor for at least the next year. I know he'll always bleed orange and be there to help close a customer if we need him.

That seems like a good segue to talk about some of Mark's teams big wins in the quarter. A rapidly growing AI company expanded their relationship with Cloudflare, signing a one-year $11 million pool of funds contract for our Workers developer platform. Tens of millions of AI generated applications have been created on its platform and legacy hyperscalers would charge this customer for massive amounts of vital compute. With Cloudflare's dynamic Workers, app start in milliseconds and the customer pays only for the compute they actually use. One of their lead engineers said "without Cloudflare's dynamic Workers, we wouldn't be able to build what we want to build". When the cost of creating software drops to near zero, the number of applications explode, and the most sophisticated builders are choosing to run them on Cloudflare.

A Fortune 100 cloud infrastructure provider expanded their relationship with us, signing a 13-month $15.5 million contract for Magic Transit. As the customer aggressively scales its global footprint for AI, their legacy DDoS hardware applications simply could not keep up, failing to scale cost effectively and missing low-level attacks that were quietly draining capacity. During the evaluation, our global network stopped attacks that their appliances simply could not, and we fully displaced the incumbent. As one of their technical leaders noted, Cloudflare's threat mitigation is one of our superpowers. When the world's biggest cloud operators build next generation AI infrastructure, they trust Cloudflare to protect it.

A cabinet level US federal department signed a five-year $10.3 million contract for our SASE portfolio. With their legacy VPN reaching end of life, the agency needed a modern replacement that could scale on a deadline it

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couldn't miss. They chose Cloudflare over a first generation Zero Trust provider for our speed, global scale and simplicity. This win positions Cloudflare as the backbone of their new cybersecurity posture and underscores the federal government is ready to leave legacy hardware behind and that unified platforms like Cloudflare will win.

A rapidly growing multinational neobank and fintech company expanded their relationship with Cloudflare, signing a three-year pool of funds agreement with an average annual contract value of more than $3 million. Their initial use cases focused on our SASE portfolio. The latency that employees experienced with the incumbent first generation Zero Trust vendor was so bad that many simply turned it off, leaving the business exposed. They moved their entire workforce to Cloudflare in a single quarter. Since then, performance tickets per user have dropped 74%. It turns out the most secure Zero Trust platform inherently is the one people actually live on. And from this customer's feedback, it seems Cloudflare maybe the only vendor that has that critical feature.

A fast-growing technology company expanded their relationship with Cloudflare, signing a 39-month, $9.5 million pool of funds contract for application services and our Workers developer platform. For this customer, latency directly impacts their bottom line. As they prepare to expand internationally, they chose Cloudflare over a major hyperscaler for the speed and reliability of our global network. As their champion put it, there is no international expansion for them without Cloudflare's global network. When milliseconds impact users and in turn financials, the network is the business and Cloudflare runs the best network.

A leading global consulting firm expanded their relationship with Cloudflare, signing a three-year pool of funds contract for more than $7 million for Zero Trust application services and our Workers developer platform. After their legacy Zero Trust provider failed to manage the complexity of securing over 10,000 custom client applications, Cloudflare's effortless deployment drove rapid company-wide adoption. The firm is now aggressively consolidating vendors onto our unified platform, including migrating their main web properties from a longstanding incumbent by the end of next year. Drawn to our forward-looking AI and developer roadmap that they want to standardize on, the customer is already exploring Workers AI and Cloudflare OS to build next generation applications and agents.

A leading European media company expanded their relationship with Cloudflare, signing a five-year, $8.1 million contract for application services and our Workers developer platform. Replacing a 17-year deployment with a legacy CDN vendor, they chose Cloudflare because our best-in-class bot management reliably identifies modern AI crawlers, giving this customer the control they need to protect their intellectual property, but also creating a direct onramp for pay per crawl and pay per use monetization. This win is a clear blueprint for how the world's largest media companies will protect and monetize their content and innovate in the agentic AI era. I could go on and on with more wins, but we'd be here all day.

To give you a sense, based on third-party data between July 1 and today, we added approximately 5% of the entire web to Cloudflare. That's wild. It's more than the total market of all our reverse proxy competitors combined added to our network in a bit over a quarter. We've been growing throughout our entire history, but recently something changed. The rate of growth inflected in October of 2025, then accelerated again in July of 2026 and then again at the beginning of this October.

So what's going on? I think it's the convergence of two things. First, we have built the development platform for the future of the AI-powered Internet. And second, the security landscape is getting so scary that the best viable strategy, regardless of who you are, is to ensure you have Cloudflare protecting you.

To the first, hyperscalers and even neoclouds were built around container technology. It was a significant improvement over bare metal or even virtual machines. Containers allowed these last generation clouds to scale

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during the explosion of mobile devices that defined their heyday. But now we're in the era of AI and agents. I predicted last quarter that within five years agents would outnumber humans online 1000 to 1. A quarter later, I'll take the under on the timing of that bet based on everything we're seeing today, the container based architecture the hyperscalers and neoclouds just can't keep up in a cost effective way with the new agentic paradigms of today.

