PagerDuty

Q3 FY25 earnings, November 26, 2024

PagerDuty's Chairperson and Chief Executive Officer, and Chief Financial Officer offer comments after the company released its Third Quarter Fiscal Year 2025 earnings.

The following are the prepared remarks provided on PagerDuty's Q3 FY25 earnings conference call held at 2 p.m. PT on November 26, 2024. These remarks include forward-looking statements that are based on the environment as seen by the company as of the time of the call and, as such, are subject to various risks and uncertainties. They also contain references to non-GAAP financial measures that the company believes provide useful information to investors. Refer to the company's earnings release for Q3 FY25, most recent annual report on Form 10-K/A and other filings with the SEC for more information on the risk factors that could cause actual results to differ materially from the company's expectations and additional information on non-GAAP financial measures, including reconciliations where appropriate to the corresponding GAAP financial measures.

Tony Righetti, **Vice President Investor Relations**

Good afternoon and thank you for joining us to discuss PagerDuty's Third Quarter Fiscal Year 2025 results. With me on today's call are **Jennifer Tejada**, PagerDuty's **Chairperson and Chief Executive Officer**; and **Howard Wilson**, our **Chief Financial Officer**.

Before we begin, let me remind everyone that statements made on this call include forward-looking statements based on the environment as we currently see it, which involve known and unknown risks and uncertainties that may cause our actual results, performance, or achievements to be materially different from those expressed or implied by the forward-looking statements. These forward-looking statements include our growth prospects, future revenue, operating margins, net income, cash balance, and total addressable market, among others, and represent our management's belief and assumptions only as of the date such statements are made and we undertake no obligation to update these.

During today's call, we will discuss non-GAAP financial measures which are in addition to, and not a substitute for, or superior to, measures of financial performance prepared in accordance with GAAP. A reconciliation between GAAP and non-GAAP financial measures is available in our earnings release.

Further information on these and other factors that could cause the company's financial results to differ materially are included in filings we make with the Securities and Exchange Commission, including our most recently filed Form 10-K/A, as well as our subsequent filings made with the SEC.

With that, I will turn the call over to Jennifer.

Jennifer Tejada, **Chairperson and Chief Executive Officer**

Good afternoon, and thanks for joining us today.

PagerDuty delivered a solid quarter with revenue and non-GAAP operating income well above our guidance ranges. Revenue growth increased to 9% and non-GAAP operating margin expanded to 21%.

Net new ARR of $9 million in the quarter was a 21% increase over Q3 of last year. Total annual recurring revenue (ARR) increased to $483 million, growing 10% year-over-year for the fourth consecutive quarter.

We were pleased to see stabilization across all segments in the quarter, with retention improving across the board. That said, we remain focused on growth reacceleration and there is room for improvement, particularly on large deal conversions. We had an unusual number of large Q3 opportunities defer, and while they are not lost, these will delay ARR acceleration to FY26. Nonetheless, we are encouraged by improvements in several key indicators, including dollar-based net retention (DBNR), multi-product adoption, enterprise contract duration, and total pipeline growth.

Converting these multi-year, multi-product agreements is a top priority as the benefits compound in future quarters and represent the manifestation of our customers aligning with us on a joint vision for a more resilient future over a longer commitment period. The comprehensive agreements we secured earlier in the year laid the foundation for sequential improvements in both Enterprise and Commercial gross retention, leading to DBNR of 107%.

As our ramped capacity has increased throughout the year, the number of accounts with ARR greater than $500,000 has risen by approximately 20%, driven by product up-sell and cross-sell. In Q3, AIOps, Automation, and Customer Service Ops contributed more than 40% to incremental ARR.

In October, Forrester quantified the monetary benefits of the Operations Cloud through research with our enterprise customers. As more enterprises adopt multiple products across the broader platform, they realize an average return on investment of nearly 250% over three years, with a payback period of less than one year. This adoption enables enterprises to achieve high availability and significant financial returns.

Product Development during the quarter continued to deliver innovation across the platform, further enhancing the value customers realize from the Operations Cloud. We are addressing several CIO imperatives, including incident management transformation, operations center modernization, and automation standardization.

