Datadog, Inc. NasdaqGS:DDOG

FQ1 2024 Earnings Call Transcripts

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Presentation

Operator

Good day and thank you for standing by. Welcome to the First Quarter 2024 Datadog Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. I would now like to hand the conference over to your first speaker today, Yuka Broderick, Vice President of Investor Relations. Please go ahead.

Yuka Broderick
Investor Relations

Thank you, Marvin. Good morning and thank you for joining us to review Datadog's First Quarter 2024 financial results, which we announced in our press release issued this morning. Joining me on the call today are Olivier Pomel, Datadog's Co-Founder and CEO; and David Obstler, Datadog's CFO.

During this call, we will make forward-looking statements, including statements related to our future financial performance, our outlook for the second quarter and fiscal year 2024 and related notes and assumptions, our gross margins and operating margins, our product capabilities, our ability to capitalize on market opportunities and usage optimization trends. The words anticipate, believe, continue, estimate, expect, intend, will and similar expressions are intended to identify forward-looking statements or similar indications of future expectations. These statements reflect our views only as of today and are subject to a variety of risks and uncertainties that could cause actual results to differ materially.

For a discussion of the material risks and other important factors that could affect our actual results, please refer to our Form 10-K for the year ended December 31, 2023. Additional information will be made available in our upcoming Form 10-Q for the fiscal quarter ended March 31, 2024, and other filings with the SEC. This information is also available on the Investor Relations section of our website, along with a replay of this call.

We will discuss non-GAAP financial measures, which are reconciled to their most directly comparable GAAP financial measures in the tables in our earnings release, which is available at investors.datadoghq.com. With that, I'd like to turn the call over to Olivier.

Olivier Pomel
Co-Founder, CEO & Director

Thanks, Yuka, and thank you all for joining us this morning. We are pleased with our execution at the start of 2024. First, we have continued to broaden our platform across observability, cloud security, software delivery as well as closing the loop with cloud service management. We also kept supporting our customers' adoption of new technologies including next-gen AI and large language models. And we have continued to add new customers and to see existing customers increase their usage growth and product adoption.

Let me start with a review of our Q1 financial performance. Revenue was $611 million, an increase of 27% year-over-year and above the high end of our guidance range. We ended the quarter with about 28,000 customers, up from about 25,500 last year. We had about 3,340 customers, with an ARR of $100,000 or more, up from about 2,910 last year. These customers generated about 87% of our ARR. And we generated free cash flow of $187 million, with a free cash flow margin of 31%.

Turning to platform adoption. Our platform strategy continues to resonate in the market. As of the end of Q1, 82% of customers were using 2 or more products, up from 81% a year ago. 47% of customers were using 4 or more products, up from 43% a year ago. 23% of our customers were using 6 or more products, up from 19% a year ago. And 10% of our customers were using 8 or more products, up from 7% last year.

We continue to see robust growth in our 3 pillars of observability: Infrastructure monitoring, APM and log management. But we also have many younger products that are becoming more meaningful contributors to our business over time. For example, our products outside of infrastructure monitoring, APM suite and Log Management exceeded $200 million in ARR in Q1. And as a reminder, within the APM suite, we include core APM, Synthetics, RUM and Continuous Profiler. And as we look at the 12 products that we launched between 2020 and 2022, those now contribute about 11% to our ARR.

Of those 12 products, 8 are over $10 million in ARR, which is a nice milestone for these relatively new additions. And we are seeing some products grow faster than we initially expected. For example, Database Monitoring is already 1% of our revenue with strong and growing product penetration across our customer base. So we are very pleased with the progress of our newer products, even though we know we have much further to go with them.

Now let's discuss this quarter's business drivers. In Q1, we saw usage growth from existing customers that was higher than in Q4. And this usage growth in Q1 was similar to what we experienced in Q2 and Q3 of 2022. As a reminder, that was a period when we started to see a normalization of usage following the accelerated growth we had experienced in 2021. Overall, we saw healthy growth across our product lines. And as usual, our newer products grew at a faster rate from a smaller base.

While some of our customers are continuing to be cost conscious, we are seeing optimization activity reduce in intensity. As an illustration, the optimizing cohort we identified several quarters ago did grow sequentially again this quarter. We also see that customers are adopting more products and increasing usage with us. We think this shows that they are moving forward with their cloud migration and digital transformation plans, and that we are executing on opportunities to consolidate point solutions into our platform.

And finally, churn continues to be low, with gross revenue retention stable in the mid- to high 90s, highlighting the mission-critical nature of our platform for our customers.

Moving on to R&D. We had another very productive quarter. In the next-gen AI space, we announced general availability of Bits AI for incident management. By using Bits AI for incident management, incident responders get auto-generated incident summaries to quickly understand the context and scope of a complex incident. And users can also query Bits AI to ask about relative incidents and perform tasks on the fly from incident creation to resolution.

We're also continuing to see more interest in AI from our customers. As a data point, ARR for our next-gen AI customers was about 3.5% of our total, a strong sign of the growing ecosystem of companies in this area.