Cloudflare's approach is different. We have based it on what we call isolates, not containers, which initially let us scale geographically to span the globe, but increasingly is allowing us to scale densely with a level of efficiency no hyperscaler or neocloud can match. The smartest developers, whether they are frontier model companies or legacy enterprises, see that the world is changing and that they need a new type of cloud in order to keep up. In other words, Cloudflare isn't a neocloud. We're also not, as some of you have called us, the fourth public cloud. We're something different. We're the first agentic cloud and developers are flocking to us to build the agentic AI future.

The second driver of our growth inflection has even broader applicability across every business. It may seem like the sky is falling with the number of new security vulnerabilities that have been reported over the last few weeks. I wish I could tell you we were through the worst, but we're not. Because of the vast percentage of the Internet that already sits behind Cloudflare, we are among the first to receive quiet disclosure of new vulnerabilities. We've partnered with nearly every major frontier AI lab and security companies searching for flaws in existing software. When they find something, they notify us through a trusted reporter process and we quietly put protection in place for all our customers, whether they pay us or not. We believe protecting everyone is important to fulfilling our mission of helping build a better Internet and living up to that mission has ensured that we are trusted and nearly always get early warning of the worst problems researchers discover.

The bugs you read about over the last few weeks, and the ones I suspect you'll read about over the next few years were less impactful because Cloudflare has the Internet's back. That, of course, creates a virtuous cycle. We know what bugs are coming. We protect our customers before the bugs are publicly disclosed. Companies increasingly know that if they are behind us, they're more likely to be protected, whatever the future breaks. And so even legacy organizations that aren't pushing the bleeding edge of AI are signing up for Cloudflare at an accelerating rate. And of course, as more of the Internet uses Cloudflare, it enables new opportunities. I'm proud to announce that we recorded in Q3 our first revenue for what we called Act 4 products, those where we're helping invent the new business model of the Internet. And I expect we'll talk a lot more about that in the quarters to come.

To sum up, our third quarter financial and operational results highlight the accelerating demand for Cloudflare solutions. Our commitment to both innovation and operational excellence and the inherent leverage in our business model, I could not be more proud of our team. But, as Michelle likes to say, we're just getting started. The opportunities ahead of us are more clear and massive than ever, and it's turning out Cloudflare was built for this moment.

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

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

Thank you, Matthew, and thank you to everyone for joining us. I want to take a moment to also extend my personal thanks to Mark Anderson for his leadership of our go-to-market transformation over the last three years and congratulate him on a well-deserved retirement. I'm also incredibly excited to welcome Christian Smith to our

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Cloudflare team. His proven track record of scaling global sales organizations and go-to-market operations is a perfect fit for Cloudflare to further accelerate our next phase of growth at scale.

Turning to the results. We delivered an outstanding third quarter. In fact, Q3 was our best quarter as a public company to date. The strength we again drove across the major metrics we track demonstrated not only the robust demand for Cloudflare's products, but also the operational leverage inherent in our business model.

Total revenue for the third quarter increased 39% year-over-year to $782.5 million, driven in particular by another quarter of rapid growth in our Workers developer platform and the agentic workflows across our network, continued momentum with our largest customer cohorts and robust go-to-market execution.

From a geographic perspective, the US represented 52% of revenue and increased 44% year-over-year. EMEA represented 26% of revenue and increased 32% year-over-year. APAC represented 14% of revenue and increased 32% year-over-year.

Turning to our customer metrics. We ended the quarter with approximately 5,000 large customers. We added 308 large customers in the quarter and nearly 1,000 year-over-year, the most we have ever added both in a single quarter and in a single year. In fact, as Matthew mentioned, every one of our large customer cohorts added a record number of net new customers year-over-year in the third quarter. The higher you go among these cohorts based on the amount of spending committed to Cloudflare, the faster revenue is growing year-over-year. In other words, the bigger the size of the customers annual spend with us, the faster they are growing with Cloudflare.

Of particular note, we added almost as many $5 million-plus customers in the first three quarters of 2026 as we had $5 million-plus customers in total at the end of just last year. Revenue contribution from large customers was 75% of revenue during the quarter, up from 73% in the third quarter last year. The significant expansion with our large customers drove an acceleration in our dollar-based net retention rate to 122% in the third quarter, up from 120% last quarter and up from 119% in the same quarter last year.

Moving to gross margin. Third quarter gross margin was 72.4%, representing a decrease of 70 basis points sequentially and 290 basis points year-over-year and within our targeted long-term range of 70% to 77%.

Our Workers developer platform delivered another quarter of exceptional growth and we expect the unit economic margin of our developer products to continue to increase as evidenced by the strong operating margin we generated this quarter, which is a good segue to operating expenses.

Third quarter operating expenses as a percentage of revenue decreased by 510 basis points year-over-year to 55%. Our total head count ended the quarter at approximately 4,700. Sales and marketing expenses were $270.2 million for the quarter. Sales and marketing as a percentage of revenue decreased to 35% from 36% in the same quarter last year. Research and development expenses were $101.7 million in the quarter. R&D as a percentage of revenue decreased to 13% from 15% in the same quarter last year.

General and administrative expenses were $57.5 million for the quarter. G&A as a percentage of revenue decreased to 7% from 10% in the same quarter last year. Operating income was $137.1 million, an increase of 60% year-over-year, compared to $85.9 million in the same period last year. Third quarter operating margin was 17.5%, an increase of 370 basis points sequentially and an increase of 220 basis points year-over-year.

