NEWR.N - New Relic Inc at TD Cowen Technology, Media & Telecom Conference

EVENT DATE/TIME: MAY 31, 2023 / 3:25PM GMT
Okay. I hope you’re feeling better. Too bad you couldn’t make it, but.

David Barter - New Relic, Inc. - CFO

Picked up a little bit of a bug while I was in the city last week. So I’m sorry, I can’t be there in person.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

No problem. Glad you could join us for -- there’s a bunch of people in the room. So I know we’re webcast here. So I’m Derrick Wood, senior analyst covering software at TD Cowen and we’ve got New Relic and Dave Barter, CFO on the Zoom here. So I’ll get right into it.

QUESTIONS AND ANSWERS

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Dave, the -- maybe we could kind of just get right into the quarter and some of the -- some of the things you talked about in terms of the outlook for the upcoming fiscal year, you guys gave some interesting new disclosures around consumption and subscription breakdown I mean, actually, if we just take a higher step back here, where are we in this transition cycle to consumption? And how do you see that playing out for the kind of last tail over the next year?

David Barter - New Relic, Inc. - CFO

I think it’s a great call out. I think when I came in, Derrick -- well, I should say, first of all, thanks for having me mean this is -- I feel bad I’m not there in person, Derrick, but we really appreciate the invitation and the opportunity to join you today, both for this as well as the one-on-ones. So look forward to seeing you in person hopefully in the near future.

In regards to the -- maybe the shift to consumption, Derrick, and I think as you and I have discussed previously, I think one of the things that was very important to us is actually to provide investors with much better disclosure, which I think you saw through both the 10-K but also through the Analyst Day presentation where we took a time to start unpacking the P&L so that as we actually enter this final inning of converting and shifting everything to all in one observability as well as consumption, that the -- just the optics in the business just become more complete and there’s a better 360 in the business.

And so our double click into the business was really trying to offer up a view of how we’ve been growing through a new logo motion, how would we be rolling through that customer base expansion motion, how have migrations impacted our growth. And then really, what does the final element look like in terms of going from over 80% in Q4? We had 84% consumption revenue and then just driving up to 100%.
And so our focus really was being able to outline the growth drivers thoughtfully. I think there's been a lot of progression around gross margin that you've seen. And we're one of those companies where we're committed to profitable growth, and we're really pleased with how we've scaled on public cloud infrastructure. And then finally, probably going down into OpEx, one of the things we really wanted to highlight was both the investment and product and how that's yielding just go just good — and just good tangible output.

But equally, the sales efficiency where everything starts with a PLG motion and our customers graduate into the sales-led motion. And so we hoped through the Q4 disclosure as well as through Analyst Day, that a lot of the moving parts that have been hard to see became quite a bit more clear.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes. That's a great overview. And so one of the things you outlined was the consumption growth, x migration. And you indicated that last fiscal year, it grew 35% and you're expecting it to grow 20% this year if I've got that correct. That is -- I mean, that is a decent amount of deceleration. So just wondering kind of how much macro is kind of weighing on that growth trajectory or other inputs to consider and looking at that glide path over the year.

David Barter - New Relic, Inc. - CFO

I mean it's a great call out. We had exited the year growing consumption, excluding migrations at 32%. So we certainly have seen some compression over the course of the year. And our orientation was to try and take a bottoms-up view of what we think would happen in the business across all of those customer growth levers between the new customer base expansion, our migrations and try and come up with, I think, what we thought was a humble view around what we thought would happen. It wasn't lost on us in terms of some of the decel that had happened both with AWS, some of the elements going on with Azure, but we also looked at some of our consumption peers as well in some of the decel that they had experienced.

So we tried to weigh a lot of factors around both macro as well as cloud optimization to probably arrive at what we thought was a very data-driven approach to setting an outlook, knowing as you're in Q1, there's a lot of real estate in front of you. And we were, I think, trying to condition the model to be able to accommodate kind of a few of the vagaries that are just remain uncertain at this point.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes, that makes sense. When did you guys -- I mean, I think most cloud consumption vendors have seen optimization trends go on? When did that -- when did you guys start to see that? And is that still kind of a behavior you're seeing within customers today?

David Barter - New Relic, Inc. - CFO

Yes. We started to see it in the autumn. I think it became a little bit more pronounced in the winter in our March quarter. I think we still see it today, and we actually are tracking both cloud optimizations, but equally, we also track something that we will allude to in our remarks around customers who are just running above their contractual commitment because we do see people starting to moderate when they're running that hot.