To help customers understand AI technologies and bring them into production applications, our AI integrations allow customers to put their AI data into the Datadog platform. And today, about 2,000 of our customers are using 1 or more of these AI integrations. And we've continued to keep up with the rapid innovation in this space. For example, adding a new integration in Q1 with the NVIDIA Triton Inference Server.

In the cloud service management area, we released Event Management in general availability. Our customers face increasing complexity at scale, causing the volume of alerts and events to explode, which makes it difficult for teams to identify, prioritize, summarize and route issue to the right responders. Event Management addresses this challenge by automatically reducing a massive volume of events and alerts into actionable insights. These are then used to generate tickets, call an incident or trigger an automated remediation.

And by combining Event Management with Watchdog, Bits AI and Workflow Automations, Datadog now provides a full AIOps solution that helps teams automate remediation, proactively prevent outages and reduce the impact of incidents.

In the observability space, our Log Management product continues to expand in capability. In March, we made error tracking for logs generally available. Error tracking intelligently combines millions of errors from logs into a manageable number of issues for customers. And beyond error tracking, we are delivering new features to allow our customers to do more with their logs within the Datadog platform, starting with new core capabilities such as enhanced full-text search and support for advanced subqueries, both highly desired by our customers.

We also continue to make progress with Flex Logs. As a reminder, Flex Logs allow customers to easily scale storage and compute separately which in turn allows for new, very high-volume use cases in a cost-effective manner. While Flex Logs remains in limited availability, we are seeing a high level of interest from customers, many of whom want to retain logs for long-term purposes such as audit, security and compliance. And we're pleased to see that with only a limited set of customers so far, Flex Logs already exceed $10 million in ARR today.

In the digital experience area, we launched mobile app testing in general availability, giving access to fast, no code, reliable testing on real mobile devices, which was a big challenge for customers given the wide range of devices and operating systems in use by consumers. And in Cloud Cost Management, we've added full support for Google Cloud, so FinOps and DevOps teams can optimize their cloud spend across their AWS, Azure and GCP footprint. Cloud Cost Management is another of our newer products that exceeds the $10 million ARR milestone, and we believe there's significantly more opportunity for us to have our customers there.

As usual, I'd like to thank our product and engineering teams for the quarter, and I'm looking forward to the many announcements we'll make at our DASH user conference in late June, here in New York.

Now let's move on to sales and marketing. We've been pleased to once again add some exciting new customers and expand with many more. So let's go through a few examples. First, we signed a 3-year, 7-figure expansion with a leading online grocery business.

This customer has used Datadog as their platform of choice for several years now. And as they migrate to Azure, they are looking to ensure reliability and security as they deploy at scale. With this renewal, they are adding Cloud Security Management, Application Security Management and Cloud SIEM to enable a shift to a DevSecOps culture in the organization. And this customer expects to add 7 products for a total of 14 across the Datadog platform.

Next, in 2 deals over the past 6 months, we had a 7-figure expansion with a medical device company. This customer was primarily using our infrastructure monitoring and APM suite, but its legacy logging solution was becoming cost prohibitive, while the lack of correlation across siloed teams was causing frustration and higher times to resolution. With this expansion, the customer plans to add up 9 products and consolidate its log management tool as well as 4 other commercial and cloud-native tools into Datadog.

Next, we signed a high 6-figure expansion with an athletic apparel company. This company had a dozen disparate monitoring tools, which wasted time and was impacting operations, revenue and customer experience. With this expansion, the company plans to consolidate out of 4 commercial and open-source point solutions. They also expect to save millions of dollars over the next several years, while providing a great consumer experience.

Next, we signed a high 6-figure expansion with a European division of 1 of the world's largest car makers. This customer has chosen Datadog as its observability vendor in many business units globally. And in Europe, they currently monitor about 1/4 of their applications with us and are migrating hundreds of applications to fully move to Datadog in the next 2 years. With this expansion, this customer is using eight products in the Datadog platform.

Next, we signed a 6-figure land with a division of a Fortune 500 industrial company. The company is moving its e-commerce application to Google Cloud. They felt that using on-prem monitoring tools would not transition well to the cloud and are starting with 3 of our products as they are confident in Datadog's ability to keep innovating in modern cloud and serverless environments.

Finally, we signed a 6-figure land with 1 of the world's largest communication infrastructure companies. This company started cloud migration a couple of years ago and found itself limited by fragmented tooling and lack of data correlation. In contrast, the Datadog service catalog gives them a single view for performance, ownership, security, SLOs and KPIs, which customer believes is a unique capability among the vendors it considered, and which aligns with their goal of delivering centralized observability across the business. And this customer is adopting 7 Datadog products initially and consolidating out of 4 tools.

And that's it for another productive quarter for our go-to-market teams.

Let me now say a few words on our longer-term outlook. Overall, we continue to see no change in the multiyear trend towards digital transformation and cloud migration. We are seeing improved usage growth with less impact from optimization than we had seen in the last few quarters. For those customers who are remaining cost focused, we are very happy to help them get value from their observability solutions and consolidate into the Datadog platform to achieve time and cost savings.

Meanwhile, we are seeing continued experimentation with new technologies, including a growing adoption of AI, which we believe will be an accelerator of technical innovation and cloud migration over time. And we're working every day to innovate and help our customers adopt new technologies with confidence and become better businesses in the process.

