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Cloudflare, Inc. (NET)

Q3 2025 Earnings Call

CORPORATE PARTICIPANTS

Philip Winslow

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

Matthew Prince

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

Chirantan Desai

President-Product & Engineering, Cloudflare, Inc.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

OTHER PARTICIPANTS

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Adam C. Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Shaul Eyal

Analyst, TD Cowen

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Jackson Ader

Analyst, KeyBanc Capital Markets, Inc.

Mike Cikos

Analyst, Needham & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by. My name is Greg and I will be your conference operator today. At this time, I would like to welcome everyone to today's Cloudflare Q3 2025 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] Thank you.

I would now like to turn the call over to Phil Winslow. Phil?

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 2025. 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 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 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 months ago.

We would also like to inform you that we will be participating in RBC's Global Technology, Internet, Media and Telecommunications Conference on November 18 and Needham's Sixth Annual Tech Week on November 24.

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. We had an extremely strong Q3. We achieved revenue of \$562 million, up 30.7% year-over-year. Great companies innovate and execute and I think we owe our reacceleration of revenue growth to doing both of these things very well. We do now have 4,009 large customers, those that pay us more than \$100,000 per year, a 23% increase year-over-year.

Revenue contribution from large customers grew 42% year-over-year, contributing in total 73% of our revenue during the quarter, up from 67% in the third quarter last year. Our dollar-based net retention was 119%, up 5 percentage points quarter-over-quarter. Our gross margin was 75.3%, within our long-term target range of 75% to 77%. We delivered an operating profit of \$85.9 million, representing an operating margin of 15.3%. And we generated strong free cash flow of \$75 million during the quarter, again exceeding expectations.

Our go-to-market transformation, evolving from purely product-led growth to true enterprise sales, continue to track along. Growth in net capacity of our sales force grew at its fastest pace year-over-year in more than two years. Sales productivity increased year-over-year for the seventh consecutive quarter.

Close rates ticked up notably both year-over-year and quarter-to-quarter. Bookings from partner-initiated opportunities doubled year-over-year. Gross retention levels increased year-over-year and quarter-to-quarter. And new pipeline attainment again exceeded our expectations. Across the company, the team is firing on all cylinders.

One bit of disappointing news is that CJ Desai is going to be leaving Cloudflare. CJ called me some time ago to talk about an opportunity he's been approached to be the CEO of an exceptional public technology company. He was torn because he loved his team, the work and the mission at Cloudflare. But since his first job in technology over 25 years ago, he dreamed one day of being the CEO of a great public company. We talked through the opportunity, his career goals and what's great and not so great about being a public company CEO. In the end, while I'm sad to see him go, I'm excited for him to get to helm his own ship. I wanted to give CJ an opportunity to say something on this call, in some ways, as practice for his many earnings calls to come. CJ?

Chirantan Desai

President-Product & Engineering, Cloudflare, Inc.

Thank you, Matthew. This was an extremely hard decision for me as I love the team and mission of Cloudflare, and I see incredible opportunities ahead. I really appreciate the support as I figured out what was right for me. This job at Cloudflare is the coolest product and engineering job in tech today. And I will help ensure whoever feels the seat next will be world-class. I'm incredibly bullish, as you know, on Cloudflare's future. I'll miss you all, but will always be among your biggest fans.

Matthew Prince

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

Thanks, CJ. I appreciate how you brought a customer-first focus to Cloudflare's already powerful innovation engine. That made us a better company able to win bigger deals. It's now part of our DNA that you deserve credit for having helped shape. And while I'm bummed you're leaving, I'm proud that Cloudflare is a place that is training the leaders of other great technology companies. You're our second product leader in a row to be recruited away to be CEO of somewhere awesome. We can't say yet where you're going, but they're lucky to have you, and I have no doubt you'll bring some of Cloudflare's relentless culture of innovation to them.

With that out of the way, let's talk about some of our wins in the quarter. A Global 2000 digital media platform expanded its relationship with Cloudflare, signing a three-year \$22.8 million pool of funds contract for Application Services and Workers. This contract marks the culmination of a powerful comeback story. We actually lost this customer to a competitor in 2016, but the Internet and Cloudflare evolved. We earned their trust back in 2023, starting with our Zero Trust portfolio. During eight months of testing before signing this deal, our world-class security, unmatched product breadth and powerful Workers platform ran circles around the incumbent.

But that's not the whole story. The decisive factor of the win was AI. This customer looked at the landscape and correctly identified Cloudflare as the only company building the essential platform to protect and manage content for the emerging AI-driven web. This strategic win established us as the customer's clear, forward-looking partner and creates a direct on-ramp for pay per crawl, which could transform Cloudflare from a vendor they pay for services into a powerful revenue generator for their business. We and they believe that this is what the future looks like.

A leading European technology company expanded its relationship with Cloudflare, signing a five-year \$34.3 million contract, representing an upsell of \$6.8 million for Workers platform and Application Services. This customer is fully redesigning their architecture to move their front end on to Workers and Durable Objects. The decision to commit to a five-year term underscores the customer's view of Cloudflare as a critical long-term strategic partner.