And we actively monitor those customers and also try and work through how do we really renew and provide more contractual bandwidth. My thesis is kind of after seeing it in the autumn now through the winter in the spring, I think it probably continues on, certainly for as we look out probably a couple more quarters. And it's probably -- I wish I had a better crystal ball, but that's probably the length through which we can kind of see it right now.
James Derrick Wood  - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Right? I think Azure kind of Microsoft alluded to the same thing that ultimately, you anniversary this stuff and there's only so much optimization that you can do and eventually, yes, and you think the same thing will happen. Okay.

David Barter  - New Relic, Inc. - CFO

I think we kind of get through the -- for us, we'll get through kind of the first half of our fiscal and probably as we go our December quarter, we'll probably have a better view. Again, we didn't -- if you recall, December was a pretty good quarter for us, both in terms of growth and profitability. So that will probably be the last tough comp for us just given how macro impacted us.

James Derrick Wood  - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Okay. And thinking about that 20% growth, is that mostly from the installed base and seeing kind of a net revenue rate expansion around 120 or 115 to 120 and then a little bit from new customers, but because they're new, they don't move the needle much.

David Barter  - New Relic, Inc. - CFO

It's a great call out. I think one of the elements, I'd probably call out in the Analyst Day presentation we gave a different view of our NRR historically, as you all recall, our NRR not compared and measured to 12-month periods. And what we included in the Analyst Day was a 3-month period, which allowed you to be able to see in any given quarter the growth from the customer base versus the growth of new logos.

And in that presentation, you're looking at a healthy -- I think it was 124% we had on that slide. And so if you kind of compare total growth in that quarter on consumption of 32, I would say you got 24 points of growth from your customer base and about 8 points from new customers. So as we start to exit this the kind of the mixed model, if you will, between subscription and consumption. We certainly [mark] where we always have a healthy balance between the customer base and new customers in any given.

James Derrick Wood  - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes, that's helpful.

David Barter  - New Relic, Inc. - CFO

It probably does come mostly just to your -- when you land small probably does mostly come from the customer base, but it can probably have that rough proportion is what we'd expect in the future.

James Derrick Wood  - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

And on that landing of new consumption customers is -- how does that new cohort look compared to your old model? Is that -- are you seeing a lot more down market? And what is the volume of new customers that you're landing on consumption?

David Barter  - New Relic, Inc. - CFO

That's a great question. I think it is one where -- and this is what kind of led to the framework around landing with PLG and then graduating up to sales lead. As we've been at it for a couple of years and what we found in the PLG motion is that we're landing Fortune 500 to F2000 to even leading public sector customers. And so this past year, as we started the new fiscal year, we went and graduated over 1,000 accounts from our self-service PLD motion, all the way up to our sales-led motion.
And it’s the first time we’ve done it since we’ve launched the sales model, but we’re pretty excited because there is a very healthy corpus of accounts within our self-serve base that just naturally represent accounts that have a very large addressable opportunity. So we’re pretty encouraged about how the PLG motion is landing not only small and midsized and just customers of smaller spend, but equally some enterprise accounts that have much larger spend or much larger attention as I should say.

James Derrick Wood  
*TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst*

Would you say that’s helped you get back to your SMB routes a little bit? I mean, I’m sure PLG enables you to do that.

David Barter  
*New Relic, Inc. - CFO*

I think it does. And at some level, I guess, if I think back to when I began my career at Microsoft, I think what we found is that having a good SMB motion did allow us to penetrate enterprises very effectively from the standpoint. I still remember we’re doing an analysis of the Fortune 500. And specifically, I looked in financial services, and I found that one of the leading banks in the world actually had over 25 different contractual relationships. That reminded me that a good SMB motion does allow you to get in and create relationships with the business units that have budget authority and ultimately, they do make decisions. And so I think having an effective PLG motion does allow us naturally to reach developers and reach budget owners even in the -- even within the confines of much larger companies.

James Derrick Wood  
*TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst*

And what does the composition look like? Is it greenfield? Is it displacement or the -- what are the average deal sizes look when you land new customers? Anything you can share there?

David Barter  
*New Relic, Inc. - CFO*

I would say they’re of 2 ilks. Certainly, it’s one where frequently, if I were to think about classic PLG many of those relationships naturally just start off on credit cards and they are smaller relationships. So they tend to be in the thousands or maybe in the tens of thousands, by definition. But on the flip side, we have some of the larger lands where they come in, where maybe the sponsor knows New Relic quite well. And those relationships naturally start off typically in the 6 figures. That’s probably the kind of the 2 cohorts, if you will.