Turning to net income and the balance sheet. Our net income in the quarter was $143.7 million or a diluted net income per share of $0.38. Free cash flow was $82.1 million in the quarter, or 10% of revenue, compared to $75

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million or 13% of revenue in the same period last year. We ended the third quarter with $5.1 billion in cash, cash equivalents and available for sale securities. During the quarter, we issued $2.5 billion of convertible senior notes and repaid $1.3 billion of convertible senior notes.

Network CapEx represented 15% of revenue in the third quarter. As a reminder, there can be some variability in this metric quarter-to-quarter and we continue to expect network CapEx to be 14% to 15% of revenue for full year 2026. Remaining performance obligations or RPO came in at $2.877 billion, representing an increase of 5% sequentially and 34% year-over-year. Current RPO was 65% of total RPO and grew 37% year-over-year.

Moving to guidance for the fourth quarter and full year 2026. For the fourth quarter, we expect revenue in the range of $845 million to $846 million, representing an increase of 38% year-over-year. We expect operating income in the range of $156 million to $157 million. We expect an effective tax rate of 20%. We expect diluted net income per share of $0.43 assuming approximately 379 million shares outstanding. We also expect to achieve GAAP profitability in the fourth quarter, significantly earlier as compared to our outlook from this year's Investor Day to reach this milestone at the latest by 2028.

For the full year 2026, we expect revenue in the range of $2.963 billion to $2.964 billion, representing an increase of 37% year-over-year. We expect operating income for the full year in the range of $462 million to $463 million. We expect an effective tax rate of 20%. We expect diluted net income per share over the period to be $1.35. We expect approximately 376 million shares outstanding.

In closing, we're consistently proving that scale, rapid innovation, profitability and growth are not trade off, but rather a compound multiplier that provide us with meaningful competitive advantages. That is the winning formula Cloudflare continues to execute against to create significant value for both our shareholders and our customers. With our network and our developer platform at the core of the transition to the agentic Internet, we intend to capitalize on this generational opportunity with a continued focus on disciplined capital allocation, rigorous operational execution and durable, efficient growth.

And with that operator, please poll for questions.

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QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Your first question comes from the line of Matt Hedberg with RBC Capital Markets. Your line is now open. Please go ahead.

Matthew Hedberg
Analyst, RBC Capital Markets LLC

Q

Great, guys. Thanks. Just incredible results all around and Christian, congrats on the new role. Excited to work with you again. [indiscernible] (00:26:20) Matthew, you spent a lot of time talking about agents growing 1000x and now I think you're taking the under on five years, which is great to hear. When we see things like Muse and all these consumer AI agents, with that as the sort of the paradigm in the lens, what does that mean just for the Internet as a whole when we get into that era and specifically on Act 4, it's great to see you're starting to monetize that, but how does that start to really kick in as we move towards that paradigm?

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

A

Yeah, first of all, thanks, Matt. Really appreciate it. And really proud of the team and also super excited to have Christian on board. As for Muse, I mean, first of all, if you haven't played with it yet, I mean, it's super cool, as are a number of the other agents that are out there. And in the case of Muse, I mean, Meta is a customer and it's been incredibly fun to watch them and help them scale that product and just see the explosive growth that we're seeing. So we're benefiting as that product grows directly.

I think the second bit, though, is I think more to your question, which is, we're in a really interesting position because the people who are building the agents are often building them on Cloudflare. And then the things that the agents want to get to are also on Cloudflare. And so we've had examples over the last several months in the case of Meta, in the case of Google, where at times there's been places where what they have been doing hasn't aligned exactly with what the content creators, publishers, application developers, financial services organizations, e-commerce companies, what they want to do. And Cloudflare is finding ourselves over and over and over again in the center of those questions and acting almost as a mediator between the two sides.

And in the process of doing that, I think what's really powerful is we're getting to set the rules of the road for what the agentic Internet is going to look like. And, the reality is that if agents are going to be a thousand times human traffic online, that's going to require more bandwidth, that's going to require more servers, that's going to require more things to actually power it. And someone has to pay for it. It can't be a free ride for all the agents that are out there.

And what I'm encouraged by and what we're already seeing in terms of Act 4 revenue is that the agentic companies get that they have to compensate the creators and the banks and everyone else who's providing this information in order to be able to continue to access it. And so I think we are at the cusp of figuring out what that next generation business model of the Internet is going to look like. And because of the fact that we are helping the companies that are building the agents and because of the fact that so much of the rest of the Internet sits behind us, Cloudflare is the company that's going to define what that looks like.

Matthew Hedberg
Analyst, RBC Capital Markets LLC

Q

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That's great. And then maybe, Thomas, just as a quick follow-up. You beat 3Q by more than 6%. And I think that was higher than last quarter's record beat. And now you're – and you grew 39%, you're guiding to 38%. So very little decel. I guess, from your perspective, what's the most important drivers not only to the quarter, but the guide as we sort of look at the exit rate this year? Thanks.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

Yeah. Well, we always guide to what we see and you heard in both Matthew's and my script that the demand is driven by a highly diversified momentum. The developer count, the traffic on the network, 160,000 net new customers, the largest [indiscernible] (00:30:10) in every cohort we count from a revenue perspective, no concentration, customers in financial verticals, government and across the globe. So we see a broad base for this momentum and we are guiding to what we see. And this is reflected I think in the strong beat and raise you see from the third quarter into the fourth quarter.