A rapidly growing media platform expanded its relationship with Cloudflare, signing a three-year \$15 million contract for Workers and Application Performance. This customer was experiencing significant egress fees, high latency for its global customer base, and vendor lock-in with a hyperscale public cloud provider. Moving to Cloudflare will enable data to be processed and served closer to their end users, delivering superior performance and eliminating egress fees. With our unified platform, this customer will be able to drive down their total cost of ownership by more than 30%.

A Fortune 500 financial technology company expanded its relationship with Cloudflare, signing a two-year \$16.1 million pool of funds contract, with an upsell of \$4.6 million for Application Services and Workers. As a textbook land-and-expand journey across three acts, this customer started with Cloudflare's Application Services in 2022,

expanded with our Zero Trust platform in 2023 and has been adding a number of products from our Workers platform over the last two years. Another Workers deal is already underway for AI use cases.

A Global 2000 European pharmaceutical company expanded its relationship with Cloudflare, signing a three-year \$12.4 million contract with an upsell of \$4.5 million. This is a great example of platform adoption as the customer is utilizing products from our first three acts, Application Services, SASE and Developer. This customer views Cloudflare as a critical strategic partner choosing to displace services from two hyperscale public clouds and multiple point solution providers because according to them, "it's so much easier to build on Cloudflare."

A US Cabinet-level agency expanded its relationship with Cloudflare, signing a two-year contract exceeding \$20 million for our complete FedRAMP portfolio. The agency is standardizing its network and security platform on Cloudflare, displacing over a dozen legacy point solutions and generating more than \$10 million in annual cost savings. We are seeing more traction than ever before across US government as it looks to modernize its digital infrastructure.

A Fortune 100 financial services company signed a three-year \$4 million contract for Magic Transit and Advanced Magic Firewall. Recent outages, capacity limitations and a lack of automation features with two legacy incumbents left this customer with DDoS vulnerabilities at their network layer in a time when we're seeing new record-breaking DDoS attacks every few weeks, like the nearly 30-terabit per second attack we mitigated earlier this month. Cloudflare won because our fundamental architecture advantage gives us literally 4 times the capacity of all our scrubbing center-based competition combined. As the Internet gets scary and scarier, customers are realizing Cloudflare is the only network engineered to survive.

A global industrial company signed a three-year \$2.2 million contract for a complete SASE portfolio, including Access, Gateway, Browser Isolation, CASB, DLP, Magic WAN and Magic Firewall to consolidate and modernize their security stack. We're displacing a first-generation Zero Trust vendor as well as a legacy on-premise VPN provider, which were expensive and difficult to maintain across their global operations. This customer chose Cloudflare for the operational simplicity of our unified platform that delivers both superior performance and significant cost reduction.

A global web infrastructure platform expanded its relationship with Cloudflare, signing a 14-month \$1.2 million contract for AI Crawl Control and Bot Management. This customer is experiencing a massive surge in AI scrapers and malicious bots hitting their origin servers, inflating costs without revenue conversion and obscuring visibility into legitimate traffic. They selected Cloudflare for our innovative best-in-class bot blocking capabilities in addition to seamless expedited deployment by our deep platform integration. We're already exploring a much larger opportunity with this customer for pay per crawl.

We talked last quarter about how the rise of AI would impact media companies. Cloudflare has emerged as a strategic partner to these firms as they work through what the new business model of the Internet will be. But it goes beyond just media. Businesses of all shapes will be transformed by the rise of AI. I don't think people yet appreciate how AI is another massive information consumption platform shift. Just as we move from consuming information via a browser on a desktop to social media and then to apps on mobile devices, AI is another information consumption platform shift. It changes where and how we will consume and interact with information.

With the last three platform shifts, the business model of the Internet remain the same: create content, generate traffic and then sell things, subscriptions or ads. With AI, for the first time in a long time, the fundamental business model is going to change. Human eyeball traffic is unlikely to be the currency of the Internet's future. We already can see glimpses of that future. It's represented in [indiscernible] (00:13:25). When George Jetson asks his

helpful robot, Rosie, for a recipe for cookies, the response isn't 10 blue links to hunt through. It's a recipe for cookies. Most of us are increasingly living in some version of that future now with tools like ChatGPT. And it seems inevitable that more and more commerce will be facilitated by AI-powered agents working on our behalf.

As that happens, new questions will arise. What happens to small businesses? What happens to brands? Brands, of course, are just shortcuts for humans to be able to assess quality and value. What do they mean in the world of agentic commerce? I don't know what the future business model of the Internet will look like, who the winners and losers will be, but I do believe Cloudflare will help shape it. We estimate 80% of the leading AI companies already rely on us. A huge percentage of the Internet sits behind us. The agents of the future will inherently have to pass through our network and abide by its rules. And as they do, we will help set the protocols, guardrails and business rules for the agentic Internet of the future. And we'll make sure the tools to participate in that future are available to all businesses, large and small. It's what we've always done.

Again, we don't know exactly what the future will look like, but I believe Cloudflare will be one of the key players helping shape it. What we are playing for is a world with as many AI companies, media companies and businesses, large and small, competing fairly to best serve customers anywhere and everywhere they and their agents transact. I'm really excited for that future and I'm optimistic about it. But to bring it back to the present, let me hand it off to Thomas to walk through this quarter's financials. Thomas, take it away.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

Thank you, Matthew, and thank you to everyone for joining us. We are pleased with our strong third quarter results that underscore how our strategy for delivering continued innovation and accelerating growth while also maintaining a relentless focus on operational excellence is working.

