# Q3 2023 Earnings

# Prepared Remarks

# November 8, 2023

**Jeff Lawson, Co-founder and CEO**

Thank you, Bryan. And, thank you everyone for joining us today. Twilio delivered a strong third quarter, exceeding our revenue and non-GAAP profitability targets and generating another record quarter of non-GAAP income from operations and free cash flow. All told, we delivered $1.034 billion of revenue, $136 million of non-GAAP income from operations, and $195 million of free cash flow. On the back of our strong year-to-date results, we're raising our full-year non-GAAP income from operations guidance to $475 million to $485 million.

As you can see, the efficiency gains are rapidly showing in our quarterly results – reflecting the fundamental strength of our Communications business which represented 88% of our revenue in Q3. In fact, our Communications business was recently recognized by Gartner as a Leader in their first ever Magic Quadrant for CPaaS[1] - a terrific recognition, indicative of our attractive market position and the strength of our platform.

We continue to focus on opportunities with our Communications go-to-market motion to win new customers, improve our self-service capabilities, and drive more cross-sell opportunities across our customer base. We're also forming meaningful partnerships to help us win further market share, including a significant expansion of our Softbank partnership. We expect these efforts will drive durable, efficient growth in our Communications business moving forward. But the real story is how, over time, we believe we can continue to grow the top line of our Communications business while controlling costs. With our more streamlined cost structure and continued innovation, we're proving every day that this business can be a powerful driver of profit and cash flow for Twilio.

As our Communications business continues to successfully execute in an environment where usage volumes are stabilizing, we're also focused on driving improvements in our Data & Applications business. We've been rebuilding our go-to-market function and have seen some initial green shoots, including a modest uptick in bookings in the third quarter. We also continue to receive external validation for the strength of our products, as Segment was once again named as the CDP market share leader as of June 2023[2], and was also named a leader in the IDC CDP MarketScape for Financial Services[3]. While these early signals are encouraging, there is still more work to be done.

Before I get further into the details of the quarter, I'd like to share that Elena Donio will be transitioning out of her role as President of Twilio Data & Applications (TD&A) and into an advisory role. Elena and I have partnered closely to decide on the best path forward to reaccelerate the business – especially in light of the AI opportunity ahead. With Elena as an advisor, I will run TD&A in the interim period until we recruit a seasoned leader to lead this part of our business.

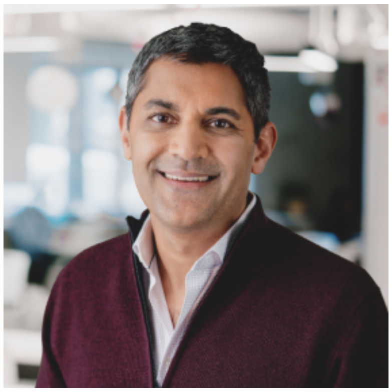
Thank you to Elena for joining the Twilio team at a critical time for our Company and leading us through a difficult but necessary transition. I respect your partnership as a board member, executive and as an advisor.

As I mentioned, the TD&A business saw a modest improvement in bookings this quarter, however those are not yet where we want them to be. While this is a very small portion of our business today – only 12% of our revenue in Q3 – we believe TD&A overall – and the foundations of AI in particular – are key assets for our future. We are committed to success in this business as we work to reaccelerate growth, drive further progress with our go-to-market scaling efforts and undertake investments to take advantage of the significant AI opportunity. We saw a number of exciting customer wins across both Flex and Segment in the quarter that are encouraging, and which I will detail later. And spending time with our customers at SIGNAL events in both San Francisco and London continues to reinforce for me the market demand for and unmatched capabilities of our software solutions.

Speaking of SIGNAL, in August, we revealed CustomerAI – a set of predictive and generative capabilities that pairs customer data with LLMs to give companies AI that truly knows their customers. When I talk to our customers – they all know AI will fundamentally re-wire the core of their companies – their workforce needs will change, the skills required to deliver their vision will change and importantly, their need for data to power their AI initiatives will grow. This is the initial set of opportunities we are working with customers – using Segment to get their customer data AI-ready and then activating on that data with Twilio Communications. This communications and data flywheel will empower brands to enter the AI race steps ahead of their competitors – armed with AI-ready data, the platform will allow them to interact with customers informed by that knowledge, and enable them to glean more insights from each message, call and email interaction. We believe this will improve their customer data sets and in doing so, help them deliver more effective, personalized customer communications.

Our teams have made immense progress over the course of 2023. In just nine months, we have delivered $360 million in non-GAAP income from operations and we've begun to generate meaningful levels of free cash flow. We are solidifying a strong foundation that positions us well to drive durable growth, deliver strong profitability and realize the benefits of our CustomerAI strategy over the long-term. I'm excited to work more closely with our Data & Applications team to deliver a value proposition around CustomerAI that is truly differentiated to Twilio.

And with that, I'll turn it over to Khozema to talk about our Communications business.