Operator: Your next question comes from the line of Gabriela Borges with Goldman Sachs. Your line is now open. Please go ahead.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

Hey, good afternoon. Thanks so much for taking my question. Matthew, I want to stay on your point of a next generation business model for the Internet. Maybe give us a little bit of a sense for timeline on when you think that Act 4 can start to be monetized in real dollar amounts and some of the key levers that could perhaps make that timeline take longer or perhaps pull in relative to whatever your base case is? Thank you.

Matthew Prince

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

A

Yeah, Gabriela, again, I'm extremely excited for this, and I think we've got to figure it out. The way of thinking of it is, I'm sitting in Manhattan and if I ask my agent where am I going to go for dinner tonight after I'm done with the earnings calls and call backs? It might go and scour the Internet and look at a thousand different restaurants, websites, pull down a thousand different menus. And then I might choose to only go to one of those. The problem is that 999 of those restaurants have now had a cost that has been applied to them, but they're not getting any benefit. And that was always true of the Internet, but the scale was different. A human might look at two or three things. But in this case, the scale is so high that we're going to have to figure out some additional way to pay for it. And so I think the ways of doing that are twofold. So one, where we're already recognizing revenue and recognizing significant amounts of revenue is how do we make that more efficient.

So we talked last quarter about how we partnered with OpenAI to make sure that as they searched the Internet, they didn't do it in the kind of dumb way of just crawling everything all the time over and over again. But instead the Cloudflare could actually give them hints when a page should change, when a menu price had updated, when anything had happened, and then they can get the freshest data and they could actually crawl it that helps OpenAI save money and that actually helps the Cloudflare customers get the freshest data to them and make sure that it doesn't waste a ton of resources. And so I think that's a clear way where we're already seeing that and that's helped. OpenAI is paying for that and a lot of other companies in the space I think you'll see do that as well.

Beyond that, though, I think that we're going to see some version of micropayments that exist where small payments get made when an agent comes. And I think it will be in exchange for the more that an agent is willing to tell you about why it's there, the more that you may be willing to charge it less to access the page. So if you

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imagine that an agent comes to a travel site and says, hey, I am looking for a vacation for my user and his or her family, it's a family of four, they want to go to Hawaii, what do you have for me? That actually then might be something where you let the agent on for free, but it opens up all kinds of opportunities for advertising. And again, I think Cloudflare is in the perfect position to help bring both of those things together, both the agent and the places that might have whatever the agent is looking for.

And so like that is coming. I don't know exactly how long it will be before it turns into major sources of revenue. But if you look out in the more distant horizon, if you look, 10 years out, I would imagine that this becomes the largest part of Cloudflare's business.

Gabriela Borges
Analyst, Goldman Sachs & Co. LLC
Q

I appreciate the color. And Thomas, the follow-up is for you on pool of funds revenue. And there are two dynamics that I think you've talked about happening at the same time. The first is more of your business is shifting towards consumption revenue. And the second is that it sounds like customers are burning through their pool of funds contracts faster than what the original base case might have been. And so talk to us about how that informs your forecasting going forward and any observations you can share with us on the pool of funds piece of the business in particular? Thank you.

Thomas Josef Seifert
Chief Financial Officer, Cloudflare, Inc.
A

Yeah. We saw continued strength in our variable revenue. It was the primary contributor to the upside and the surprising or positive part of that was it was tripping across a lot of customers, either joining pool of funds or, as you said, burning to their pool of funds commitments faster and therefore have to renew earlier and as part of their renewal process, sign up to even bigger pool of funds concept. Because it has been driven by a long tail of customers, this of course influences how we put guidance for the fourth quarter. But it was not a concentrated event but a long tail of events across many customers and is part of the reason why we guided to what we guided.

Gabriela Borges
Analyst, Goldman Sachs & Co. LLC
Q

Thank you and congratulations to the team.

Operator: Your next question comes from the line of Ryan MacWilliams with Wells Fargo. Your line is now open. Please go ahead.

Ryan MacWilliams
Analyst, Wells Fargo Securities LLC
Q

Hi. Thanks for taking the questions. So the contribution from net new customers over the last year seems to be growing strongly for Cloudflare. How are you seeing new AI native customers ramp across your acts compared to past cohorts and are AI native driving any stronger growth in any act for the third quarter? Thanks.

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

Yeah. Thanks, Ryan. I would say that, we're seeing real strength across just about every different vertical that's out there. And so, yeah, we're seeing AI growth, but by no means would I say that this is really concentrated

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around AI in particular. We're seeing strong growth around financial services, government, manufacturing, healthcare, e-commerce across the board that's coming on board. And it is new customers. And so as I talked about in the prepared remarks, I think one of the biggest drivers is the fact that it's sort of a secondary effect of AI, which is, AI is finding more and more security flaws that are out there.

Just last week and the week before, we had six of the worst Internet security bugs of all time announced over the course of a fewer than 14 days. And we're not done. We have already gotten disclosures of many, many, many more extremely scary bugs, which researchers have found have quietly disclosed to us and we have protected our customers from. And so – and some of, I guess, that's AI driving this because AI is helping find these bugs.