Revenue growth accelerated for the second consecutive quarter to 31% year-over-year, providing clear evidence of the momentum building in our business. We complemented this robust growth with a highly balanced operating plan, investing significantly in our innovation pipeline and expanding our go-to-market capacity while simultaneously remaining committed to the strong unit economics of our business to drive operating leverage and deliver compounding shareholder value.

Turning to revenue. Total revenue for the third quarter increased 31% year-over-year to \$562 million. From a geographic perspective, the US represented 50% of revenue and increased 31% year-over-year, which is up nearly 10 percentage points sequentially. Growth in the US region was primarily driven by strength with partners, our Workers' developer platform and large customers, including pool of funds. EMEA represented 27% of revenue and increased 26% year-over-year. APAC represented 15% of revenue and increased 43% year-over-year.

Turning to our customer metrics. In the third quarter, we had approximately 296,000 paying customers, representing a record net addition of nearly 30,000 paying customers sequentially and an increase of 33% year-over-year, driven by an uptick in customers, including those graduating from the freer tier to small paid accounts for developer platform products around our AI Week and Birthday Week. We ended the quarter with more than 4,000 large customers, representing an increase of 23% year-over-year. Revenue contribution from large customers increased to 73% of revenue during the quarter, up from 67% in the third quarter last year.

We again saw particular strength in our largest customer cohorts. For the fourth consecutive quarter, we added a record number of our largest customers year-over-year, those that spend over \$1 million and \$5 million with Cloudflare annually. Accelerating sequential and year-over-year revenue growth from both of these cohorts

served as a significant tailwind to our expansion business. As a result, our dollar-based net retention rate accelerated to 119% during the third quarter, up 5% sequentially and 9% year-over-year.

Moving to gross margin. Third quarter gross margin was 75.3%, remaining within our long-term target range of 75% to 77% and representing a decrease of 100 basis points sequentially and a decrease of 350 basis points year-over-year. During the third quarter, paid versus free customer traffic again increased both year-over-year and quarter-to-quarter, resulting in a higher allocation of expenses to cost of goods sold from sales and marketing.

Our Workers developer platform continues to deliver outsized growth with the world's most innovative companies increasingly adopting Workers for running AI inference tasks as well as building AI agents and full stack applications. While the relative revenue contribution across our four acts can impact near-term gross margin, the unit economic margin of our business remains very consistent. Network CapEx represented 14% of revenue in the third quarter. We expect network CapEx to be approximately 13% of revenue for full year 2025.

Turning to operating expenses. Third quarter operating expenses as a percentage of revenue decreased by 4% year-over-year to 60%. Our total number of employees increased 16% year-over-year, bringing our total head count to roughly 4,800 at the end of the quarter. Sales and marketing expenses were \$201.2 million for the quarter.

Sales and marketing as a percentage of revenue decreased to 36% from 37% in the same quarter last year. Research and development expenses were \$82.5 million in the quarter. R&D as a percentage of revenue decreased to 15% from 16% in the same quarter last year. General and administrative expenses were \$53.5 million for the quarter. G&A as a percentage of revenue remained consistent at 10% compared to the same quarter last year.

Operating income was \$85.9 million, an increase of 35% year-over-year compared to \$63.5 million in the same period last year. Third quarter operating margin was 15.3%, an increase of 50 basis points year-over-year.

Turning to net income and the balance sheet. Our net income in the quarter was \$102.6 million or diluted net income per share of \$0.27. Free cash flow was \$75 million in the quarter or 13% of revenue compared to \$45.3 million or 11% of revenue in the same period last year. We are comfortable with consensus free cash flow estimates for the fourth quarter of fiscal 2025.

We ended the third quarter with \$4 billion in cash, cash equivalents and available-for-sale securities. Remaining performance obligations, or RPO, came in at \$2.143 billion, representing an increase of 8% sequentially and 43% year-over-year. Current RPO was 64% of total RPO.

Moving to guidance for the fourth quarter and full year 2025. For the fourth quarter, we expect revenue in the range of \$588.5 million to \$589.5 million, representing an increase of 28% year-over-year. We expect operating income in the range of \$83 million to \$84 million, and we expect an effective tax rate of 20%. We expect diluted net income per share of \$0.27, assuming approximately 377 million shares outstanding.

For the full year 2025, we expect revenue in the range of \$2.142 billion to \$2.143 billion, representing an increase of 28% year-over-year. We expect operating income for the full year in the range of \$297 million to \$298 million and we expect an effective tax rate of 20%. We expect diluted net income per share over that period to be \$0.91, assuming approximately 370 million shares outstanding.

In closing, the strength of our third quarter results confirms that our strategy to deliver continued innovation with accelerating growth and strong unit economics is driving significant and measurable value. At the beginning of the year, we committed to reaccelerating revenue growth over the course of 2025 on the way to our goal of achieving \$5 billion in annualized revenue by the fourth quarter of 2028. Our performance over the last two quarters demonstrates that we are effectively executing against both of these objectives. In fact, we expect to reach a \$3 billion annualized revenue run rate in the fourth quarter of 2026 on our journey to \$5 billion and beyond. This trajectory reinforces our conviction in our strategy and our ability to deliver exceptional long-term value for our shareholders and customers.