With that, I will turn it over to our CFO. David?

David M. Obstler
Chief Financial Officer

Thanks, Olivier. Q1 revenue was $611 million, up 27% year-over-year and up 4% quarter-over-quarter. To dive into some of the drivers of the Q1 performance, first, regarding usage growth, in Q1, we saw sequential usage growth from existing customers that was higher than the usage growth in Q4. Q1's usage growth was similar to what we experienced in Q2 and Q3 of 2022. And given this steep growth and off a larger base, our sequential ARR dollars added was the highest since Q4 2021. During Q1, we experienced a linearity pattern that was very typical for us, which included usage growth in March that was higher than January and February.

Regarding usage growth by customer size in Q1, we saw usage growth accelerate across our larger customers, those with $100,000 of annual spend or higher. And we saw particularly strong usage growth with our largest customers who spend multiple millions of dollars with us annually. Geographically, we experienced stronger year-over-year revenue growth in international markets than in North America. And finally, for our retention metrics, our trailing 12-month net revenue retention was in the mid-100s in Q1 -- sorry, in the mid-110s in Q1, similar to last quarter. Our trailing 12-month gross revenue retention continues to be stable in the mid- to high 90s.

Now moving on to our financial results. Billings were $618 million, up 21% year-over-year. Billings duration increased year-over-year. Sequential billings growth was seasonally lower as it was in Q1 2023. Remaining performance obligations, or RPO, was $1.73 billion, up 52% year-over-year, and current RPO growth was in the low 40% growth year-over-year. RPO duration increased year-over-year but was down quarter-over-quarter as we saw fewer multiyear deals relative to last quarter.

In general, we are continuing to see an increasing interest with our larger customers in multiyear commitments, which results in longer RPO duration in both total and current RPO. As a reminder, our RPO has been and continues to be lumpy, an effect that may be amplified as our customers move towards multiyear deals.

We continue to believe revenue is a better indication of our business trends than billings and RPO as those can fluctuate relative to revenue based on the timing of invoicing and the duration of customer contracts.

Now let's review some key income statement results. Unless otherwise noted, all metrics are non-GAAP. We have provided a reconciliation of GAAP to non-GAAP financials in our earnings release.

First, gross profit in the quarter was $509 million, representing a gross margin of 83.3%. This compares to a gross margin of 83.4% last quarter and 80.5% in the year-ago quarter. We continue to experience efficiencies in cloud costs reflected in our cost of goods sold as our engineering teams pursue cost savings and efficiency projects.

Our Q1 OpEx grew 14% year-over-year and increased from 10% year-over-year growth last quarter. As discussed last quarter, we intend to invest in headcount in 2024, and we have accelerated hiring in sales and marketing and R&D to execute on our growth plans. Q1 operating income was $164 million, or a 27% operating margin compared to 28% last quarter and 18% in the year-ago quarter.

And now turning to the balance sheet and cash flow statements. We ended the quarter with $2.8 billion in cash, cash equivalents and marketable securities. Cash flow from operations was $212 million in the quarter. After taking into consideration capital expenditures and capitalized software, free cash flow was $187 million for a free cash flow margin of 31%.

Now for our outlook for the second quarter and the fiscal year 2024. Our guidance philosophy remains unchanged. As a reminder, we based our guidance on trends observed in recent months and apply conservatism on these growth trends. So for the second quarter, we expect revenue to be in the range of $620 million to $624 million, which represents a 22% year-over-year growth. Non-GAAP operating income is expected to be in the range of $134 million to $138 million, which implies an operating margin of 22%. In Q2, we will be holding our DASH user conference, which we estimate to cost about $11 million. Our operating income guidance reflects this event.

Non-GAAP net income per share is expected to be $0.34 to $0.36 per share based on approximately 360 million weighted average diluted shares outstanding. For fiscal year 2024, we expect revenue to be in the range of $2.59 billion to $2.61 billion, which represents 22% to 23% year-over-year growth. Non-GAAP operating income is expected to be in the range of $585 million to $605 million, which implies an operating margin of 23%. And non-GAAP net income per share is expected to be in the range of $1.51 to $1.57 per share based on approximately 361 million weighted average diluted shares outstanding.

Now for some additional notes on our guidance. First, we expect net interest income and other income together for fiscal 2024 to be approximately $110 million. Next, we expect cash taxes in 2024 to be in the $20 million to $25 million range, and we continue to apply a 21% non-GAAP tax rate for 2024 and going forward. And finally, we continue to expect capital expenditures and capitalized software together to be 3% to 4% of revenues in fiscal 2024.
To summarize, we are pleased with how we started 2024. And I want to thank Datadogs worldwide for their efforts. And now with that, we will open the call for questions. Operator, let's begin the Q&A.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Sanjit Singh of Morgan Stanley.

Sanjit Kumar Singh
Morgan Stanley, Research Division

It was encouraging to see that usage trends continue to improve, at least sequentially Q1 over Q4. I wanted to see if you could put like the usage trends you're seeing in your business in context of like the broader cloud landscape. And we're seeing some really nice results out of the hyperscalers. Obviously, there's -- those are much larger businesses and in different -- can be in different product areas. But when we think about the tailwinds of like cloud migrations and also AI workloads starting to come on board, how does that -- how is that playing out in Datadog's business versus what we may be seeing from like the hyperscales who are -- who seem to be accelerating to a higher degree?