James Derrick Wood  
*TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst*

And are they -- they tend to be new applications being built that don’t have any observability attached or is the strategy to try to displace legacy? Or again, going back to the question around greenfield versus displacement?

David Barter  
*New Relic, Inc. - CFO*

I appreciate you. Sorry, I didn’t get to that part. Frequently, I find that it is a more of a greenfield orientation where it is somebody coming in and saying, “Gosh, I need a tool for a digital transformation or gosh, we now have multiple public clouds, which is increasingly a way people will work where they’ll have a combination of Azure, AWS or GCP. And they’d like to have one monitoring and complete platform to monitor 2 or more clouds.

And so that’s a great situation for New Relic to enter. And those tend to be probably the 2 places you naturally begin where it’s really not a competitive situation. I’d say later on in the journey becomes a situation where they would say I am -- I have -- I think BlackLine at our conference called out
that they had a dozen or more tools. The second act usually becomes one where people are starting to consolidate their tools. But the first act is more blue ocean or greenfield in nature.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes. Speaking of multi-cloud, I mean the fact that you guys replatformed onto hyperscalers, how does that help you better address applications that are being built and deployed in public clouds?

David Barter - New Relic, Inc. - CFO

Well, I think it’s one where, from an all-in-one perspective, I think we provide the ability probably to do 2 things. One, we help you look across multiple clouds. And so we are not constrained by our platform in terms of the clouds, the location of the clouds we can provide an all-in-one observability experience that’s true multi-cloud in nature.

And so I think that’s one of our key advantages. It’s interesting. One -- another advantage that I’ve heard come up is we’ve also gone through and figured out optimize public clouds in a way that’s actually pretty remarkable. And when people look at our cost of revenue, it does capture attention where they’re trying to learn from that experience of how do they kind of benefit from the wisdom of the experience of how we’ve optimized really our cost of revenue.

And so I think we have a couple of things to ultimately offer customers both in terms of both operationally, how advanced the technology is, but equally just how to instrument in a cost-effective way.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Okay. I wanted to ask about the other side of the revenue equation with respect to the subscription revenue. And you talked about that declining kind of low single digits ex migration. Can you give us a sense for why that revenue is declining? And is that related to churn or other factors?

David Barter - New Relic, Inc. - CFO

I think as of last quarter, it was down 8%, which I think overall for a line of business where you’re not spending a lot of time on, and it’s not the focus, having churn of 8% isn’t bad. But I think it is one where we certainly find and I think I tried to be pretty open during our Analyst Day, as we’re shifting people really from -- we have 3 types of contracts in the market right now, Derrick.

As you know, we have our legacy agreements with the first generation of our consumption contracts and then we have all of our modern consumption contracts. We’re kind of moving everybody over. And there’s always a bit of contract fatigue that can occur as you’re moving people across buying programs, and that certainly happens.

And then there’s certainly the dynamic where you’re not going to win them all. And I think those certainly ultimately kind of play out as you -- as we consolidate the kind of all customers and serve all customers, both with one tech stack, but ultimately with one modern set of buying programs.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

And when you’re converting those legacy customers to the modern consumption contract, I think there’s some kind of initial deflationary impact on revenue in a lot of cases, and then you look to build that back up. Can you give a little bit more color around that?
David Barter - New Relic, Inc. - CFO

I think it’s one in general in some of the legacy subscriptions customers. It’s not uncommon where the utilization has been larger than what was originally conceived when the contract was written. And what we’ll find is that people will have deployed gosh, in a variety of ways that are probably outside of how our center of excellence would normally advise you to set up the observability platform.

And so naturally, there is a little bit of rationing where people reinstrument probably upgrade their agents but just reassess exactly the level of consumption frequently, it is around ingest. And -- yes. I think it’s just -- it’s one where the consumption can be at a higher water line when they get into a consumption contract, which is truly cost following and value following, it does compel people to go through an optimization process.

Quite frankly, Derrick, no different than what we’ve done on AWS, where we figured out how to optimize and use the cloud to its maximum advantage.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Have you.

David Barter - New Relic, Inc. - CFO

And once people get to a contemporary state and a contemporary implementation, then naturally, you get the growth from there.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Right, right. And I was going to ask about if you’ve done an [ET] study around once you get to the optimization and then start growing again, like when do you get back up to that level of legacy revenue levels.

David Barter - New Relic, Inc. - CFO

And that’s why I felt actually really comfortable when we unpacked our NRR on a 3-month basis where we looked at total company, and then we looked at our consumption business. We found a lot of trends across the business, whether it was customer base expansion or migrations. It naturally aligned with that NRR.