Before opening it up for questions, I would also like to extend my personal thanks and congratulations to CJ. The processes, discipline and leadership bench he established at Cloudflare will enable our innovation engine to continue to scale well beyond his tenure. All of us at Cloudflare wish CJ continued success in his next chapter.

And with that, operator, please poll for questions.

QUESTION AND ANSWER SECTION

Operator: Thanks, Thomas. [Operator Instructions] And our first question today comes from the line of Matt Hedberg with RBC Capital Markets. Matt, please go ahead.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Q

Great. Thanks, guys. Congrats on the results. And CJ, we look forward to hearing about your future role. Matthew, there were a lot of strong metrics this quarter, but 43% RPO growth that accelerated, I think that was the highest RPO growth that you guys have reported since 2022, certainly stood out. I'm wondering if you could provide a bit deeper dive into what drove that acceleration this quarter.

Matthew Prince

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

A

Yeah. I'll start and I think Thomas can probably add to it as well. I think we try to be a place that says what we do and do what we say. And so I think the real thing that's happening is we are transforming from being a product-led growth company to being a true enterprise sales company. So you're seeing the average tickets tick up. You're seeing the large deals tick up. And that's driving just success in taking what have always been exceptional products and getting them in the hands of customers. And so I think our sales team deserves a lot of credit for really just driving great, great execution.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

What I would add is, we are – I think the RPO growth points to primarily two drivers, the customer quality and the platform expansion. And we are seeing exceptional strength with our large customer cohorts. Specifically, those that spend more than \$1 million or \$5 million with us, both delivered record growth this quarter.

And in addition to that strength is the increased consumption of our large pool of fund customers, demonstrating, I think, the increasing strategic importance of our platform for those large enterprises globally. And in addition to that, our Workers platform, the developer platform, including Workers AI, is just providing to be a significant new vector for long-term commitment and with that long – growth.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Q

That's great. Actually, could I double-click just, Thomas, on – you mentioned the pool of funds, and I know you mentioned it in your prepared remarks. But specifically, like, how is that showing up in results? You introduced that several, I think, years ago at this point now. But how is that driving some of this as well? Thanks, guys.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

The share of pool of funds deal this quarter was again up. It's now low double digits of total ACV. And we are seeing now across our pool of funds contracts an extremely balanced consumption of these contracts. On average, we're slightly ahead and that delivered to the strong performance in the quarter.

So the – this – if you have a platform like ours with more than 55 revenue contributing products now, we need a vehicle that allow us frictionless adoption and consumption of these products. And I think the sales team and the organization at Cloudflare has become quite good at deploying these contracts and driving consumptions with customers.

Matthew Prince

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

A

The other thing that I'd add is, I think we saw downward pressure on things like dollar-based net retention as we rolled out pool of funds. As those pools are now getting consumed, you can see our dollar-based net retention is ticking back up. And so I think the pool funds will show up in RPOs, pool of funds will – as it – it initially puts downward pressure on things like dollar-based net retention, but you can see that that's now ticking up again.

And so just to reiterate what Thomas said, these are an indication of customers trusting us as a strategic vendor, making larger, bigger bets on us. And it is an undoubtedly positive sign for us as a strategic vendor to more and more large customers.

Operator: All right. Thanks for the questions, Matt. And our next question comes from the line of Adam Borg with Stifel. Adam, please go ahead.

Adam C. Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And thanks so much for taking the questions. Maybe for Matthew, on the sales productivity gains, it's been great to see that continue. Are we at a point now where these gains are beginning to flatten out or are there still room for this to continue to trend higher in the coming quarters?

Matthew Prince

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

A

I think that we think that these will continue to – that productivity will continue to tick up in coming quarters. I think that the caliber of the team that we're bringing on, their ability to sell much larger deals, all of which contribute to having a much higher productivity from the sales team. And so we think that that – that there is still headroom there.

And then I think importantly, in addition to that headroom, we've turned the corner, starting last quarter, on having the ramped rep capacity also ticking up again. So I think we've gotten through what was a period of time where

we really needed to revamp the sales team, and we're now – and now we're seeing the benefits of that coming out the other side.

Adam C. Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's great to hear. And maybe just as my follow-up, it was really interesting to see a few weeks back the integration with Oracle OCI that was announced. Maybe talk a little bit about what advantages does it provide to those OCI customers? Thanks so much.

Matthew Prince

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

A

Yeah. So we're really excited to work with Oracle. They've been a terrific partner for us over the years. They evaluated Cloudflare's products and realized that we were really the best of breed for what they could offer to their customers. And so Cloudflare will be natively available within Oracle's OCI platform, including across hybrid, multi-cloud and OCI-hosted workloads, which gives us access to a large pool of customers and gives Oracle's customers access to Cloudflare's world-class tools.

I think one of the things that we're particularly aligned on is that we and Oracle both see the future as a multi-cloud future, where customers are going to have many different cloud providers. And what they need is one consistent interface where they can apply security rules, have consistent network performance, and Cloudflare is the best in the world at doing that.

And so I think the fact that we have been able to work with Oracle, integrate our products directly into Oracle that Oracle's customers are going to be able to enjoy the benefits of that. That's great for us, but it's also great for Oracle and we're excited to have them as a even more deeply integrated partner.

Adam C. Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. Thanks again.