Olivier Pomel
Co-Founder, CEO & Director

Yes. Sanjit, this is Olivier. So I think, in general, it's hard to be -- to do a precise quarter-by-quarter one-to-one mapping between the revenue and the cloud providers and our revenue. I think you pointed out, there are things in their products that don't relate to us directly or things in their internal revenue that don't relate to us directly. We have products that don't tie one-to-one with infrastructure on their end. But in general, over the longer term, we are very exposed to the growth trend you will see with the cloud providers, and the correlation you've seen in the past between our businesses, we expect will remain in some form in the future.

We also are very exposed to the same tailwinds, obviously, cloud migration, but also AI adoption. I will say also on AI adoption that some of the revenue jumps you might see from the cloud providers might relate to supply of GPUs coming online and a lot of training clusters being provisioned. And those typically won't generate a lot of new usage for us. We tend to be more correlative with the live applications, production applications and inference workloads that tend to follow after that, and that are more tied to all of these applications going into production. So these are the things to factor. But overall, same trends, just not a one-to-one timing.

Sanjit Kumar Singh
Morgan Stanley, Research Division

That makes complete sense. And I was wondering if you had any comments on how usage trends coming out of March would seem to be stronger than in the beginning of Q1, how that sort of played out in April?

David M. Obstler
Chief Financial Officer

Sure. Sanjit, it's David here. As we always say, we try to look into the next month, but that's a small-time set. In this case, the April trends continue to exhibit higher sequential growth rates than the year-ago quarter. But we caution everybody that 1 month does not a quarter make, and we'll continue to update that next quarter as we report.

Olivier Pomel
Co-Founder, CEO & Director

And the seasonality in Q1 was very usual. Every year, there's a drop around the holidays in Q1 and January starts slowly, and then it accelerates into March, and we've seen that pretty much every year so far and we're seeing it this year as well.

Operator

Our next question comes from the line of Mark Murphy of JPMorgan.

Mark Ronald Murphy
JPMorgan Chase & Co, Research Division

Congratulations on the revenue acceleration during the quarter. Olivier, I'm wondering how commonly are customers in your gen AI cohort using Datadog to monitor for bias and hallucinations within their AI models as opposed to just keeping the systems running?

And also, do you see more concentration of customers within that cohort? Or is there actually more diversity as more of the models move beyond the training stage and into the inferencing stage?

Olivier Pomel
Co-Founder, CEO & Director

Yes. So we have products for monitoring, not just the infrastructure, but what the LLMs are doing. Those products are still not in GA, so we're working with a smaller number of design partners for that. As I think not only these products are maturing, but also the industry around us is maturing and more of these applications are getting into production. You should expect to hear more from us on that topic in the near future.

The customers we have that are the most scaled on AI workloads are the model providers themselves, and they tend to have their own infrastructure for monitoring the quality of the models. But we think there are good/bad weather in terms of what the adoption of AI is going to be from all the other companies, and we definitely see a trend where customers start with an API-driven or API-accessible model, build applications and then offload some of that application to other models that typically come from the open source and they might train, fine-tune themselves to get to a lower cost and lower time to respond.

Mark Ronald Murphy
JPMorgan Chase & Co, Research Division

I understand. Okay. And then, David, you had mentioned, I think, last quarter that the cloud-native spending had rebounded. It was outpacing the broader business. And just to clarify, are you saying that the traditional large enterprise business during Q1 you picked up in terms of the cloud migration activity as the hyperscalers might have suggested, was that -- I'm just wondering if you could double-click on that comment and whether there was something really noticeable, intangible there among the large enterprise, more traditional businesses?

David M. Obstler
Chief Financial Officer

Yes, we saw -- as said, we saw growth accelerate in our larger customers including the larger cloud natives and enterprise. So we did see more normal activity, including new workloads in both of those cohorts.

Operator

Our next question comes from the line of Kash Rangan of GS.

Kasthuri Gopalan Rangan
Goldman Sachs Group, Inc., Research Division

Congratulations to the team on very good results here. Olivier, I was wondering if you could talk about the consolidation trend that you're talking about. It looks like the pace of consolidation and also, the intensity of lands and expands seems to be a bit more remarkable at the starting point of this calendar year. So if you could expand on that a little bit.

And one for you, David, our cRPO has been accelerating. I think at low 20s to 30s to 40s over the last few quarters. but revenue expectations have not edged up pretty significantly. So can you just talk about the lead lag effect, granted that you always try to tell us that revenue is best indicator but none the less it's hard to dismiss the cRPO acceleration we've seen off of -- in the last few quarters.

Olivier Pomel
Co-Founder, CEO & Director

Yes. So I'll let David speak about the cRPO dynamics, but the -- so look, we've seen over the couple of years really, but really the past few quarters, more consolidation than we've seen in the past, in part driven by customers wanting to -- being cost conscious, wanting to save money, but in part also by customers getting a little bit further into their cloud migration and rationalizing what they're using as they do that. So we keep seeing that. We've mentioned a number of those deals in the examples we've given. That's a large part of what our enterprise business is doing in particular. There's no particular change in Q1 compared to what we've seen in Q4 before. Q1 is -- we typically do a lot of larger deals in Q1 -- in Q4 compared to Q1, seasonally in general.