PagerDuty Advance, our generative AI offering, is now integrated across the platform to automate triage, expedite incident response, summarize communications, and reduce the cost and time to take action. Our generative AI assistant leverages an extensive proprietary data model along with the context of an incident lifecycle to make recommendations and answer common questions. This new unified chat experience with PagerDuty Advance built-in, enables teams to manage an entire incident from within Slack or Microsoft Teams. It was encouraging in the quarter to close our first paid PagerDuty Advance customers.

Our new version of the Operations Console supports operations center modernization by providing comprehensive visibility, which minimizes context-switching and enhances focus. The latest version of Global Intelligent Alert Grouping is generating significant interest by leveraging neural networks to deliver heightened precision, effectively isolating signals and accelerating resolution.

Recognizing that many of our largest customers are investing in automation standardization, we expanded our automation library in Q3. This includes more templates and workflows, as well as runbooks that automate common dev and IT activities. These enhancements address manual, repetitive, and time-consuming tasks such as consolidating log diagnostics, container management, and database management.

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Industry analysts continue to recognize our product leadership as our customers adopt new and existing capabilities of the Operations Cloud, especially AIOps. Recently, we were included among the top 25 solutions in Forrester's AIOps Landscape report, and GigaOm named PagerDuty a Leader for the third consecutive year in its annual GigaOm Radar for AIOps. AIOps and automation are vital as ‘data-driven decision-making’ and ‘advanced analytics’ set a new standard for operations. These trends are accelerating the pace and precision of corrective actions in IT while paving the way for long-term, preventive solutions.

The Enterprise segment continued to grow above the average with particular strength in our core verticals Software and Technology, Financial Services, and Telecommunications. From a geographic perspective, EMEA is emerging as a source of stability that we believe is building a foundation for higher growth in FY26.

Customers within our high-value segments continued a consistent trend of six-figure expansions during the quarter.

For example, a leading digital travel company strengthened its partnership with PagerDuty through a multi-year renewal and expansion agreement. This renewal strengthens the long-term strategic partnership, allowing both organizations to continue collaborating effectively. The company leverages the Operations Cloud for 'scaled service ownership,' aligning with its 'build it/own it' culture.

A top-tier financial services firm also expanded its relationship with PagerDuty, selecting us as its incident response platform. Our unique ability to support both central and distributed teams elevated PagerDuty to become their preferred platform. This marks the sixth expansion in five years, with the organization increasing users by nearly 3x over this period.

Continuing to lead through innovation, a cybersecurity firm has expanded its use of PagerDuty twice in the last 12 months, integrating products such as AIOps, Incident Management, and Customer Service to transform its incident management workflow. The decision to standardize on PagerDuty was driven by the need to prevent and reduce outages, provide quicker customer updates, and increase operational resilience. By moving away from multiple tools and manual

processes, our customer has standardized their resolution process, resulting in reduced operational costs, improved efficiency, and a risk reduction to the business.

During the quarter, we welcomed two new leaders to PagerDuty - Rukmini Reddy, SVP of Engineering, and Pritesh Parekh, Chief Information Security Officer. Rukmini brings a wealth of experience, most recently as the SVP of Engineering at Slack for the past four-plus years. Pritesh joins us from Delphix, where he was the Chief Trust & Security Officer and SVP of Engineering. Their contributions will enable us to continue positioning the Operations Cloud as a strategic asset for all our customers.

Fortune's Best Workplaces recognized us as a top 25 company for Women in their small/medium designation. We also continue to make progress with impact customers, with over 500 from the non-profit sector as of Q3. And, we received validation from the Science Based Targets initiative for our commitments to reduce our operational and supply-chain carbon emissions.

We are well-positioned to exit FY25 with ARR growth poised for reacceleration, supported by rising retention, high-caliber sales hiring, and a robust pipeline. Following several quarters of stability, our primary focus is to deliver a strong fourth quarter of net-new ARR and to carry this momentum into FY26.

I look forward to seeing many of you at AWS ReInvent next week, where I will be speaking during Matt Garman's keynote about our longstanding partnership and co-innovation.