But what else is happening is, the small bank in middle America, that's like how in the world do I stay in front of all of this tsunami of threats which is coming. It's getting advice from their peers, from government officials, I mean, it was discussed literally in the White House the other day where a bunch of AI leaders got together with the White House officials and asked, like – and the White House was like, how are we going to make sure that everyone's protected against these vulnerabilities? And the answer came back, Cloudflare, because we sit in front of so much of the Internet and we are such a responsible player protecting the Internet. I think that's what's driving a huge amount of our growth. And so, sure, AI companies are growing and they're growing across all of our different sectors. But across the board, this is a really a broad-based win, not one which is entirely focused on just a small number of AI companies.

Ryan MacWilliams
Analyst, Wells Fargo Securities LLC

Q

Great to hear. And then I want to hear at a high level how you're seeing the end customers are evaluating significantly more of their web traffic, becoming agent based or coming from agents? Like are they happy to get more of that traffic or are they working with Cloudflare to make sure they receive and then pay for like the right traffic coming in?

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

A

Yeah, I think the answer depends on the customer. Some customers see agents as wonderful and they want to have them as many of them come to them as possible. Others see them as a bane to their business and want to keep them away. And we need to be able to serve both of those needs. And so for those customers that want more agentic traffic, we're helping them with modern – we have – there are different terms for it. But sort of the new version of SEO sort of how do you optimize to get as much agentic traffic as possible? How do you make sure that it's being served in the most efficient way possible? And we're making that as easy as possible for them.

On the other hand, customers that want to keep those agents, the way they see them as a threat, we're blocking that and then they're not getting charged for that traffic. And I think one of the things that's different from us then, I mean, we've never been a CDN like that's – the fact that we do caching is only because we were afraid that our security services would slow things down and caching is an obvious computer science way of dealing with that. But we've really never been focused on charging for CDN traffic in any meaningful way. It's not a big driver of our business. And so, when the traffic goes up or the traffic goes down, I think that more and more customers are flocking to Cloudflare because unlike some of the pure CDN plays that are out there where their bills are going up or they're not seeing the benefit, we're able to give them real control over what customers come to them and not charge them for what frankly, I don't think they should be charged for in the beginning.

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Ryan MacWilliams
Analyst, Wells Fargo Securities LLC

Q

Appreciate the color. Thank you.

Operator: Your next question comes from the line of Saket Kalia with Barclays. Your line is now open. Please go ahead.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Okay, great. Hey, guys. Thanks for taking my questions here and perhaps on another quarter of acceleration.

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

A

Thank you.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

Matthew maybe – absolutely. Matthew, maybe for you. There's clearly a lot of questions out there about what happens if data center construction slows. And I want to touch on the comparison that you made in your prepared remarks between container-based clouds versus Cloudflare's isolate architecture? Now a lot can happen in terms of data center construction in the future but hypothetically if it were to slow, it feels like it could make your agentic cloud more valuable. But I'm curious how you think about that scenario, and how it could impact Cloudflare's business, if at all?

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

A

Sure. So I know we – it's – we've gotten approached over and over again to say, would we do something like what the neoclouds are doing. And I think that, what our answer has always been is we're an engineering company, we're not a financial engineering company. And so we're focused on how we can actually deliver real operational excellence and get real advantages for every CapEx dollar that we spend in order to deliver more benefit. And so we've lost a bunch of really dumb deals get done and obviously the market is digesting those right now. Those just aren't the sorts of deals that we would ever do. And I think as the market gets more rational and as we actually figure out, okay, you can't sell a dollar for $0.50 and be in business over the long-term. What will happen is people will focus instead on where can we get more value, where can we drive more efficiency? And it turns out that we're the platform that has built that.

As I said in the prepared remarks, the isolates technology allowed us to distribute our systems globally and do that in an incredibly efficient way. But what we're increasingly finding is in those places where we need more density, where agents are talking to agents and they might be in two data centers right next to each other, that density also benefits from that same isolates architecture. And so again, I – it's – my crystal ball isn't perfect but your prediction that as the – as some of the financial engineering that's driven this growth goes away, I think it will focus us more on who are the companies that have real operational excellence can deliver and have real engineering differentiation and a diversified business model. And I think that's exactly what Cloudflare has.

Saket Kalia
Analyst, Barclays Capital, Inc.

Q

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Makes a ton of sense. Thomas, maybe for my follow-up for you. Great to see the dollar based net retention continue to improve. I think we're back at levels that we haven't seen in almost four years, so congrats. Can you just maybe dig into where the cross sell is particularly breaking out in terms of which acts or customer segments and could that net retention continue to improve looking forward?

Thomas Josef Seifert A
Chief Financial Officer, Cloudflare, Inc.

Starting with your last part first. Yes, it can. We have higher ambitions when it comes to DNR than what we're currently achieving. And I think the combination of pool of funds, the largest customers growing the fastest, and the friction that these concepts – the pool of funds contracts take out of the expansion process are driving that. Where do we see that? We see that across the portfolio currently. Security is playing a heavier and heavier role just following the remarks that Matthew made in his prepared statement, but also now in the Q&A session. So it's a broad-based expansion, especially in the large customer cohorts across all products, and especially with customers that are in pool of funds relationships with us.

Saket Kalia Q
Analyst, Barclays Capital, Inc.

Very helpful. Thank you.