**Khozema Shipchandler, President, Twilio Communications**

Thanks, Jeff. Twilio Communications delivered $907 million in revenue in Q3, up 5% year-over-year on a reported basis and 8% on an organic basis, with a non-GAAP gross margin of 49.8%. As a team, we continue to focus on driving efficient growth, landing new logos, cross-selling across our Communications portfolio and generating meaningful non-GAAP profits, and we're executing well against all of these objectives.

We're continuing to push the bounds of innovation, highlighted by our recent new product announcements focused on CustomerAI, including Voice Intelligence, Traffic Optimization Engine, Branded Calling, Sendgrid Engagement Quality, and Fraud Guard, which are already creating new opportunities for our Communications customers and prospects. For example, our customers can assign preferences for high priority messages, such as one-time-passcodes, to be delivered leveraging the most timely route, whereas a marketing communication can be delivered via the most cost effective route.

We continued to demonstrate solid traction in our ability to drive growth with a more efficient cost structure. Our go-to-market model has been streamlined and we've had success in expanding our ISV and global technology partnerships. As a result, we are seeing momentum with landing large new logos across our Communications product portfolio, and through focused cross-selling efforts. In fact, roughly half of our expansion deals in North America were in non-messaging use cases.

A couple of cross-sell wins to highlight from Q3 include a long-standing Communications customer in the financial services industry, who adopted Verify to replace their legacy solution for identity and security. Additionally, a leading Latin American e-commerce platform added Twilio Interactive Voice Response ("IVR") while also expanding their Voice business with us. We saw encouraging results in our Voice business overall in the quarter.

We also landed several new logos in Q3, beginning with one of the largest European airlines, who chose Twilio Programmable Messaging based on our reliability and superior compliance standards to streamline their customer feedback workflows. Similarly, a global hotel brand chose Twilio's account security capabilities to serve their millions of app users, again citing our ability to navigate global regulatory and compliance while delivering a seamless customer experience. Finally, a leading AI company adopted Verify Pro, which allows customers to consume Verify as a subscription with upfront payments.

We're continuing to broaden our go-to-market footprint, leveraging our market leadership position to drive wins with ISVs and global technology leaders. In Q3, we signed a landmark agreement with Softbank. Softbank will offer Twilio services through its sales channels in Japan, which have a strong domestic customer base to draw upon. Softbank will also provide 24/7 support for Japanese customers. This is an exciting expansion of our partnership with Softbank, and we will continue to pursue strategic partnerships to efficiently capture additional market share.

We're also focused on improving our self-service motion and automation efforts so customers can more easily purchase, build and grow with us. In the near term, we are expecting to bring more purchasing, billing, and contract management capabilities into the Twilio console where customers can seamlessly adopt new products and expand usage. In addition, our teams will continue to automate compliance requirements and phone number provisioning that allow new customers to onboard much more quickly.

As a reminder, we previously made a commitment to our carrier partners to only permit registered U.S.-bound 10DLC SMS and MMS traffic effective August 31, 2023. I am very pleased with our success in executing against our 10DLC registration deadline and exceeding our initial goals. Thus far, we've been able to register virtually all of this traffic, which has enabled us to mitigate much of the revenue risk we had anticipated for the second half of the year. We now expect the revenue impact in Q4 to be minimal in light of the amount of registered traffic going into the quarter. This is an improvement from the potential headwind of up to 300 basis points that we'd previously referenced.

Similar to our efforts in registering U.S.-bound 10DLC SMS and MMS traffic, we will also be requiring our customers to register U.S.bound traffic from toll-free phone numbers as of today, November 8th. We expect the revenue impact in Q4 and beyond to be immaterial.

Our Q3 Dollar-Based Net Expansion Rate for Communications was 101%, and 104% excluding crypto customers. Similar to last quarter, new customers are driving a greater portion of the overall growth, while crypto and social & messaging headwinds mask the success we are seeing with our cross-sell and expansion opportunities. Churn continues to remain relatively stable, and we are seeing year-over-year volume growth across many industries.

I'm proud of the execution that our team demonstrated in the third quarter. Leading the charge on compliance and enacting our 10DLC registration deadline was no small feat. We continue to focus on streamlining our go-to-market, including improving our self-service motion and capitalizing on cross-sell opportunities across Communications. We are seeing encouraging results, and there is still further opportunity to improve, so I'm confident we will be able to make sustained progress over the coming quarters.

And with that, I'll turn it back to Jeff to talk about the TD&A business.

**Jeff Lawson, Interim Head, Twilio Data & Applications**

Thanks, Khozema. Turning to TD&A's results, our primary focus continues to be reaccelerating growth. In Q3, this business unit delivered $127 million in revenue, up 9% year-over-year, with a non-GAAP gross margin of 79.8%. The evolution of our TD&A business is ongoing, and while we've seen some initial encouraging signals from our go-to-market rebuild efforts, we need to translate early proof points into further bookings reacceleration.