And so I think it was one where we looked over the last couple of years and felt like that was actually a good leading indicator for how we could expand either post migration or just as accounts continue to mature and grow with us.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Okay. One interesting slide you had at the Analyst Day was talking about the number of capabilities adopted with your base versus the Datadog base, and it was a lot higher for your base. I think in terms of -- I think it was 86% with 4-plus capabilities, almost double that of Datadog. What was the -- what was your kind of message with laying those metrics out?

David Barter - New Relic, Inc. - CFO

Well, I think it was just -- we were trying to -- I guess it’s a piece of benchmarking that it had been observed to us by investors of how do we measure up vis-a-vis a Splunk to datadog or (inaudible). And so we took a just -- we took one example. I think that’s readily available in the marketplace and said, when you look at our APM, our logs, or mobile or browser kind of our -- some of our popular products, I guess what we were trying to illustrate is, how is the adoption of all-in-one observability starting to take shape now that we’ve had this platform out there for a couple of years.
And I think this was just an easy way to provide some simple benchmarking to investors that to highlight, this is fundamentally what's driving that NRR and ultimately contributing to the organic growth of the company.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes, that’s impressive. And what is the -- why do you win against those competitors you just listed?

David Barter - New Relic, Inc. - CFO

It’s a great question. I think, one, when we look at our all-in-one observability approach, it certainly starts with our superpower, which has always been APM. But what’s unique about it, you may have seen our recent press release around infrastructure is our approach is really going after, I’d say, a set of personas that are always developer-centric.

But equally, we would like to go in and provide a double-click into any experience. So if you’re in APM, every application emits logs. So being able to double-click through APM into logging or every application is mounted on infrastructure, being able to double-click in and being able to quickly as a developer see what is exactly going on in the infrastructure stack understand which microservice actually might not be working the way it was designed or expected to work, we think, is a very strong inherent advantage where we really go out and empower people directly through either our software or ultimately through one of the APIs that might integrate with an IDE where they have the full power of telemetry, but also full drill down in full click-through.

I think Peter did a great job at our Analyst Day just showing how that actually works in the wild when a developer is using our software. And so I’d encourage you to take a look at Peter’s demo. I thought it was really instructive both in terms of how people will use New Relic in a very powerful way. But equally, how people might be using New Relic in the future using generative AI.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes. which I want to talk about in a sec. But -- so it’s -- your platform is that it just enables developers a lot easier instrumentation than maybe others. Is the developer still the core audience or I mean, how much are you trying to target SREs or IT ops with respect to infrastructure and logs?

David Barter - New Relic, Inc. - CFO

Certainly, those are among the 25% is that we target and our software is, again, really geared around a set of engineering disciplines that starts with the developer. But as you rightfully call out, it includes ops and SRE as well. And again, our goal is to provide not only the most ubiquitous platform but provide a platform that really enables those disciplines to collaborate and effectively, both manage their software and obviously keep it in a way where it’s highly performance and it is -- well, it enables our customers really to serve their customers well.

So if you think about any digital business, Bill talked about McDonald’s. Our goal is certainly enabling all of their digital sales, which means great -- obviously, great performance and great uptime on the software. And we think we do that really, really well by empowering developers to understand how well their software is serving their end customer.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Right. And you guys, you should talk about data versus users. I think that’s a little bit less focused today. But if you think about what is the bigger driver of kind of expansion opportunity, which one would you? Is it both kind of evenly balanced? Or anything you’d see kind of weighted more between those 2?
David Barter - New Relic, Inc. - CFO

Well, certainly, there is no slowdown in the growth of data. And with the advent of open telemetry, where every device, every operating system, every application, submitting data, we still think there is a tremendous opportunity, and we’ve geared our platform and our technology around that idea that just data will continue to grow. But equally, data is not enough, and that’s why we do focus on the users and user engagement, whether it’s directly through the software, whether it’s through in API, whether it’s through a custom dashboard.

So we do believe that, that’s important. And as Bill highlighted in the conference, that’s why we’re in the -- during our Analyst Day presentation, that’s why certain customers are also experimenting with situations where we’ll use a query as one of our telemetry measures because, in some cases, that just works better for our customers. We do think the usage of the software and user engagement is an important and leading indicator of the strength of the platform.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Okay. And in terms of generative AI, there’s, I guess, kind of 2 sides of the coin to think about, one would be Grok and what you guys have built within that product set. And then 2 would be as this takes hold in the broader market, [LLM] get built new applications on top, what that means for kind of developer demand for instrumentation going forward. So can you talk about those 2 dynamics and how you’re positioned for that?