Operator: Your next question comes from the line of Sanjit Singh with Morgan Stanley. Your line is now open. Please go ahead.

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

Yeah, thank you for taking the questions. And on that point of engineering differentiation, you guys have disclosed that you guys are up to 10 million developers now on the platform. So just wanted to get a sense of are we seeing that developer traction and that adoption translate into paid Workers consumption and ultimately sort of enterprise revenue? And to that end, can you help us give us a sense of how much of agent or AI inferences contribute to Workers growth today versus maybe a more traditional sort of developer use case? How quickly is that mix changing? If you give us any sort of a high level view on that would be great.

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

Yeah. Sanjit, appreciate the question. Again, the rate at which developers are growing is just extraordinary. We went from 7 million to 10 million in just a quarter. And I'm just incredibly proud that when developers are looking for what the platform of the future is, they're choosing Cloudflare. The first way it's translating into it is in paying customer account. You can see that we had a record addition of new paying customers this quarter up 158,000 paying customers, almost double our previous record from last quarter. And a lot of that is because those are developer customers that are there. Some of those are going to stay small customers forever. And some of those are folks like my EA, who's building her first app and using Cloudflare to do that. And she might pay $5 a month or something like that in order to do that. But it's again, it's great and it contributes to everything.

But some of those are, what are new startups that turn into larger businesses. And increasingly what we're seeing is large existing businesses onboarding more of their developers to the Cloudflare platform, and that's driving, just as Thomas already talked about, faster pool of funds consumption, which is leading to earlier renewals, which is leading to better DNR and again driving the flywheel across all of our business. So we're really proud of the fact that the developer platform business is growing as well as it is that we've, I think, hit what is critical mass and we'll

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continue to grow from here in terms of developer count. And I think more and more you're seeing that people are building full applications entirely on Cloudflare Workers and there are whole classes of startups. It was really fun in our customer conference, we actually did a little sort of mini kind of startup competition pitch and like the companies that pitched were incredible and they were entirely built on Cloudflare Workers. And I think that's something you're just going to see more and more and more of over time. And the developer count is one way to measure it.

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

Q

Yeah, and that's super encouraging Matt. Tom, going back to the Analyst Day, you guys called out that the developer platform carries a lower gross margin today, but ultimately could have really compelling superior unit economics. Given the acceleration that you're seeing in this part of the business, could you remind us of what the core levers [indiscernible] (00:49:05) you have to get Workers unit economics at or above the core business?

Thomas Josef Seifert
Chief Financial Officer, Cloudflare, Inc.

A

Yeah. I mean, what we talked about at Investor Day and hinted to is that our products all have very different unit economics, some with very high gross margin, longer sales cycles, but also higher cost of book like our Zero Trust products and our Workers product falls into this category where we have slightly lower gross margins but significantly lower cost of book, for example. And this is – it's directly reflected in the operating margin we are achieving. And this quarter was a good testament of that. The significant expansion of our operating margin as a result of our accelerated Workers developers platform growth. And our guidance now to get to GAAP profitability in the fourth quarter is also a result of this.

So there are a couple of levers to even make that stronger. Their engineering is working really, really hard to get more efficiency in our compute infrastructure, how compute infrastructure is utilized by Workers and we are making really good progress. So there is continued gross margin expansion if you want to say so. And then there is improvements on the unit economics side below gross margin, if you want to say so. And if you remember, we said we would exit the year with momentum from a rule of 40 moving to a rule of 50%. We are far ahead of that currently, and that is a testament to both the growth in the platform, the developer count in the business, but also the significant improvement we are already making on the engineering platform and the compute platform.

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

Q

Appreciate the thoughts. Thank you.

Operator: Your next question comes from the line of Samik Chatterjee with JPMorgan. Your line is now open. Please go ahead.

Samik Chatterjee
Analyst, JPMorgan Securities LLC

Q

Thanks for taking my questions and congrats on the strong print here. Matthew, you and Thomas both talked about the – on the security side that is now playing a heavier role in terms of the NDR expansion. Can you just talk about sort of what you're seeing in terms of win rates in relation to Cloudflare, one, maybe against some of the first generation Zero Trust vendors? And why are your customers choosing overall Cloudflare products over some of the legacy vendors there? And I have a follow-up.

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

A

Yeah, Samik I really appreciate it. I think that, we were sort of second generation entrant into the Zero Trust and SASE space. And so as such, a lot of what we had to do for a while was just get recognized, get in the conversation. And I think what's really helped us there is actually the developer platform that we've had being out there talking about here's how you build agents, here's how you think about agents, because it turns out those agents need identity. They need to have some way of being protected. And if you're going to turn agents loose within your organization, having the bulkhead that a Zero Trust system provides is more critical than it ever has before.

And so as we were talking about, the developer platform, what we found is more and more of the time the chief security officer was sitting in the room, taking notes. And the number of meetings that I've been in where people have said, I'm way down the RFP process with a traditional kind of Gen 1 Zero Trust vendor. And I'm going to tear it up because they really aren't thinking about agents and the agentic space and how that is different than human users whereas Cloudflare is. I think that's given us a significant leg up and it's improved our win rates. But I think even more importantly, it's improved the number of deals that we're in.