I want to thank our shareholders, customers, partners and employees for their continued support.

With that, I'll turn the call to Howard and look forward to your questions.

Howard Wilson, **Chief Financial Officer**

Thank you, Jenn and good day to everyone joining us on this afternoon's call.

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Unless otherwise stated, all references to our expenses and operating results are on a non-GAAP basis and are reconciled to our GAAP results in the earnings release that was posted before the call.

In the third quarter, we continued to solidify our Enterprise motion and stabilize the contribution from our Commercial segment. This success, along with strong operating margin expansion and improved visibility from building a robust Q4 pipeline, were key highlights for the quarter.

Revenue for the quarter was $119 million, up 9% year-over-year.

The contribution from international was 28% of total revenues, up from 27% in the year ago period.

Annual recurring revenue exiting Q3 grew 10% year-over-year to $483 million. We anticipate a similar growth rate in Q4, slightly below the 11% rate we had been tracking toward. As our business becomes increasingly focused on the Enterprise segment, we continue to learn and adjust our expectations regarding typical seasonality. Our precision in handling large deals is improving as Enterprise momentum builds.

We delivered 107% dollar based net retention, above our Q3 expectation and in line with our expectation for the full fiscal year. Similar to last quarter, Enterprise DBNR remained 10 points above our Commercial segment.

Customers spending over $100,000 in annual recurring revenue grew to 825, up 6% from a year ago.

Total paid customers remained relatively flat year-over-year at 15,050 as growth in Enterprise was offset by a modest decline in the number of Commercial accounts.

Free and paid companies on our platform grew to over 30,000, an increase of approximately 11% compared to Q3 of last year.

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Q3 gross margin was 86%, at the high end of our 84% to 86% target range.

Operating income was $25 million or 21% of revenue, compared to $15 million or 14% of revenue in the same quarter last year. The outperformance relative to our guidance was driven by delays in headcount starts, and timing of marketing and consulting expenses.

In terms of cash flow for the quarter, cash from operations was $22 million, or 19% of revenue, and free cash flow was $19 million, or 16% of revenue. We continue to expect free cash flow margin for the full fiscal year to be ahead of our operating margin by a couple of percentage points.

Turning to the balance sheet, we ended the quarter with $542 million in cash, cash equivalents and investments. In Q3, we repurchased 3.8 million shares from our $100 million repurchase plan, and at the end of the quarter $1.5 million of the total amount authorized to be repurchased remained available.

On a trailing 12 months basis, billings were $478 million, an increase of 9% compared to a year ago, slightly below our 10% target.

With respect to Q4, we anticipate trailing 12 months billings growth to be approximately 9%.

At the end of Q3, total RPO was approximately $405 million. Of this amount, approximately $278 million, or 69%, is expected to be recognized over the next 12 months. As a reminder, as of FY25 our RPO disclosure includes contracts with an original term of less than 12 months. Applying the current definition to the year ago period, total RPO increased 35% on a like for like basis over Q3 FY24, which would have been $298 million.

Turning to our guidance…

For the fourth quarter fiscal 2025, we expect:

- Revenue in the range of $118.5 to $120.5 million, representing a growth rate of 7% to 8%.
- And,
- Net income per diluted share attributable to PagerDuty Inc. in the range of $0.15 to $0.16. This implies an operating margin of 13%.

For the full fiscal year 2025, …

- We are raising the midpoint of revenue with an updated range of $464.5 to $466.5 million, representing a growth rate of 8%. This compares to the range previously provided of $463 to $467 million.
- And,
- We are increasing our expectation for net income per diluted share attributable to PagerDuty Inc.to $0.78 to $0.79. This implies an operating margin of 16% and compares to our prior guide of $0.67 to $0.72 and 14%, respectively.

Reflecting on the year so far, we have stabilized ARR growth at 10%, maintained steady DBNR, and moderated growth headwinds in the Commercial segment. Additionally, we have significantly expanded our operating margins while continuing to mature and grow our Enterprise pipeline. Exiting the year with a 10% ARR growth rate provides a strong foundation for the upcoming fiscal year.

With that, I will open up the call for Q&A.