To the point you made earlier, we do see typically a bit of a lag between these big consolidation deals and the moment where we see our revenue recognized. Typically, when we consolidate products, what we'll see is, we'll assume the ramp time for moving usage from other products to our platform over what can be a number of quarters or even years sometimes. And it might take some time for those deals to or those numbers to materialize in the revenue.

On the flip side, we also have a number of deals where customers are growing very quickly into their usage, and we capture new commitments with them. That might lag a little bit their consumption and the revenue we recognize, so we see a little bit of both.

David, do you want to speak a little bit more?

David M. Obstler
Chief Financial Officer

Sure. Similar to what we said last time, we are seeing our customers, particularly our larger customers commit longer to us. That can be multiyear deals or even out towards -- the weighted average towards annual deals as opposed to shorter-term deals. So basically, it is a positive in that it does connote that clients are committing to Datadog more as their core platform. It is a trend that we're seeing, particularly in larger customers. But we repeat what we said that really how we contract, and bill is not necessarily one-to-one correlated with our revenues. Our revenues are correlated with our usage. So it's a positive, but I think that we want to keep everybody grounded on our revenues as the most important metric, and then secondarily, our ARR as predicting future revenue growth.

Operator

Our next question comes from the line of Raimo Lenschow of Barclays.

Raimo Lenschow
Barclays Bank PLC, Research Division

Going back to the workload migration that seems to be kicking back in again from listening to the hyperscalers and you talked about the timing difference there. I wanted to kind of ask on a different aspect here and that's kind of your sales capacity and the ramp in sales capacity that we should think about it. Like can you speak about like where you are at the moment in terms of capacity? And then as the market reaccelerates, like what sort of investments should we think about there?

Olivier Pomel
Co-Founder, CEO & Director

So we're growing sales capacity. We've been growing it for the past few years. We grew it a little bit slower -- more slowly last year as we were careful about profitability and not getting too far ahead of ourselves in what looked like a tough market, but we're definitely growing sales capacity. And there's a ramp model that is associated with that. So the capacity typically lags a little bit the growth in terms of headcount. It takes time for people to get productive. But we're investing. We're growing and...

David M. Obstler
Chief Financial Officer

Long-term sales capacity is very much calibrated to revenue and UAR growth. As Oli mentioned, there are periods where it will move higher than that as we make investments, and there's periods where we might optimize. I think last year was a period where we digested previous investments, optimized a bit. And we said, this year, we're leaning into expansion of our sales capacity and investment. But long term, it correlates with revenue. And we look at that. We look at do we have enough sales capacity relative to what we see as the demand in the market, the territories and the expected ARR growth.

Olivier Pomel
Co-Founder, CEO & Director

To give you just a -- kind of a bit more color, like one of the big areas of focus inside the company is ramping up recruiting again. So we're recruiting a lot faster, a lot more than we were last year. And so we had to rev up that recruiting engine again. I won't -- I think they're listening to us, I want to congratulate our business recruiting team there for doing a fantastic job, really bringing that engine back up.

Operator

Our next question comes from the line of Matt Hedberg of RBC.

Matthew George Hedberg
RBC Capital Markets, Research Division

Oli, you mentioned newer products continue to do really, really well. You gave some interesting data on Database Monitoring, for instance. I'm wondering, are these newer products resonating up and down your customer base? Or are these -- some of these cross-sell statistics stronger with some of your bigger customers?

Olivier Pomel
Co-Founder, CEO & Director

Yes. So it really depends on the product. Some products are extremely broad based in terms of their appeal. And some others are really more directed to that -- certain types of customers. For example, all products that have to do with monitoring physical networks, they tend to be more appealing to larger, older enterprises because they are the ones with large physical footprint, whereas products like Cloud Cost Management, for example, or even Database Monitoring have very, very broad appeal because every single customer cares about their cloud cost. And every single customer is using databases that are at the center of their applications, and that are absolutely critical to understand.

And we mentioned those products because really like we see that as our efforts paying off in terms of broadening the offering and investing in R&D. And these are green shoots that we expect to grow into the future. Some of those products, we have extremely high expectations for because they correspond to very large categories, which we can think can be very meaningful to the business in the long run. Some others are surprising us a little bit. That's why we mentioned Database Monitoring. We were not sure if it was going to be a huge category in cloud environment, but it turns out, not only is there a very big problem our customers need us to solve there, but also this product hit that problem on the head from day 1 really, and we expect -- now we expect a lot more from it.

Operator

Our next question comes from the line of Fatima Boolani of Citi.

Fatima Aslam Boolani
Citigroup Inc., Research Division

David, you explicitly mentioned that the international book of business and activity was stronger than domestic. So I wanted to better understand some of the more intrinsic and maybe extrinsic dynamics that are driving that divergence in terms of geographically your performance? And if you could sort of help us understand if it's an end market, a product based or a budgetary based set of distinctions that would be very helpful.