David Barter - New Relic, Inc. - CFO

Well, I think it’s one where fundamentally from a technology perspective with the advent of both multiple AI engines as well as just the evolution of LLM, I think we really are structuring our technology so that we really continue to benefit. So our platform has been designed really for what we think of as rapid innovation, rapid product development. I don’t know that the story has been written exactly on how Gen AI ultimately unfolds.

But I think we’re setting up our tools and our platform so that we can rapidly innovate. We can bring value to developers and all engineers as quickly as possible and provide some of that automation that we showcased last week.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

And can you give a brief description of what Grok is.

David Barter - New Relic, Inc. - CFO

Sure. So Grok right now is our Gen AI assistant. Through Grok, you can ultimately query through just natural language and through the example that we shared last week. It allows you to quickly query and gather insights from the telemetry data around the performance of the software potential peaks and challenges, but it also will — Grok will enable you to automatically deploy observability for any new instance or any new environment.

So it truly is a both a kind of a, I’ll call it, a tool in the sense that it helps you with the observability process, but it also helps you with just even through the deployment of observability and deploying it in line with best practices. So we think it is one where it takes any technical difficulty associated with observability. It really brings it — brings down the level of knowledge that you need and then it enables every developer and every engineer to have access to it.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Right. And is that natural language capability is that built with like leveraging open AI?
David Barter - New Relic, Inc. - CFO

It does. Yes. That’s where we’ve started.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Okay. And just in terms of the longer-term targets you laid out, 20% to 25% growth. Can you remind us what parameter or time frame that is? And given that you haven’t seen that growth level in a few years, can you give us a sense of what has given you the confidence to get back to those levels?

David Barter - New Relic, Inc. - CFO

Yes. I think it’s a great question. I think we tried to approach the presentation of a long-term model with a couple of things in mind. Probably first and foremost, we wanted to be really open around how much of the business is consumption versus subscription. I think we wanted to provide a view of how fast consumption has been growing.

And then we still had about 4 to 6 quarters of transition and transition headwind. Our hope through at the Analyst Day presentation was to provide an update around new logo growth, customer base expansion and how migrations tend to work, that it ultimately allows investors to look at post transition. So if you were to look out, just even be conservative post 6 quarters, what are those fundamental drivers that they give both the company as well as investors’ confidence that there’s plenty of levers to use.

And our viewpoint is that once we complete the transition, our customer acquisition motion as well as the expansion motion as well as the breadth of the platform, all provide fundamental the fundamental growth levers, if you will, to attain those levels of growth and also be down all the way down to the levels of profitability that we offered up.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Is that -- so is that $20 million to $25 million could start 6 quarters from now? Or that’s just kind of 3 to 5 years out? What’s the.

David Barter - New Relic, Inc. - CFO

That’s a great clarifying question. So the way we think about a long-term model is it’s a view of where the company will be trending in 3 to 5 years. I guess the way I would articulate it is, I think there’s a natural glide path where you would exit out in that 4 to 6 quarter range from being in transition to just being a pure play. And at that point, you would kind of glide right up to those growth rates of 20% to 25%.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Okay. Any questions in the audience. No. Not sure how much you can comment, but there’s been some news on -- not from you guys, but other outlets recently. And anything you can address from a New Relic that standpoint?

David Barter - New Relic, Inc. - CFO

No. I mean, Derrick, we don’t comment on, I think, some of the things you’re alluding to.
James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Yes. Yes, that's like that. So I guess we've got a -- we have one question. We got one minute left and we've got one question out here.

Unidentified Analyst

Yes. If you could just talk about any M&A plans going forward, that would be great.

David Barter - New Relic, Inc. - CFO

We don't have any M&A plans. Right now, I think right now, we feel really good about our R&D organization. We feel really good about the product they're building, and we intend to grow just the old fashion way just through good old-fashioned organic product development, and then we'll go out and sell it thoughtfully.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Anything else around capital allocation or margin targets you want to highlight?

David Barter - New Relic, Inc. - CFO

I think it's just more that we've kind of pushed our way in to durable profitability, Derrick. And as you know, our outlook for this year is 14% to 15% non-GAAP op margins and exiting the year above that level. So our view is this is a business and a sector of the economy that can support 20% to 25% growth, but equally healthy levels of margin and healthy levels of free cash flow. We do believe our free cash flow margin will continue to attract our non-GAAP op margin even as we're phasing in consumption and voicing.

James Derrick Wood - TD Cowen, Research Division - MD of TMT - Software & Senior Software Analyst

Great. Well, we're out of time. And that's it. Dave, thanks.