Operator: Thanks, Adam. And our next question comes from the line of Gabriela Borges with Goldman Sachs. Gabriela, please go ahead.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

Hey. Good afternoon and congrats on the quarter. Matthew and Thomas, I wanted to revisit your comment from earlier in the year about doubling your network capacity this year. So my question is, do you think that you're capacity constrained in Workers? To what extent are the capacity decisions that you're making this year essentially dictating a range of outcomes on what Workers revenue could be next year? And I know you have some really interesting thoughts on fungibility of workloads between CPUs, older gen GPUs and newer gen GPUs. So would love to hear your comments there as well. Thank you.

Matthew Prince

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

A

Sure. I don't think we're capacity constrained because of somewhat the nature of how we've architected Cloudflare and the philosophy of how we make CapEx and network investments. We always have tried to invest

behind demand, not ahead of demand. And the thing that allows us to do that is that what we are selling is not a particular box in a particular place or a fraction of a particular box in a particular place. What we're selling is the ability to get work done across our network.

And so Cloudflare itself is effectively a giant scheduler where we can move workloads to wherever we have capacity anywhere in the world. And the nature of the network is that it's – always somewhere, it's the middle of the night and there's always excess capacity there. Now, that's not ideal, but the good news is that for some of our smaller customers or low-end customers or free customers, we can move them to places across the network that has that free capacity, still gives them a great performance. but then reserve the capacity that we have as close as possible to our largest customers. As we see that growth, that then means that we can invest behind it and be able to just make sure that we're getting the most utilization possible.

The other thing that I think is unique about us is that – certainly, versus the hyperscalers, the primary business of the hyperscaler is to essentially rent you a server or a fraction of a server, and they try to effectively get, whatever they paid for the server, back 5 times over the life of the server. That's their business. Whereas we, we're about, again, getting work done for our customers. We're selling something different, which is a sort of level of abstraction up from that. What that means is that we believe it's our job, not our customers' job, to make the utilization rates as high as possible, make our systems as efficient as possible.

And so it's been remarkable to see over the last 15 years, how our team has been able to squeeze as much as possible out of the CPU capacity that we have, where we can run that CPU capacity at 70% to 80% utilization, and get more out of every CapEx dollar we spend. But what's fascinating is we're sort of speed running the last 15 years now with GPUs, where we're figuring out how to make GPUs multi-tenant, how to make them load and unload models more quickly and driving the utilization of GPUs up substantially.

And so that is still well below what we have with CPUs, but we see no reason that we can't get GPUs also up to that 70% to 80% utilization. And that, again, just means that every CapEx dollar that we spend, both can be behind the demand that we see, and then secondly, that we'll get more out of it, more effective value out of it for the services that we're delivering our customers versus some of the legacy hyperscaler models.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

That makes sense. Thank you. The follow-up...

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

The additional point I would make is in addition to what Matthew said is that the supply chain within Cloudflare is so optimized that to a large degree, because we use off-the-shelf equipment and parts, that we can deploy hardware, especially in Tier 1 cities and generate revenue even before we start to pay for the equipment. So not only do we have the flexibility that Matthew described really well at length, our reaction time to deploy hardware where we need it is really, really fast.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

That makes sense. Thank you. The follow-up is on competition for Cloudflare in the enterprise for securing those inference workloads and winning those inference workloads, in particular. Matthew, I would love to hear your comments, how do you think competition is evolving in the enterprise as you build out some of the breadth and

depth of your functionality? And on the flip side, are you seeing anything new from newer platforms, newer cloud platforms, that are AI native or inference focused? Thank you.

Matthew Prince

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

A

I think that the primary competition for inference workloads continues to be the hyperscalers and it continues to be the model of do you want to do this work yourself and have to optimize yourself or do you want to hand it off to Cloudflare. And I think in the cases where we're in the conversation, we're able to show that there's just a much better TCO, total cost of ownership, a much lower cost, much better performance when we manage that for you.

And so I – there's kind of a standard way people do things, which is the hyperscaler way. We're having to teach them that there is a different way that's out there. But the primary competition still comes from the hyperscalers. And I think that we are finding, though, that once somebody learns that there's a better way that Cloudflare is very, very sticky, and we keep those customers over the long term.

Gabriela Borges

Analyst, Goldman Sachs & Co. LLC

Q

Thank you for the thoughts.

Operator: Thanks, Gabriela. And our next question comes from the line of Shaul Eyal with TD Cowen. Shaul, please go ahead.

Shaul Eyal

Analyst, TD Cowen

Q

Thank you so much. Good afternoon and congrats on the quarterly results. So many new product announcements in recent weeks during Cloudflare Connect and Birthday Week. Specifically, Matthew, I wanted to ask about NET Dollar. We have received many questions about this product. It could become a meaningful long-term growth driver. How should we think about the regulatory framework around it? And what has been maybe the early reception kind of out there?

And maybe along these lines, my follow-up will be maybe a word about AI gatekeeper. I know you started discussing it more vocally last quarter. Lots has changed over the past few months. You've indicated some initial activity, some contract wins around the guardrails from publishers and AI companies. So can you talk to us about what has changed in recent months? And is there anyone else out there emerging with a similar offering?