This business deserves to grow faster and has all the ingredients to do so. I believe that reconstituting our old go-to-market playbook was necessary, but not enough. We have to continue to evolve it as well - given a rapidly changing market. Now that we have the selling team in place, I'll be working with our go-to-market leadership to accelerate further changes to our playbooks taking into account recent learnings.

At this stage, we continue to see increased churn and contraction in TD&A, reflecting the current dynamic environment and issues some of our customers are experiencing with growth in their own businesses. Despite this market dynamic, we're still continuing to land exciting new customer deals across both Flex and Segment.

We saw several Flex customer wins this quarter including a competitive seven-figure deal with a leading insurance company which was looking to migrate not only agents off their legacy on-premise solution, but also their IVR and Messaging/chat, ultimately consolidating all contact center flows to Twilio.

We also signed a cross-sell deal with Sweetwater, a musical instrument retailer. A long time Twilio customer of Voice, Messaging, and Email, Sweetwater is now actively bringing all their agents onto the Flex platform from their previous on-premise vendor. Sweetwater is a great example of a company who came to Twilio as a Communications customer looking to deliver a bespoke experience to their customers and has since gone all in on the full Twilio platform because of the customizability of the experience they are able to deliver across our solutions.

Turning to Segment – at SIGNAL London last week, we announced that we have processed more than 12.0 trillion data events in the last 12 months and resolved those data points into over 100 billion customer profiles on behalf of brands – and we can do all of that in milliseconds. This is the basis of our market share leadership recognition – and underscores the need for a real-time CDP in the market – which Segment delivers.

In Q3, the Segment team signed a deal with a leading fintech company and longstanding Communications customer who is driving a product-led-growth initiative. Their first use-case is leveraging Segment to process real time transactional data across all of their data systems in order to identify cross-sell opportunities – all in real time. We also established a new relationship with a software company in the construction space. As the company has been very acquisitive historically, they needed to consolidate data from multiple, disparate systems to build a 360 degree view of the customer to inform their marketing journeys.

We also inked a deal with a leading global toy company that will be using Segment's reverse ETL capabilities with Databricks to offer their millions of customers real-time personalization across their most popular apps and games. What's most exciting is that Segment will give hundreds of employees access to advanced customer data models and insights to help improve the customer experience for a globally recognized brand. This exciting deal was won with a great GSI partner. We think this is a repeatable partner model and look forward to continuing to invest in our partner ecosystem around Segment.

Segment's capabilities are foundational to CustomerAI. We've already announced the general availability of our first TD&A CustomerAI product, Predictions, which allows customers to create hyper-targeted audiences based on predictive traits like lifetime value, likelihood to churn or the propensity to take an action – such as making a purchase, subscribing, etc. We have more than 100 customers using Predictions already and they're quickly seeing results. One company has seen their cost of customer acquisition fall by 85% with more targeted advertising based on propensity to convert predictions. Another company saw a 2x improvement across all funnel metrics for their email campaigns – including opens, click throughs, etc. – based on product-recommendation predictions. Our early customers show that engagement is multiplying and costs are rapidly declining - that's just the first of several CustomerAI capabilities that we're working on bringing to market. Our short-term goal is to help customers see how the coming AI use-cases require better customer data – something that Segment can provide today. Our long-term goal is to provide unprecedented automation, cost savings, and better customer relationships thanks to AI.

So, we are seeing significant customer wins within TD&A and our investments in AI products are generating significant customer interest. We have more work to do and I intend to get closer to our field teams, our product teams and most importantly our customers – to build on our foundation and deliver on the incredible potential of this business.

I'll now turn it over to Aidan to walk through the financials in more detail.

**Aidan Viggiano, Chief Financial Officer**

Thank you, Jeff. We continue to build a strong financial foundation for Twilio. We exceeded our Q3 revenue guidance and delivered another record quarter of non-GAAP income from operations and free cash flow. We came into the year targeting $250-350 million of non-GAAP income from operations and have exceeded that goal in three quarters, delivering $360 million year-to-date. Our results demonstrate our ability and commitment to drive meaningful levels of profitability in our business over time.

Third quarter revenue was $1.034 billion, up 5% and 8% year-over-year on a reported and organic basis, respectively. As a reminder, this compares to second quarter revenue of $1.013 billion after adjusting for the $25 million of revenue from our divested ValueFirst and IoT businesses.

- Communications revenue was $907 million, up 5% year-over-year on a reported basis and 8% on an organic basis;
- Data & Applications revenue was $127 million, up 9% year-over-year

We continued to see stabilization in volumes across our usage-based products throughout the quarter. We also executed well against our 10DLC registration goals, mitigating revenue risk. Both of these factors helped drive our revenue beat in Q3.

As we referenced during our Q2 earnings call, our Q3 revenue growth rate was negatively impacted by headwinds from customers in the crypto industry. Total Q3 organic revenue growth excluding crypto customers was 11% year-over-year. While the impact has started to moderate, we still expect about 200 basis points of crypto-related revenue headwinds in Q4, down from 370 basis points in Q2 and 290 basis points in Q3.