And so, what we're seeing more than anything is people are buying just Zero Trust. They're not just buying app, they're not just buying DDoS, they're not just buying the developer platform. They're buying the overall platform of Cloudflare. And they're seeing that if you incorporate and use all of what we do, that you get a much more holistic solution. And as a result, like the Zero Trust vendors effectively just become features within what is a much larger platform play. And so I think that the biggest recognition is that the smartest companies in the world are increasingly seeing Cloudflare as a true strategic partner to provide one of their core platforms. And that's what's driving not only our wins in Zero Trust, but our wins across the entire platform. And the increased adoption that we're seeing and the faster consumption that we're seeing are the pool of fund deals that we sell.

Samik Chatterjee
Analyst, JPMorgan Securities LLC

Q

Okay. Fair. And for my follow-up, if I can go back to the Workers product and you've seen strong traction with developers on that front. In terms of the large customers that you work with and the new wins you have there, any way to sort of help us think about what portion of your new wins with large customers have Workers incorporated as part of the deal now versus maybe how that's progressed over time? And where do you see more headroom in terms of incorporating that in some of your discussions and wins with new customers? Thank you.

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

A

Yeah. I mean, I think it is increasing. I don't think we're disclosing exactly what percentage of deals it attaches to. But almost every pool of funds deal that we sell, Workers is a big component of it and it's in the toolkit that's there. And what we find is even if somebody bought, they bought the Cloudflare platform, they sign up for a pool of funds deal, they may not have even initially thought that they were signing up for Workers, the minute their developer team hears that now they have access to Workers all of a sudden they're turning to it because it's such a powerful tool in their toolbox in order to get their job done.

And so, across the board, we're seeing much more adoption of Workers. We're seeing it not just from small customers, but from very large customers as well. It's not just from AI companies, it's from across the board almost every industry that's out there. And more and more people are seeing that they need to have Workers as a tool in the toolkit of their developers, their developers are insisting on that. And that's driving not just the sale of

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Workers, but then also the sale of our SASE products, the sale of our other products. Cloudflare is a platform and increasingly our customers are recognizing us as that key strategic vendor that is providing one of their key platforms.

Samik Chatterjee
Analyst, JPMorgan Securities LLC

Q

Thank you. Congrats again.

Operator: Your next question comes from the line of Joseph Gallo with Jefferies. Your line is now open. Please go ahead.

Joseph Gallo
Analyst, Jefferies LLC

Q

Hey, guys. Thanks for the question. Matthew, I wanted to follow up on your earlier cyber comments. You talked about the vulnerability tsunami. Are you seeing cyber budgets inflect? Like, what are CISOs doing right now or getting in terms of dollars to fix this never ending avalanche? And then, how can you attack that? Is the better market response to just offer free solutions and then cross-sell into other acts?

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

A

I think right now what CISOs are doing is panic. I mean, it feels like the sky is falling and again, I think everyone is sort of holding their breath and saying, hopefully the worst of it is over. I know for a fact the worst of it is not over. There are significant vulnerabilities that are coming. And you got to stay on top of them and you've got to be protected by them. And again, I think that the researcher community is doing a great job disclosing those things, responsibly getting the protections in place as early as possible. But there's scary things that are happening out there.

I think the good news of that is we're actually finding these vulnerabilities. The story I keep telling is, which is a more dangerous world to live in? One in which you live in a house where there are incredibly deadly monsters living under every bed, in every cabinet and in every closet. But you don't know they're there. Or one in which someone is relentlessly going through every closet and cabinet and under every bed, finding the monsters and killing them off. I think we had been for a long time living in that world where the monsters are out there. These vulnerabilities like the PHP vulnerabilities that were disclosed the other day, had been in the wild for years. And we're going back to our logs looking for any evidence that hackers or nation state actors or others had been using them in the past. And I know that we're going to find examples of that.

I think it's amazing that we're getting those things cleaned up. I think it's great that Cloudflare is protecting everyone. And I think what we're seeing is every company is turning to us and yeah, sure, we're going to provide the services for free. But if you're a major bank, you're not going to sign up for a free service and think that that's good enough. They are turning to us saying we need your help. They're signing major contracts and they're relying on Cloudflare to be that trusted party that gets information before everyone else and make sure that they have protection in place for this tsunami that hasn't hit. It's coming and it's going to be bad and it's going to be bad for, I think, two years. But the good news is, we're finding the monsters, we're cleaning them up, and the Internet is actually getting safer. And I'm incredibly proud of our team for staying on top of it, working incredibly hard because there's a lot of new vulnerabilities that are coming out there. And we want to make sure that every single one of our customers have the protection they need.

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Joseph Gallo
Analyst, Jefferies LLC

Q

That's really helpful. Thank you. Maybe just as a follow-up, exciting news and the appointment of Christian Smith, you highlighted doubling down on go-to-market execution. Where is the greatest opportunity that improves execution? And then do you envision a continuation of the current playbook or what tactical changes across enterprise sales or channel should we expect? Thank you.

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

A

Yeah, I mean I think in the short-term, and I talked with Christian about this and Christian, I think has an incredibly good vision for both, what's the playbook that we should continue, but also what changes in the future, given all of the changes in how sales is going to look driven in a world that is increasingly technical and increasingly has AI as a component of it. I think in the short-term it's how do we continue to hire at scale, make sure we're bringing on really great people, how do we increase our awareness, especially with our largest customers to make sure that they know that we are a significant strategic platform, and a partner to them? How do we make sure that people have awareness of all of the capabilities that Cloudflare has? And how do we continue to double down on what Mark Anderson has done just such a great job of. And I think Christian is leading that.