Matthew Prince

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

A

So let's start with NET Dollar. So as we have really interacted both with AI companies, but also the merchants and media companies and the real long tail of the Internet, much of which sits behind us, what we realized was that as we move into a world of agentic commerce, we're going to need a currency to pay for the commerce that is done between agents that is really designed specifically for that task. And that's the spirit with which we started the NET Dollar project. We're not – we're unlikely to do it entirely ourselves for some of the regulatory reasons that you're familiar with, but there are lots of opportunities.

And if you think about someone like Stephanie Cohen on our team, who is very familiar with the challenges of working in the financial services space, I think we're approaching it in a thoughtful way and are confident that we

can execute in a way that is both going to help facilitate agent-to-agent commerce and be something that it fits well within any of the regulatory regimes that we have both in the US and around the rest of the world.

At the same time, that is only one of our bets in this area. And I think a little bit the way that we're thinking about this is that we want to be the Babel fish of AI, sort of the universal translator, whether you're using MCP, the Anthropic protocol or Google's version of it or Microsoft's version of it, Cloudflare supports all of those.

And so I think in addition to the excitement that we've seen around NET Dollar, I am equally excited about the partnerships that we're doing with Coinbase around x402, with Visa, Mastercard, American Express, around how you can create agent-to-agent payments. And I think that Cloudflare is a network and what you want networks to be able to do is facilitate the ability for connection to happen and do it regardless of what makes sense.

So we think there are potentially some advantages to what we're building with NET Dollar, but we're not all-in on any one of these things. We want to make sure that we support everything and we can meet both customers and merchants and media companies, small, large, everything in between, wherever it is that they exist. And I think that's something that is unique about our approach.

It's actually very similar to the answer to the previous question. We really do believe in multi-cloud and that we can be the facilitator of that. We also believe that there are going to be multiple different ways to pay. There are going to be multiple different agentic protocols. And there are going to be hopefully many, many, many AI companies interacting with many media and businesses to create a more frictionless and AI-powered future of commerce. And I think that we see ourselves in the center of that.

In terms of sort of gatekeeper, so we have a product that's called AI Gateway. I don't think that's what you're asking about. I think you're asking about the product around us thinking about how do we help media companies figure out a new business model for the future.

.....
Shaul Eyal

Analyst, TD Cowen

That is correct.

Q

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Matthew Prince

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

Yeah. I think that's going just extremely well. Like, the number of media companies that are signed up and engaged is powerful. We're hearing from them about how the deals that they are able to do with AI companies have gotten markedly better, and we are getting a lot of praise for that. There will be others that compete with us in this space.

A

But I think one of the things that has really set us apart is – and this is thanks to our, over time, just significant investment in public policy and the side of the house that maybe doesn't always get as much attention. But I think we have been thought leaders in thinking about what does the future business model of the Internet look like. And that is getting us into a number of different conversations.

And as we have done that, it's been clear that it's not just traditional media companies. But frankly, at banks, the research departments, they're a little nervous because they're seeing ticks down in the amount of research that people are paying for because the AI companies are just slurping that up. So that's open conversations with financial services companies.

We're seeing challenges with brands that are worried about what does a brand mean in the future of agentic commerce. We're seeing challenges from small businesses. And I think one of the things that I am passionate about is how do we make sure that as this new paradigm, as this new platform emerges, how do we make sure that everybody has a fair shot to be able to participate in it. And so we will continue to do what we always have done, which is make our tools available to everyone, large and small.

Shaul Eyal

Analyst, TD Cowen

Thank you.

Q

Operator: Thanks, Shaul. And our next question comes from the line of Fatima Boolani. Fatima, please go ahead.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Thank you. Good afternoon. Thanks for taking my question. Matthew, I wanted to ask you about the AI native ecosystem. It is embryonic, but on an absolute tear. There's so much capital flowing into the space. And you have taken a very active interest in bringing these AI natives on to the Workers and Workers AI platform. So what I wanted to ask you specifically was, can you help us think about the AI native exposure that you have today in the business? Anything that we should worry about from a concentration standpoint at this present time?

Q

And then maybe at a higher level, some of the engagement that you are seeing from a pool of funds perspective, how much of that is drawing in more AI native eyeballs specifically because of the differentiation that you provide from an architectural standpoint at the edge for AI inferencing? Thank you.

Matthew Prince

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

Yeah. So I think that even though we're excited about AI and AI inference, it is still a relatively de minimis portion of our overall revenue, growing fast, but not – I don't see any current concentration risk that's there. And what we're seeing is, actually, sometimes it's not the inference products that initially get interest from the AI native companies. It's actually the security products. And the reason why is the cost of AI, every query can be so high that making sure that you don't have fraudulent queries running through your system is critical in order to make sure that you can continue to operate cost effectively.

A

And so many of the AI companies, we estimate that about 80% of AI companies use us in one way or another, but a lot of the times that's using us for actually securing some of our – really our Act 1 products. And then we are working on getting more and more of them to use the inference products as well.

In terms of what we can do that others can't do, I think you're absolutely right that being able to be close to users is important from a latency perspective. And that's – and when you have human computer interaction, especially with something that is – seems almost alive when you're interacting with it, every millisecond counts because it breaks that illusion, if things slow down, especially as you get to, things like voice communication and other things that need to have kind of a natural rhythm to them. And so I think we're well positioned for that.