David M. Obstler
Chief Financial Officer

Yes. It's very similar to what we've been saying over time. The international markets have been more immature as to their cloud migrations and their deployment of digital applications than the North American markets, and we've been more immature in terms of our footprint. So we've talked about some examples in Investor Day and otherwise of places like Brazil and Korea to name just a couple, where we are seeing an increase of activity as well as an increase of our deployment of our capacity, which has resulted in an uptick of the international demand over time.

Olivier Pomel
Co-Founder, CEO & Director

Yes. For us to be successful, there are two factors that are needed. So the first one is cloud adoption needs to happen because we can't outrun it really. And the second one is we need to deploy sales capacity and grow sales capacity, and that's really combination of the two. In most markets today, cloud adoption is happening. There still may be a few holdouts that are a little bit slower. And -- but we're not yet deploying enough sales capacity everywhere, and that's one of our big areas of focus, as I mentioned earlier.

Operator

Our next question comes from the line of Brent Thill of Jefferies.

Brent John Thill
Jefferies LLC, Research Division

David, good margins, 27%, but you're guiding full year to 23%. I know you mentioned you're stepping on the sales investments, but anything else that's coming into the investment mix this year that is different than we've seen in the past years to drive that margin lower throughout the year?

David M. Obstler
Chief Financial Officer

Sales and R&D investment, we are -- we have both the sales capacity and the whole ecosystem that we've been talking about. And as Oli often says, we have more high-return product projects than we always have capacity and are attempting to make the appropriate investments. So it's really that we are layering in. We said all along that this can't be changed, headcount can't be changed as quickly as revenues. So we have periods where we're investing more than revenue growth or less. And this year is the one where we're coming from a more conservative posture of last year into more investment in both R&D and sales and marketing. There's nothing onetime or special. It relates to both sales capacity and R&D projects. Oli, anything else?

Olivier Pomel
Co-Founder, CEO & Director

Yes. Again, I mean, I -- bringing it back to what I was saying earlier, a big focus internally is recruiting and making sure that we go fast enough there. I would say one more thing. Last year, when the market was slowing down, most of our peers have laid off their recruiting teams, and we didn't do that because we knew we need to -- our success will depend on revving the recruiting engine back up and growing the engineering and the sales team fast enough for us to go after the gen AI market opportunity we have. So we are very happy we haven't done that, but we still have a lot of work to do to recruit enough of the right people fast enough.

David M. Obstler
Chief Financial Officer

I'd add as we always have said that we have a very efficient, scalable business, and we control the pace of our investments. And we -- at the same time, that we're investing, we've been investing in efficiency projects, like we talked about in the cloud to balance those things to deliver a strong profitability posture with strong investment.

Brent John Thill
Jefferies LLC, Research Division

David, can I just ask a quick clarification on commitment overage and usage. I think you had a roughly 75%, 25% split across commit coverage and usage. Is that still in the same ballpark?

David M. Obstler
Chief Financial Officer

Yes. I think we said it's been in the range of sort of upper teens to mid-20s over time. But that type of posture of clients under-committing and evolving into their usage hasn't changed over time. So that is still in the range that we've talked about since we went public.

Operator

Our next question comes from the line of Jake Roberge of William Blair.

Jacob Roberge
William Blair & Company L.L.C., Research Division

Great to hear that AI-native customers represented 3.5% of ARR. I'm curious on what you're seeing on the demand front for your own AI products like AIOps and cloud service management? And then you mentioned that the model providers have built their own tools to monitor the training of their models. As you start to roll out your own LLM observability solutions, do you see that trend changing? And is that something that customers have been asking you to build?

Olivier Pomel
Co-Founder, CEO & Director

So on the first question, so we -- so look, we see a lot of interest in the new products. These are new products so we just announced in GA, the Event Management product, which is the main missing building block we had for AIOps platform. And we also just released into GA, Bits for incident management. So there's a lot of demand for it. The products are actually, I will say it, for Bits for incident management is a joy to use. So that's great. But you should also expect to hear more from us on that topic in the next 12 months. So this is all very exciting.

On the tooling, I would say there's a handful of players that have been building that tooling for a few years for -- in a way that's very specialized to what they do internally. They are not necessarily the representative of the bulk of the market. So in those situations, we're always careful about overfitting products to a group that might not be the right target customer group in the end in the same way that building infrastructure monitoring for the cloud providers to use internally might not be an exact fit for what the rest of the world needs.

That being said, I mean, look, we work a lot with those companies, and they have a number of needs that some of them they can meet internally and some of them, they don't. And if I go back to the example of hyperscalers, we actually have teams at the hyperscalers that use us for application or infrastructure or logs internally, even though they've built a lot of that tooling themselves. So I think everything is possible in the long run. But our focus is really on the vast majority of the customer base that's going to either use those API-based products or tune and run their own models.

Operator

Our next question comes from the line of Karl Keirstead of UBS.

Karl Emil Keirstead
UBS Investment Bank, Research Division

Great. Maybe to Olivier. Could you give a little context to the President stepping down into the Board, he's obviously been there a long time and has been a big part of the Datadog story.

And then for David, you've done a great job over the years dissuading us from over-indexing on DR and billings. But as you actually pointed out, the sequential decline in DR and billings was quite a bit larger than normal. I'm just curious if there's a story there?