Our Q3 Dollar-Based Net Expansion Rate was 101%. As Khozema mentioned, Dollar-Based Net Expansion for Communications was 101%, or 104% excluding crypto customers. Dollar-Based Net Expansion for Data & Applications was 96%, driven primarily by instances of higher contraction and churn among Segment customers. We continue to see some customers experiencing growth slowdowns and facing cost cutting initiatives in their own businesses given the current macro environment.

We delivered non-GAAP gross profit in Q3 of $553 million, growing 11% year-over-year and representing a non-GAAP gross margin of 53.5%. This was up 270 basis points year-over-year and up 120 basis points quarter-over-quarter, driven by Messaging termination mix and product mix within Communications. Gross margins also benefited from our recent divestitures. Non-GAAP gross margins for our Communications and Data & Applications segments were 49.8% and 79.8%, respectively.

Q3 non-GAAP income from operations came in meaningfully ahead of expectations at $136 million, representing a non-GAAP operating margin of 13.2%. This was due to our revenue beat and our continued focus on driving more efficiencies across the business.

Q3 GAAP loss from operations was $109 million, which includes $7 million of expenses associated with restructuring and real estate impairment charges. Stock-based compensation as a percentage of revenue was 17.9% in Q3 excluding approximately $0.5 million of restructuring costs, up 320 basis points quarter-over-quarter but down 180 basis points year-over-year. The sequential increase was primarily driven by the timing of employee refresh grants, which occurred later than in prior years. We expect stock-based compensation as a percentage of revenue to decline modestly in Q4.

In Q3 we generated free cash flow of $195 million, driven in part by heightened collections. While we do not expect this level to recur each quarter, free cash flow remains a focus for us as we drive greater profitability in the business. Lastly, we continued to execute against our $1 billion share repurchase program that we announced in February, and have now completed approximately $620 million of repurchases to date.

Moving on to guidance, for Q4 we're initiating a revenue target of $1.030 billion to $1.040 billion, representing year-over-year growth of 1%-2% on a reported basis and 4%-5% on an organic basis, which accounts for our recent ValueFirst and IoT divestitures. We expect Q4 non-GAAP income from operations of $115 million to $125 million and we are raising our full-year non-GAAP income from operations guidance to $475 million to $485 million.

I'm pleased with the progress we've made on our profitability targets to date. The teams are executing well, which provides a good set-up as we look to deliver a strong finish to the year and enter 2024 with momentum. And with that, let's open it up for questions.

# APPENDIX

**Footnotes**

[1] Magic Quadrant for Communications Platform as a Service, Gatner, September 2023, ID G00784989
[2]IDC Worldwide Customer Data Platform Applications Software Market Shares, 2022: Continued CDP Growth to $2.7 Billion Proves Value of Unified Data for CX and Digital Business, June 2023, IDC #US50861023.
[3]DC MarketScape: Worldwide Customer Data Platforms Focused on the Financial Services Industry 2023 Vendor Assessment, September 2023, #US51211923e

**Forward-Looking Statements**

This document and the accompanying conference call contain forward-looking statements within the meaning of the federal securities laws, which statements involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “can,” “will,” “would,” “should,” “expects,” “plans,” “anticipates,” “could,” “intends,” “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “forecasts,” “potential” or “continue” or the negative of these words or other similar terms or expressions that concern our expectations, strategy, plans or intentions. Forward-looking statements contained in this document and the accompanying conference call include, but are not limited to, statements about: our future financial performance, including our expected financial results and our guidance; our expectations regarding profitability, including when we will become profitable on GAAP and non-GAAP bases; our anticipated strategies and business plans, including future strategic partnerships; the ongoing effects of our recent workforce reductions and other cost-saving measures; the reorganization of our business and the shift in our segment reporting structure; our expectations regarding the impact of our divestitures of our IoT and ValueFirst businesses on our business as a whole; our expectations regarding our Data & Applications business, including our sales pipeline and bookings, new product releases, increased investment and go-to-market focus to capture market share, increased revenue growth, and when revenue growth will accelerate; our expectations regarding our Communications business, including profit potential, anticipated cash flows, our strategy for streamlining the customer experience, including increased focus on self-service capabilities, and the effects of registering certain messaging traffic on our results of operations; our ability to develop products related to generative artificial intelligence and machine learning, including CustomerAI; our ability to deliver on our product roadmap; our expectations regarding share repurchases, including the timing and amount of repurchases and impact on our balance sheet; and our expectations regarding the impact of macroeconomic and industry conditions, the impact of such conditions on our customers, and our ability to operate in such conditions. You should not rely upon forward-looking statements as predictions of future events.