But in addition to that, because of the fact that we are taking the responsibility for driving utilization, and we're better at that than most customers are on their own, we can often, in addition to giving better performance, also give a lower cost of functioning. And again, I think that that keeps us in a pretty healthy space.

And so I have no doubt that there's going to be kind of ups and downs in AI over the coming months and years. But it's clear to me that there is something very, very real here, that it is going to be transformative, that a lot of inference will run on your handset or your driverless car directly there, but that if it can't run there, if it needs to run somewhere else, the next best place for it to run is in the network. And Cloudflare is the only network that gives you that capability on a global basis today. And I think that that's going to continue to allow us to win workloads regardless of what happens to AI generally.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

One comment I want to make, just to make sure we have no misunderstanding. When we say de minimis, we mean that no customer is bigger than 2% of revenue.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Thank you, Thomas.

Operator: All right. Thanks, Fatima. And our next question comes from the line of Mark Murphy with JPMorgan. Mark, please go ahead.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Thank you. So Matthew, we noticed that Cloudflare is upgrading its security to be quantum safe so that data stays protected even when quantum computers eventually arrive, whenever that's going to be. I'm wondering if you can just describe the work you're doing? And do you think this is more of a long-term science project that won't matter for, say, 5 to 10 years? Or do you think it's something that could have some implications in the medium term? And then I have a quick follow-up.

Matthew Prince

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

A

Yeah. I have sort of mixed feelings on quantum, where I think there's a lot of – there's a sort of a lot of fear, uncertainty and doubt in the marketplace where people are going to say on quantum changes everything and it's going to be apocalyptic. That is not my opinion.

I think quantum changes some interesting things. I think it's likely that you'll have more efficient package delivery that you'll be less likely to be delayed on your flight. And it does – it will cause problems for some of the older generations of cryptography. But that's a very solvable problem. And I think the thing that was unique – that is unique about Cloudflare is that we have the scale on the content side to help figure out what the right solution is.

And so we have partnered in the past and are continuing to partner with Google, who has scale on the eyeball side with Chrome browsers, to be able to figure out what is a future-proof version of cryptography that will stand up even as we eventually have powerful quantum computers. And so we've worked together. We helped submit the data that went back to the Internet Engineering Task Force, the IETF, and to NIST to standardize some of the new protocols that have been released. We have rolled that out across our entire network for every customer, whether they pay us or not, because we believe that everybody should have the foundational levels of the best of security at no cost.

And as you all upgrade your browsers on your phones and your laptops, all of them now are supporting post-quantum cryptography. The reason it's important to do now, even if we don't think that there are going to be quantum computers that can factor giant numbers, which is what you need to do in order for it to affect cryptography, is the risk of storing the data. So if you just hoovered up a bunch of Internet data and then held on to it, you could, in the future, replay that and decrypt it.

And so for most of our customers, like, it's no big deal. Like, if your credit card number today gets compromised 10 years from now, it doesn't really matter because your credit card number has probably changed several times in that period of time. But for some of our customers, including the US government Cabinet-level agency that we did a renewal with, this is incredibly important. And the reason it's important to do it broadly is you need to make sure that you're doing it in a way which is still fast, isn't burning a ton of battery life on phones. And what we can do in partnership with organizations like Google is actually roll out real-world tests and prove that it's possible and cost effective to do it.

So I think – I don't think science project is the right thing. I do think forward leaning is the right thing. And I think it is an example of how Cloudflare is always trying to live up to our mission of helping build a better Internet.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Yeah, that is pretty fascinating. Just as a very quick follow-up. You mentioned egress fees I think last call, and again, this call, I should say, the elimination of egress fees. It feels like you're winning some real business that's partly tied to that. Can you just touch on the economics that that would unlock for the customer by removing those fees?

Matthew Prince

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

A

Yeah. I mean – so egress fees are the cost that – when we talk about them, the cost that hyperscalers charge you every time your data leaves their system and hyperscalers have been notorious at keeping egress fees high. And it's actually one of the places where there's the most leverage, because at scale, bandwidth becomes extremely inexpensive and really gets close to being free. And that's a longer conversation than we probably have time for, but that's just the fact. And yet, even as the hyperscalers' bandwidth costs have dropped and dropped and dropped, they've not passed those savings on to customers. The reason they don't pass those savings on to customers is because they don't want the data to leave. They like to hoard all of a customer's data.

And so what we believe is that it's the right thing to let customers take their data wherever. We believe that a multi-cloud universe is the right universe. And so products like R2, which is our object store, allow customers to take their data, their heavy object data that they usually have to pay a lot for if they have to move it around, and move it onto our network where they can move it anywhere they need and be able to access it.

And so I think that what we're trying to do is say, customers should be able to use whatever combination of clouds makes sense for them and that Cloudflare is the network that connects them all together and gives them the controls they need in order to do so safely, securely, efficiently, reliably and quickly.

Mark R. Murphy

Analyst, JPMorgan Securities LLC

Q

Thank very much.

Operator: Thank you, Mark. And our next question comes from the line of Jackson Ader with KeyBanc Capital Markets, excuse me. Jackson, please go ahead.

Jackson Ader

Analyst, KeyBanc Capital Markets, Inc.

Q

That's great. Thanks for taking our questions, guys. The first one, Matthew, certainly, losing CJ is a real loss, even if it is a great opportunity. And I'm just curious, whether you feel comfortable with the bench that he leaves behind and how you kind of ensure maybe that he either is or will be replaceable.