Olivier Pomel
Co-Founder, CEO & Director

So I'll start with Amit, our President. So Amit wanted to stop working as a full-time operator but wants to stay close to the company and we want to stay close to him, too. I mean, he's been, as you pointed out, a big part of the Datadog story, and we definitely want to keep him involved in the company and keep working with him.

So the plan is for him to join the Board. You should expect him to maybe reappear at some point as a VC investor, something that's less operational than what he's doing today. And we expect him to be a part of the company for the future as well. I've always said, I will miss him every day in the office.

David, do you want to comment on the...

David M. Obstler
Chief Financial Officer

Yes. Now to the more mundane topic of billings. So yes, I think that we did see a decel. We had a very strong Q4 in terms of commitments to us, which manifests itself in billings. We talked about the larger customers committing to multiyear deals and committing to us. We do have a sequential factor, not in our revenues, which are based on usage as must, but basically in our billings and operations like that, usually in Q1 as clients sort of commit. So in some ways, we don't have the seasonality to speak of in the revenues, but like we talked about in billings and RPO, we do have variations in billings.

We're not reading that much into it. In that -- overall weighted, it's going to vary, and we point everyone back towards ARR and revenues, but acknowledge that, that seasonality may have been a little more pronounced in this cycle than in the previous one.

Operator

Our next question comes from the line of Brad Reback of Stifel.

Brad Robert Reback
Stifel, Nicolaus & Company, Incorporated, Research Division

Oli, one of the fastest ways to recruit quickly is via larger acquisitions. So maybe you can give us your thoughts on potentially going a little bigger here given that you're generating close to $1 billion of OCF a year right now?

Olivier Pomel
Co-Founder, CEO & Director

Yes. So look, everything is on the table for us. Like we're very busy on the M&A side. We have a team that is, at any point in time, reviewing multiple deals. And everything is possible. I would say the larger the acquisition, the less likely it is to happen because we're extremely selective in terms of, not only the economics of any deal, but also the fit and whether we think it's truly going to accelerate us in the mid- to long term. But everything is possible.

We are very fortunate to have a very efficient business. As we pointed, they're generating quite a bit of cash now, and that opens a number of doors for us, and we fully intend to use that if we have the right opportunity.

Operator

Our next question comes from the line of Koji Ikeda of Bank of America Securities.

Koji Ikeda
BofA Securities, Research Division

I wanted to ask a question on AI. You mentioned in the prepared remarks about 3.5% of ARR, last quarter about 3%. So it looks like the trend is about plus 50 basis points a quarter right now. So really great to see the ongoing expansion there. So from a big-picture perspective, in your view, what needs to happen for this metric to start expanding, say, 1, 2, 3 points a quarter?

Olivier Pomel
Co-Founder, CEO & Director

I mean, look, it's -- so first of all, I'm not sure this is a metric we'll keep bringing up. It was interesting for us to look at this small group of early AI-native companies to get a sense of what might come next in the world of AI. But I think as we -- as time goes by and as AI adoption broadens, I think it becomes less and less relevant.

But the one thing I will say is, we -- so we try to compare our exposure to AI to what we see from the hyperscalers because they are upstream from us in that respect. The hyperscaler that is the most open by is -- or transparent by in terms of numbers is Microsoft as they disclose how much of their growth comes from AI more specifically. And I will say that if you compare our business to theirs, the Azure part of our business is growing faster than Azure itself. And the AI-driven part of our Azure business itself is also growing faster than what you see on the on the overall Azure number. So we think we have similar exposure, and we track to the same trends broadly.

The other cloud providers are not as forthcoming with metrics so it's harder to do a direct comparison. But in the longer term, we expect the same trends to apply.

Operator

Our next question comes from the line of Peter M. Weed of Bernstein.

Peter Weed
Sanford C. Bernstein & Co., LLC., Research Division

One of the things that jumped out at me is you saw some improvement in net new customer adds quarter-over-quarter kind of for the first time maybe over the last year or so, which is pretty exciting. Obviously, I know there's a long tail effect with this. But as you look at that, do you see that as kind of a reflection of momentum in kind of the larger enterprise or a rebound in kind of the digital native venture-backed community, perhaps from that broadened AI. And if you think about pipeline going forward, should we anticipate kind of this bottoming and strength to continue and maybe accelerate?

Olivier Pomel
Co-Founder, CEO & Director

So I mean, yes, the number of customers going up faster than it was the past few quarters. I would say it's hard to read too much into it because we have a large number of smaller customers. And there's more variability into the number of those smaller customers we get, and we lose at any point in time and without really having a very large impact on the business. So I wouldn't read too much into that. I will say that the trends are -- all in customer acquisitions and retention are good.

Another number we reported on, which I think is worth mentioning is we saw also a higher number of customers above $100,000, cross that mark, basically cross that mark of $100,000 in revenue. And that's a return to the mean of what we had seen before, I think last quarter that number was a little bit lower. And it really shows what we were saying last quarter, which is that customers are growing on that revenue curve. And sometimes, there are little peaks and valleys in that, in the distribution of customers across the revenue curve for us. But overall, the motion is still the same. Customers are landing with us small and they're growing and they're getting bigger. And as a result, we're getting a larger and larger number of customers above $100,000 and above $1 million and are driving the major ratio of our revenue.