The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to differ materially from those described in the forward-looking statements, including, among other things: our ability to successfully implement our cost-saving initiatives and to capture expected efficiencies; our ability to realize the anticipated benefits of changes to our operating model and organizational structure; the impact of macroeconomic uncertainties and market volatility; our financial performance, including expectations regarding our results of operations and the assumptions underlying such expectations and ability to achieve and sustain profitability; our ability to attract and retain customers; our ability to compete effectively in an intensely competitive market; our ability to comply with modified or new industry standards, laws and regulations applying to our business, and increased costs associated with regulatory compliance; our ability to manage changes in network service provider fees and optimize our network service provider coverage and connectivity; our ability to form and expand partnerships; and our ability to successfully enter into new markets and manage our international expansion.

The forward-looking statements contained in this document and the accompanying conference call are also subject to additional risks, uncertainties, and factors, including those more fully described in our most recent filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K and subsequent Quarterly Reports on Form 10-Q. Should any of these risks materialize, or should our assumptions prove to be incorrect, actual financial results could differ materially from our projections or those implied by these forward-looking statements. Moreover, we operate in a very competitive and rapidly changing environment, and new risks and uncertainties may emerge that could have an impact on the forward-looking statements contained in this document and the accompanying conference call.

Forward-looking statements represent our management's beliefs and assumptions only as of the date such statements are made. We undertake no obligation to update any forward-looking statements made in this document or the accompanying conference call to reflect events or circumstances after the date of this document or to reflect new information or the occurrence of unanticipated events, except as required by law.

**Non-GAAP Financial Measures**

In addition to financial information presented in accordance with U.S. generally accepted accounting principles ("GAAP"), this document and the accompanying conference call include certain non-GAAP financial measures, including non-GAAP gross profit and non-GAAP gross profit growth, non-GAAP gross margin, non-GAAP operating margin, non-GAAP net income (loss) per share attributable to common stockholders, basic and diluted (which we refer to as non-GAAP diluted earnings per share), non-GAAP income (loss) from operations, organic revenue and organic revenue growth, organic revenue and organic revenue growth adjusted to exclude revenue from crypto customers, revenue adjusted to exclude the impact of our IoT and ValueFirst divestitures, non-GAAP stock-based compensation expense, non-GAAP stock-based compensation expense as a percentage of revenue, and free cash flow. We use these non-GAAP financial measures to evaluate our ongoing operations and for internal planning and forecasting purposes. We believe that these non-GAAP financial measures may be helpful to investors because they provide consistency and comparability with past financial performance, facilitate period-to-period comparisons of results of operations and assist in comparisons with other companies, many of which use similar non-GAAP financial measures to supplement their GAAP results. We believe organic revenue and organic revenue growth are useful in understanding the ongoing results of our operations. We believe free cash flow provides useful supplemental information to help investors understand underlying trends in our business and our liquidity. These non-GAAP financial measures are presented for supplemental informational purposes only, should not be considered substitutes for financial information presented in accordance with GAAP, and may be different from similarly-titled non-GAAP measures used by other companies. A reconciliation of these measures to the most directly comparable GAAP measures is included at the end of these prepared remarks. We have not provided the forward-looking GAAP equivalents for certain forward-looking non-GAAP measures presented in the accompanying conference call, or a GAAP reconciliation, as a result of the uncertainty regarding, and the potential variability of, reconciling items such as stock-based compensation expense. Accordingly, a reconciliation of these non-GAAP guidance metrics to their corresponding forward-looking GAAP equivalents is not available without unreasonable effort. However, it is important to note that material changes to reconciling items could have a significant effect on future GAAP results.

*Non-GAAP Gross Profit and Non-GAAP Gross Margin.* For the periods presented, we define non-GAAP gross profit and non-GAAP gross margin as GAAP gross profit and GAAP gross margin, respectively, adjusted to exclude stock-based compensation, amortization of acquired intangibles and payroll taxes related to stock-based compensation.

*Non-GAAP Gross Profit Growth.* For the periods presented, we calculate non-GAAP gross profit growth by dividing (i) non-GAAP gross profit for the period presented less non-GAAP gross profit in the comparative period by (ii) non-GAAP gross profit in the comparative period.

*Non-GAAP Income (Loss) from Operations and Non-GAAP Operating Margin.* For the periods presented, we define non-GAAP income (loss) from operations and non-GAAP operating margin as GAAP loss from operations and GAAP operating margin, respectively, adjusted to exclude, as applicable, stock-based compensation, amortization of acquired intangibles, loss on net assets held for sale, acquisition and divestiture related expenses, payroll taxes related to stock-based compensation, charitable contributions, restructuring costs, and impairment of long-lived assets.

*Non-GAAP Stock-Based Compensation Expense and Non-GAAP Stock-Based Compensation Expense as a Percentage of Revenue.* For the periods presented, we define non-GAAP stock-based compensation expense as GAAP stock-based compensation expense, adjusted to exclude stock-based compensation reflected in restructuring costs.