But going forward, I think we're going to be experimenting with what's the shift, like how much are we doing what we're already doing, but at greater scale. How many forward deployed engineers do we have that are out there, which we already have at our largest customers helping them get the most out of Cloudflare. So that's certainly is going to increase. What's the ratio of solutions engineers to AEs? What exactly are the specific technical overlays and how specific do we want the individual salespeople to have knowledge in all of the different products that we have? I think that's all going to redefine what sales looks like in an increasingly, again, AI-driven and an increasingly technical world. And I think that there will be an evolution. And as we talk to and we got to talk to so many incredible candidates. The thing that really stood out to me was Christian knew both how to continue to execute on what we need to deliver today, but also how do we stay malleable and adaptable to how sales is going to change and evolve over the next years to come. And I can't imagine a better partner than he is.

Joseph Gallo
Analyst, Jefferies LLC

Q

Thank you and really nice job.

Operator: Your next question comes from the line of Fatima Boolani with Citi. Your line is now open. Please go ahead.

Fatima Boolani
Analyst, Citigroup Global Markets, Inc.

Q

Thank you. I appreciate you taking my question. Matthew, I'd like to ask this of you, about six months ago, you made a decisive and difficult decision to restructure the organization. And certainly the impetus was not to drive operating leverage. And that was certainly something you communicated. But with six months under your belt with this change from a financial perspective, it's not like we've seen margin expansion right. I'm just kind of reiterating my point that that was not the impetus. I'm curious if you can talk to us about how this has fundamentally and structurally changed the way Cloudflare goes to business and show that, both in terms of your agility and some of the comments that you just made from a go-to-market perspective, how that colors your lens there. But just if you

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can give us some concrete examples of what the aftermath of some of those difficult restructuring moves has been in terms of your ability and your successes in operating the business at this level? Thank you.

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

A

Yeah. So first of all, Fatima, when we made the decision to lay people off, it was incredibly hard decision. We let go of a number of people who were extremely talented, people who I consider friends and I'm proud of the fact that we had an incredibly generous severance package. We continued to vest people shares, which was the most companies haven't done. And also that we worked with them to figure out great places that they could work because someone who is the middle manager at Cloudflare could be a great senior manager at a fast growing startup. And I'm proud of the fact that we really helped place a large number of the people who we let go, because they're very talented and they deserve to be treated with respect.

It really had less to do with the people. It had much more to do with what we saw as the way that organizations were going to be structured going forward. And I wrote an editorial in The Wall Street Journal about how Peter Drucker used to talk about how there are three types of functions within any company. There are people who build things. There are people who sell things and there are people who measure things. And what we found with AI is that the builders are getting more efficient than ever. And so we're trying to hire as many great builders as we can.

And again, as you said, we're not trying to cut head count. We actually are just shifting head count to more builders. Same thing with sellers. In the past, sellers might have spent 60% of their time getting prepared for meetings, filling out sales force reports, doing all of that. That's not what they love doing. What they love doing is being in front of customers. And we've been able to dramatically increase the amount of time that sellers are in front of customers. And you see that in sales productivity. What's changed are the people who are the measurers. And AI is incredibly good at measuring things and we have found across our business that in many cases it's better than what humans can do. AI is bias, but the bias is not correlated to the rest of the organization, unlike what everything else has done.

And so, for a very specific example, which I ask if I could tweet and everybody said not until after earnings. And the person who – I'm staring at the person who knows I'm going to tell our story right now on a screen. But Heather on our team who for a long time was on our IR team, has built an agent now that has automated pulling together all the investor materials, all of the sort of statistical cheat sheets that we have that make sure that we have all the metrics right at our fingertips, giving us suggestions on kind of our earnings scripts, being able to deliver that. And instead of that being something that took a large team, a significant amount of time to do every single quarter it now takes an agent less than couple of hundred bucks in token costs to be able to put that together. And we've seen a higher quality of what gets put out, more accuracy, fewer errors, and it's just better.

And so I think what we knew we needed to do was flatten Cloudflare's organization. We needed to double down on builders. We needed to double down on sellers, and then we needed to get more efficient in those places where AI could help us be significantly more efficient. And so, again, as I said at the time, when we lay people off, I think our head count is going to be larger by the end of the year than it was even before the layoffs. We're hiring like crazy, it's who we're hiring and the roles that we're hiring for that are changing. And frankly, I think that we were early in that, but just about every company is going to go through that transition and as you come out the other side of it, I think our financial results show you can become a much more nimble, much more innovative, just much more successful company if you get the right people in the right functions and use technology to help those people, not replace those people, but help those people do their jobs better.

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Operator: We have now reached the end of this Q&A session. I would like to turn the call back to Matthew Prince for closing remarks.

Matthew Prince

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

I want to thank the entire team and especially Mark Anderson, for all of his service. We couldn't have done this without you. It's your last earnings call with us, we're super happy to have you on board. I'm being choked up, thank you so much for everyone. It was an incredible quarter, a monster quarter. We'll see you back here next quarter.

Operator: This concludes today's call. Thank you for attending. You may now disconnect.

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