Operator

Our next question comes from the line of Eric Heath of KeyBanc.

Eric Michael Heath
KeyBanc Capital Markets Inc., Research Division

Oli, in your prepared remarks, I don't think you talked too much on security and just given we're out here at RSA this week. I was curious if you could talk about traction you're seeing there. And then maybe any feedback on adoption trends following the new packaging you rolled out a couple of quarters ago?

Olivier Pomel
Co-Founder, CEO & Director

Yes. So the -- so far, the news are pretty good on the -- these new packages. Again, we want to wait to have seen them in the market for a few quarters before we comment too much on those, but the uptake is good. They seem to resonate well with customers, response to the right need, and they're fairly easy to insert into the sales process. So all that are good news so far.

I realize we didn't put too much in the script on security. We actually have a few things coming out. As there's RSA this week in San Francisco and our team is there to meet with customers. One of the new piece of functionality we've announced last week was the agentless scanning for cloud security products, which we think is going to help a lot of customers deploy our product much more broadly, much more quickly. So we're very excited about that. It's in beta right now.

And yes, overall, the same trends we commented on last quarter are still true, thousands of customers on security, revenue growth, growth on a number of different pillars at the same time, which is very exciting and really speaks to our platform approach for security as well.

Operator

Our next question comes from the line of Andrew Nowinski of Wells Fargo.

Andrew James Nowinski
Wells Fargo Securities, LLC, Research Division

I had a question on guidance for Q2. You had strong net new ARR in Q1. And you said you're seeing improved usage growth and less optimization. But based on your Q2 revenue guidance, it looks like you're assuming net new ARR in Q2 declines pretty significantly. I guess did you have some deals that pulled into Q1? And if not, why would net new ARR in Q2 be down year-over-year?

David M. Obstler
Chief Financial Officer

No. I mean, we -- it's the same thing that we've said in every quarter that our guidance is taking the trends both in terms of usage growth and new business accumulation and it discounts them. And that's exactly the same as we said since we've been a public company. So that's what we do in providing the guidance and continue to do that in this quarter.

Andrew James Nowinski
Wells Fargo Securities, LLC, Research Division

All right, and I'm wondering if you're seeing any sort of uptick in consolidation in the log management and SIEM markets given the M&A activity in that space?

Olivier Pomel
Co-Founder, CEO & Director

Yes, there are definitely opportunities there. And so we spoke on the, I think, in the script on the -- about some of the advanced query functionalities, we're adding to logs. We spoke about Flex Logs. So those are all geared towards going after this opportunity. And we think also there's more specifically an opportunity around SIEM workloads, which is why we are investing heavily in our Cloud SIEM product. And so we think there's definitely a lot of opportunities there, and the teams are very focused on that.

I don't expect these opportunities to make a big dent in our numbers in the next couple of quarters. But in the next year or so, definitely, we expect to see more.

Operator

Our next question comes from the line of Mike Cikos of Needham.

Michael Joseph Cikos
Needham & Company, LLC, Research Division

Just one topic, a bit of a 2-parter here, but I think in the prepared remarks, management incited improving trends for the number of or the cohort of customers who are moving past optimization sequentially. So I guess the question is really, can you help us think about the rate or pace of customers that are moving into this cohort, is the first piece of the question.

And then the second piece, what kind of assumptions do you have for sustained improvement or additional customers entering that cohort as we think about the guidance that we have here today. I'm wondering how much needs to happen on that front for you guys to get more comfortable with the guidance? Or are you guys assuming steady state here and anything else is kind of really just upside?

David M. Obstler
Chief Financial Officer

Yes. No, we said that we don't provide guidance on the percentage of customers that are in this cohort. We just are commenting that the trends that we mentioned last quarter of the abatement of optimization in this cohort manifested itself again, and they continue to grow. Like always, our guidance takes conservative assumptions and looks across the trends in the business and assumes that there would be more conservative drivers of the business than we've had in the last quarters. So we continue with that methodology.

Olivier Pomel
Co-Founder, CEO & Director

And look, we mentioned that cohort because we thought it was a bad weather, right? We thought they were the first to really optimize and they felt they exhibited all the highest need, I would say, for a quick turnaround on their own financial profile, but there are other pockets of optimization in the business. There are other customers that are going through that later. There are customers that are still going through it. It's an ongoing -- it's going to be an ongoing phenomenon. It's been throughout the history of the company. So as we get further and further from the macro situation last year -- from last year, I think this cohort will lose in relevance in terms of its -- what we can read into it for the rest of the business.

Operator

This concludes the question-and-answer session. I would now like to turn it back to CEO, Olivier Pomel for closing remarks.

Olivier Pomel
Co-Founder, CEO & Director

All right. Thank you. So again, I want to thank the whole team for what was a great quarter. And I know many of our customers and users are listening to the earnings call. So I want to make sure everybody knows we're having our DASH Conference in June in New York. You can go to dashcon.io, and we really look forward to seeing you there. So thank you all.

David M. Obstler
Chief Financial Officer

Thank you.

Operator
Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.