*Organic Revenue*. For the periods presented, we define organic revenue as GAAP revenue, excluding (i) revenue from each acquired business and revenue from application-to-person (“A2P”) 10DLC fees imposed by major U.S. carriers on our core messaging business, in each case until the beginning of the first full quarter following the one-year anniversary of the closing date of such acquisition or divestiture or the initial date such fees were charged and (ii) revenue from each divested business beginning in the quarter of the closing date of such divestiture; provided that (a) if an acquisition closes or such fees are initially charged on the first day of a quarter, such revenue will be included in organic revenue beginning on the one-year anniversary of the closing date of such acquisition or the initial date such fees were charged, and (b) if a divestiture closes on the last day of a quarter, such revenue will be included in organic revenue for that quarter. A2P 10DLC fees are fees imposed by U.S. mobile carriers for A2P SMS messages delivered to its subscribers, and we pass these fees to our messaging customers at cost. Communications organic revenue is calculated using the same methodology, but using (and excluding, as applicable) only revenue attributable to the Communications segment.

*Organic Revenue Growth*. For the periods presented, we calculate organic revenue growth by dividing (i) organic revenue for the period presented less organic revenue in the comparative period by (ii) organic revenue in the comparative period. If revenue from certain acquisitions, divestitures or A2P 10DLC fees is included or excluded in organic revenue in the period presented, then revenue from the same acquisitions, divestitures and A2P 10DLC fees is included or excluded in organic revenue in the comparative period for purposes of the denominator in the organic revenue growth calculation. As a result, the denominator used in this calculation will not always equal the organic revenue reported for the comparative period. Communications organic revenue growth is calculated using the same methodology, but using (and excluding, as applicable) only revenue attributable to the Communications segment.

*Free Cash Flow*. For the periods presented, we calculate free cash flow as net cash provided by operating activities, excluding capitalized software development costs and purchases of long-lived and intangible assets.

**Key Business Metrics**

We review a number of operational and financial metrics, including Active Customer Accounts and Dollar-Based Net Expansion Rate, to evaluate our business, measure our performance, identify trends affecting our business, formulate business plans and make strategic decisions.

Our key metrics are not based on any standardized industry methodology and are not necessarily calculated in the same manner or comparable to similarly titled measures presented by other companies. Similarly, our key metrics may differ from estimates published by third parties or from similarly titled metrics of our competitors due to differences in methodology. The numbers that we use to calculate Active Customer Accounts and Dollar-Based Net Expansion Rate are based on internal data. While these numbers are based on what we believe to be reasonable judgments and estimates for the applicable period of measurement, there are inherent challenges in measuring usage. We regularly review and may adjust our processes for calculating our internal metrics to improve their accuracy. If investors or analysts do not perceive our metrics to be accurate representations of our business, or if we discover material inaccuracies in our metrics, our reputation, business, results of operations, and financial condition would be harmed.

***Active Customer Accounts***

We define an Active Customer Account at the end of any period as an individual account, as identified by a unique account identifier, for which we have recognized at least $5 of revenue in the last month of the period. A single organization may constitute multiple unique Active Customer Accounts if it has multiple account identifiers, each of which is treated as a separate Active Customer Account. Active Customer Accounts excludes customer accounts from Zipwhip, Inc. Communications Active Customer Accounts and Data & Applications Active Customer Accounts are calculated using the same methodology, but using only revenue recognized from accounts in the respective segment. Because an individual Active Customer Account may be counted as both a Communications Active Customer Account and a Data & Applications Active Customer Account, the sum of the segment-level Active Customer Accounts may exceed our total company Active Customer Accounts.

We believe that the number of Active Customer Accounts, on an aggregate basis and at the segment level, is an important indicator of the growth of our business, the market acceptance of our platform and future revenue trends. We believe that use of our platform by customers at or above the $5 per month threshold is a stronger indicator of potential future engagement than trial usage of our platform or usage at levels below $5 per month.

***Dollar-Based Net Expansion Rate***

Our Dollar-Based Net Expansion Rate compares the revenue from all Active Customer Accounts and customer accounts from Zipwhip, Inc. in a quarter to the same quarter in the prior year. To calculate the Dollar-Based Net Expansion Rate, we first identify the cohort of Active Customer Accounts and customer accounts from Zipwhip, Inc. that were Active Customer Accounts or customer accounts from Zipwhip, Inc. in the same quarter of the prior year. The Dollar-Based Net Expansion Rate is the quotient obtained by dividing the revenue generated from that cohort in a quarter, by the revenue generated from that same cohort in the corresponding quarter in the prior year. When we calculate Dollar-Based Net Expansion Rate for periods longer than one quarter, we use the average of the applicable quarterly Dollar-Based Net Expansion Rates for each of the quarters in such period. Revenue from acquisitions does not impact the Dollar-Based Net Expansion Rate calculation until the quarter following the one-year anniversary of the applicable acquisition, unless the acquisition closing date is the first day of a quarter. As a result, for the quarter ended September 30, 2023, our Dollar-Based Net Expansion Rate excludes the contributions from acquisitions made after July 1, 2022. Revenue from divestitures does not impact the Dollar-Based Net Expansion Rate calculation beginning in the quarter the divestiture closed, unless the divestiture closing date is the last day of a quarter. As a result, for the quarter ended September 30, 2023, our Dollar-Based Net Expansion Rate excludes the contributions from divestitures made after September 30, 2022. Communications Dollar-Based Net Expansion Rate and Data & Applications Dollar-Based Net Expansion Rate are calculated using the same methodology, but using only revenue attributable to the respective segment and Active Customer Accounts and customer accounts from Zipwhip, Inc. for that respective segment. Dollar-Based Net Expansion Rate excluding crypto customers is calculated using the same methodology described above, but excluding revenue attributable to customers that operate in the cryptocurrency space in each respective period. Revenue from customer accounts from Zipwhip, Inc., which we acquired on July 14, 2021, has been included in our Dollar-Based Net Expansion Rate beginning in the quarter ended December 31, 2022.