Matthew Prince

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

A

Yeah. So first of all, I mean, CJ is terrific. And we can't talk about where he's going, obviously, but they are lucky to have him. And while we are bummed that he's leaving, I'm also really proud and excited for him. And this has definitely been a career goal of his for a long time. And so I'm glad that he's found his way to what I think is an outstanding technology company that he'll be leading.

What's the good news for us is that when CJ came in, he actually didn't make many changes or even hire all that many people to Cloudflare. He looked around our engineering team and said, these are exceptional engineers. These are exceptional product leaders. What they need is someone who can come in and really focus them on being customer obsessed. And CJ has done a great job of inculcating that customer obsession into our product and engineering team. And that's something that we're not going to forget. But there isn't – I don't think that there's a significant flight risk of people fleeing because they came for CJ and now CJ has gone. They came for Cloudflare. CJ was great as a member of Cloudflare. And I think that that bench continues to be strong.

And then both CJ as well as our team, now that we've got the news out of the way, I think that this is the most exciting job if you're a product or engineering leader anywhere in the world working in tech, you get to help build the future. You get to help invent what the business model of the future of the Internet is going to be. There is nothing that is more exciting than that.

And so I think we'll have – CJ is one of a kind, but we will have no trouble finding someone else who is world-class. And I think the thing that will be the real legacy of CJ is that you will have taught us how important in product and engineering being customer-obsessed is. And whoever comes next, I bet that's going to be something that you'll say, wow, that person has that quality as well.

Jackson Ader

Analyst, KeyBanc Capital Markets, Inc.

Q

Okay. That makes sense. And then a real quick follow-up. Matthew, you mentioned earlier the move from a product-led growth company to more of an enterprise company. The other side of that coin is, now seasonality matters, right? We're heading into a fourth quarter. If you're selling to more enterprises, that makes December all that much more important than prior December. So I'm curious about how the pipeline has built through the year and what you're kind of expecting as you're going into a more enterprise-ready fourth quarter than is typical for Cloudflare.

Thomas Josef Seifert

Chief Financial Officer, Cloudflare, Inc.

A

Let me get started and Matthew can jump in. We gave the guidance we gave for the fourth quarter in light of what we are seeing. So we are very encouraged by the pipeline buildup for the fourth quarter, but guidance and

foreshadowing what is going to come is more than just pipeline. We look at sales productivity. We look at the net sales capacity we add. We look at the motion and velocity in the developer business. And all the indicators that we are currently seeing are reflected in how we guide for the quarter. So it's pipeline is encouraging, but there are more factors contributing to the picture we have of what is in front of us. And you heard from both of us that we are quite optimistic in how we look at the future.

Matthew Prince

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

A

Yeah. And we've had – we have lived with some level of seasonality for quite some time. You can see that, historically, Q4 performs more than earlier quarters. But having sat in pipeline review meetings, I think we feel very good about where the coverage is for what we have in Q4. And again, it's just part of the journey of being more and more of a true enterprise sales company.

Jackson Ader

Analyst, KeyBanc Capital Markets, Inc.

Q

All right. Thank you.

Operator: Thanks, Jackson. And our final question today comes from the line of Mike Cikos with Needham. Mike, please go ahead.

Mike Cikos

Analyst, Needham & Co. LLC

Q

Great. Thanks for getting me on here, guys. I appreciate it. Matthew, first for you. I just wanted to see, can you please provide an update on the trends you're seeing in the SASE market specifically? Would just love to get an update on traction you're seeing out there as well as how the competitive landscape is changing, if at all, from where we were a couple of months ago.

Matthew Prince

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

A

Yeah. I mean I think our SASE product when we're in consideration is performing extremely well. We don't see significant changes in the competitive landscape. We think we are very competitive. I think the biggest change for us has been just kind of the proverbial forward – forehead slapping moment of just looking at Netskope's S-1, seeing that 95% of their sales are through channel, seeing the same thing for a while we thought that, that was sort of an aberration for Zscaler, and realizing the way that you sell these products is through partners.

And so we are doubling down on that. You see that we're seeing a significant uptick in the partner-led opportunities. We have always, I think, had good kind of willingness to partner, but we haven't always made it as easy as possible to partner with us. I think we're cleaning that up and doing a good job getting that in shape. And that I think will be the big unlock for those products to be able to be sold. And those are critically important products for us because their gross margins are so high.

And so as we're seeing strength in parts of our business, like Workers, the best way to balance that out is also sell SASE as well, because, again, it's something that has just extraordinarily high gross margins to it, whereas products like Workers, the gross margins are good and will get better and better over time, but because they are newer products, they're not as optimized in that space. So I think this is a really opportune time and I'm excited about sort of the partner-first strategy, especially with our SASE products.

Operator: All right. Thanks for the question, Mike. And with that, I will now turn the call back over to CEO and Co-Founder, Matthew Prince for closing comments. Matthew?

Matthew Prince

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

Just wanted to thank our entire team for an incredible quarter. It takes a ton of effort of people executing, of people innovating and us being able to deliver results like this. Thank you so much and we'll see you back here again next quarter.

Operator: Thanks, Matthew. And that concludes today's conference call. You may now disconnect. Have a great day, everyone.

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