We believe that measuring Dollar-Based Net Expansion Rate, on an aggregate basis and at the segment level, provides a more meaningful indication of the performance of our efforts to increase revenue from existing customers. Our ability to drive growth and generate incremental revenue depends, in part, on our ability to maintain and grow our relationships with existing Active Customer Accounts and to increase their use of the platform. An important way in which we have historically tracked performance in this area is by measuring the Dollar-Based Net Expansion Rate for Active Customer Accounts. Our Dollar-Based Net Expansion Rate increases when such Active Customer Accounts increase their usage of a product, extend their usage of a product to new applications or adopt a new product. Our Dollar-Based Net Expansion Rate decreases when such Active Customer Accounts cease or reduce their usage of a product or when we lower usage prices on a product. As our customers grow their businesses and extend the use of our platform, they sometimes create multiple customer accounts with us for operational or other reasons. As such, when we identify a significant customer organization (defined as a single customer organization generating more than 1% of revenue in a quarterly reporting period) that has created a new Active Customer Account, this new Active Customer Account is tied to, and revenue from this new Active Customer Account is included with, the original Active Customer Account for the purposes of calculating this metric.

## Non-GAAP Financial Measures Reconciliation

*(in thousands, unaudited)*

| | Three Months Ended September 30, 2022 | Three Months Ended June 30, 2023 | Three Months Ended September 30, 2023 |
|---|---|---|---|
| **Non-GAAP gross margin reconciliation** | | | |
| Revenue | $ 983,030 | $ 1,037,761 | $ 1,033,670 |
| GAAP gross profit | $ 462,075 | $ 505,755 | $ 516,319 |
| GAAP gross profit growth (Y/Y) | | | 12 % |
| GAAP gross margin | 47.0 % | 48.7 % | 50.0 % |
| Non-GAAP adjustments: | | | |
| Stock-based compensation | 6,114 | 6,334 | 7,053 |
| Amortization of acquired intangibles | 30,729 | 29,669 | 29,045 |
| Payroll taxes related to stock-based compensation | 215 | 123 | 181 |
| **Non-GAAP gross profit** | **$ 499,133** | **$ 541,881** | **$ 552,598** |
| **Non-GAAP gross profit growth (Y/Y)** | | | **11 %** |
| **Non-GAAP gross margin** | **50.8 %** | **52.2 %** | **53.5 %** |

| | Three Months Ended September 30, 2022 | Three Months Ended June 30, 2023 | Three Months Ended September 30, 2023 |
|---|---|---|---|
| **Stock-based compensation, net of amounts recognized in restructuring costs** | | | |
| Revenue | $ 983,030 | $ 1,037,761 | $ 1,033,670 |
| Stock-based compensation | 208,895 | 153,094 | 185,474 |
| Stock-based compensation as a percent of revenue | 21.3 % | 14.8 % | 17.9 % |
| Adjustments: | | | |
| Stock-based compensation reflected in restructuring costs | (15,274) | (296) | (467) |
| **Stock-based compensation, net of amounts recognized in restructuring costs** | **$ 193,621** | **$ 152,798** | **$ 185,007** |
| **Stock-based compensation, net of amounts recognized in restructuring costs as a percent of revenue** | **19.7 %** | **14.7 %** | **17.9 %** |

## Non-GAAP Financial Measures Reconciliation

*(in thousands, unaudited)*

| | Three Months Ended September 30, 2023 | Nine Months Ended September 30, 2023 |
|---|---|---|
| **Non-GAAP operating margin** | | |
| Revenue | $ 1,033,670 | $ 3,077,995 |
| GAAP gross profit | $ 516,319 | $ 1,512,764 |
| Non-GAAP adjustments: | | |
| Stock-based compensation | 7,053 | 18,677 |
| Amortization of acquired intangibles | 29,045 | 88,675 |
| Payroll taxes related to stock-based compensation | 181 | 499 |
| Non-GAAP gross profit | $ 552,598 | $ 1,620,615 |
| Non-GAAP gross margin | 53.5% | 52.7% |
| GAAP operating expenses | $625,222 | $2,027,578 |
| Non-GAAP adjustments: | | |
| Stock-based compensation | (177,954) | (479,594) |
| Amortization of acquired intangibles | (19,827) | (61,161) |
| Acquisition and divestiture related expenses | (183) | (5,515) |
| Loss on divestiture | — | (32,277) |
| Payroll taxes related to stock-based compensation | (3,156) | (10,240) |
| Charitable contributions | (1,339) | (3,985) |
| Restructuring costs | (3,437) | (140,281) |
| Impairment of long-lived assets | (3,162) | (34,278) |
| Non-GAAP operating expenses | $ 416,164 | $ 1,260,247 |
| GAAP loss from operations | $ (108,903) | $ (514,814) |
| GAAP operating margin | -10.5% | -16.7% |
| Non-GAAP adjustments: | | |
| Stock-based compensation | 185,007 | 498,271 |
| Amortization of acquired intangibles | 48,872 | 149,836 |
| Acquisition and divestiture related expenses | 183 | 5,515 |
| Loss on divestiture | — | 32,277 |
| Payroll taxes related to stock-based compensation | 3,337 | 10,739 |
| Charitable contributions | 1,339 | 3,985 |
| Restructuring costs | 3,437 | 140,281 |
| Impairment of long-lived assets | 3,162 | 34,278 |
| **Non-GAAP income from operations** | $ 136,434 | $ 360,368 |
| **Non-GAAP operating margin** | 13.2% | 11.7% |

## Non-GAAP Financial Measures Reconciliation

*(in thousands, unaudited)*

| | Three Months Ended September 30, 2023 |
|---|---|
| **Organic revenue** | |
| Total Revenue | $ 1,033,670 |
| Divestiture revenue | — |
| **Organic revenue** | $ 1,033,670 |
| **Revenue growth** | 5 % |
| **Organic revenue growth** | 8%[1] |

[1] Organic revenue for the three months ended September 30, 2022, when used as the denominator for Organic Revenue Growth for the three months ended September 30, 2023, excludes $28.5 million of divestiture revenue. Revenue for the three months ended September 30, 2022 was $983.0 million.

| | Three Months Ended September 30, 2023 |
|---|---|
| **Communications organic revenue** | |
| Communications revenue | $ 906,714 |
| Divestiture revenue | — |
| **Communications organic revenue** | $ 906,714 |
| **Communications revenue growth** | 5 % |
| **Communications organic revenue growth** | 8%[1] |

[1] Communications organic revenue for the three months ended September 30, 2022, when used as the denominator for Communications Organic Revenue Growth for the three months ended September 30, 2023, excludes $28.5 million of divestiture revenue. Communications revenue for the three months ended September 30, 2022, was $866.2 million.

## Non-GAAP Financial Measures Reconciliation

*(in thousands, unaudited)*

| | Three Months Ended September 30, 2023 |
|---|---|
| **Free cash flow** | |
| Net cash provided by operating activities | $ 206,427 |
| Capitalized software development costs | (10,451) |
| Purchase of long-lived and intangible assets | (765) |
| **Free cash flow** | $ 195,211 |

| | Three Months Ended | |
|---|---|---|
| | September 30, 2022 | September 30, 2023 |
| **Organic revenue excluding Crypto industry** | | |
| Total Revenue | $ 983,030 | $ 1,033,670 |
| Divestiture revenue | (28,499) | — |
| Crypto industry revenue | (31,786) | (7,426) |
| **Organic revenue excluding Crypto industry** | $ 922,746 | $ 1,026,244 |
| **Revenue growth** | 33 % | 5 % |
| **Organic revenue excluding Crypto industry growth** | | 11 % |

## Segment Operating Results

*(in thousands, unaudited)*

| | Three Months Ended | | | |
|---|---|---|---|---|
| | September 30, 2022 | | September 30, 2023 | |
| **Revenue:** | | | | |
| Communications | $ | 866,193 | $ | 906,714 |
| Data & Applications | | 116,837 | | 126,956 |
| Total | $ | 983,030 | $ | 1,033,670 |
| **Non-GAAP gross profit:** | | | | |
| Communications | | 401,236 | | 451,330 |
| Data & Applications | | 97,897 | | 101,268 |
| Total | $ | 499,133 | $ | 552,598 |
| **Non-GAAP gross margin:** | | | | |
| Communications | | 46.3% | | 49.8% |
| Data & Applications | | 83.8% | | 79.8% |
| | | | | |
| Reconciliation of non-GAAP gross profit to gross profit: | | | | |
| Total non-GAAP gross profit | $ | 499,133 | $ | 552,598 |
| Stock-based compensation | | (6,114) | | (7,053) |
| Amortization of acquired intangibles | | (30,729) | | (29,045) |
| Payroll taxes related to stock-based compensation | | (215) | | (181) |
| Gross profit | | 462,075 | | 516,319 |
| Operating expenses | | (919,072) | | (625,222) |
| Other expenses, net | | (21,750) | | (31,057) |
| Loss before provision for income taxes | $ | (478,747) | $ | (139,960) |