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JFrog Ltd.

Fourth Quarter Fiscal 2023 Financial Results Conference Call

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CORPORATE SPEAKERS:

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Ed Grabscheid
JFrog Ltd.; Chief Financial Officer
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Truist; Analyst
Mark Bachner
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Cantor Fitzgerald; Analyst
Robbie Owens
Piper Sandler; Analyst
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PRESENTATION:

Operator^ Ladies and gentlemen, thank you for joining us. And welcome to JFrog's Fourth Quarter and Fiscal 2023 Financial Results Conference Call.

I'll hand the conference over today to Jeffrey Schreiner, VP, Investor Relations.

Jeffrey, please go ahead.

Jeffrey Schreiner^ Good afternoon. And thank you for joining us as we review JFrog's fourth quarter and full year fiscal 2023 financial results, which were announced following the market close today via a press release.

Leading the call today will be JFrog's CEO and Co-Founder, Shlomi Haim; and Ed Grabsheid, JFrog's CFO.

During this call we may make statements related to our business that are forward-looking under federal securities laws and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, including statements related to our future financial performance, including our outlook for Q1 and the full year of 2024.

The words anticipate, believe, continue, estimate, expect, intend, will and similar expressions are intended to identify forward-looking statements or similar indications of future expectations.

You are cautioned not to place undue reliance on these forward-looking statements, which reflect our views only as of today and not as of any subsequent date.

Please keep in mind that we are not obligating ourselves to revise or publicly release the results of any revision to these forward-looking statements in light of new information or future events.

These statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations.

For a discussion of material risks and other important factors that could affect our actual results, please refer to our Form 10-K for the year ended December 31, 2022, and our most recent report on Form 10-Q, which is available on the Investor Relations section of our website and the earnings press release issued earlier today.

Additional information will be made available in our Form 10-K for the year ended December 31, 2023, to be filed with the SEC on February 15, 2024, and other filings and reports that we may file from time to time with the SEC.

Additionally, non-GAAP financial measures will be discussed on this conference call.

These non-GAAP financial measures, which are used as a measure of JFrog's performance, should be considered in addition to, not as a substitute for or in isolation from GAAP measures.

Please refer to the tables in our earnings release for a reconciliation of those measures to their most directly comparable GAAP financial measures.

A replay of this call will be available on the JFrog's and Investor Relations website for a limited time.

With that, I'd like to turn the call over to JFrog's CEO, Shlomi Haim.

Shlomi?

Shlomi Haim^ Thank you, Jeff. Good afternoon to you all. And thank you for joining the call. I'm proud to report that JFrog's closed fiscal year 2023 on a strong note with quarterly and annual results that exceeded our guidance.

Despite macroeconomic and geopolitical headwinds, JFrog delivered on our commitments to the market, driving consistent revenue growth and profitability. Our commitment to meeting extending market demand through a unified platform that integrates DevOps security and MLOps across the entire software supply chain, extending to the edge device once again both fruit this quarter and throughout the entire year.

This is evident in the significant adoption of our platform by the enterprise, which will also be discussed in today's call. In fiscal year 2023, JFrog delivered total revenue of $349.9 million, up 25% year-over-year. JFrog's fourth quarter revenue was $97.3 million, reflecting 27% year-over-year growth with a gross margin of 84.6% and $32 million in free cash flow. Our cloud revenue continued to show momentum in Q4, equaling $36 million, a growth of 59% year-over-year. This growth was primarily driven by our cloud first and multi-cloud strategy, which powered growth in cloud platform subscription as well as increases in consumption.

In Q4, JFrog customers with ARR greater than $100,000 grew to $886 compared to 736 in the prior year, increasing 20% year-over-year. Customers with ARR greater than $1 million increased

to 37%, up from 19% in the year ago period, growing 95% year-over-year, which we attribute to our strategic investment in the enterprise top-down go-to-market approach. Now I will address some of the market themes we are observing and standard set by JFrog. Developers and machines on the left as well as production owners and hackers on the right, continue to be laser focused on the binary as the key assets being utilized throughout the software supply chain. We believe the DevOps, DevSecOps, MLOps and MLSecOps will continue to converge into a single system of records for the enterprise.

The most important asset, binaries, is at the core of every software supply chain and will need to be effectively secured and managed by every organization. As we observe in the market, a fast and trusted software supply chain flow with embedded security is a flow of binaries. This trend drove some of our customers' top priorities in Q4 as well as emerging opportunities in our markets. On today's call, I will discuss cloud consumption and cloud migrations. Next, I will cover the enterprise demand for modern holistic security solutions, then the trend of point solution tooling consolidation around the JFrog software supply chain platform; and finally, discuss the emerging opportunities for AI and ML tooling.

First, I will address our cloud business. Early in 2023 due to the macroeconomic changes and cost optimization efforts by our customers, some cloud initiatives were delayed. Slowly into the year, we saw an improvement in the frequency of on-prem to cloud migration projects being restarted alongside expanding consumption in the second half of the year, as we shared in previous calls. We sold themes of platform consolidation and modern security tool adoption together with DevOps capabilities in the cloud becoming the stand-off. Late in Q3, JFrog teamed with a large-scale deal with AT&T to become the single source of record for secure binary management and delivery, including with our advanced security offerings.

Working hand-in-hand with AT&T's leadership teams, JFrog was chosen as a strategic partner to consolidate software supply chain tools with a single platform in the cloud. AT&T's General Manager and Vice President of R&D, Ronald Weinstein noted, "With tens of thousands of developers building applications across our business, we need a single system of record to allow us to shift left effectively as well as take advantage of all the benefits cloud has to offer a modern business. We are proud to be working with JFrog as we move towards a consolidated scalable infrastructure to build the next generation of applications to serve hundreds of millions of our customers." Platform and cloud priorities are not unique to AT&T. Recent public CIO surveys have validated a 2024 cloud spend for application development, DevOps, security and machine learning are anticipated to see improving growth trends relative to the slower

environment seen in 2023. JFrog is positioned to answer this exact demand, not only in a hybrid but also in a multi-cloud robust environment.

Second, we see continued interest in holistic DevSecOps solution as part of our platform. JFrog is partnering with enterprises across the globe to improve software development and consolidating DevSecOps solutions, including in highly regulated or compliance-driven environments like public service. IVU Traffic Technologies, a leading provider of civil engineering IT systems in Germany recently chose JFrog to instill trust and efficiency in their software development and application security efforts. IVU has spent the last 45 years partnering with local governments to build IT systems that ensure efficient and environmentally friendly public transport. To ensure top-notch service and smooth transportation for city residents, IVU partnered with JFrog to meet their holistic security needs, including investments in JFrog Curation, cost scanning, also known as SaaS and the prioritization of CVEs with contextual analysis for their developers.

IVU, chose JFrog Curation and JFrog Advanced Security to consolidate DevSecOps capabilities using one platform with a single source of record at its pace. In another example, we were excited to bring on board Israel's leading health care provider, Clalit. With over 5 million subscribers and a workforce of 50,000 employees, Clalit stands as one of the largest HMOs in the world. In the fourth quarter of 2023, Clalit, an active user of Artifactory and X-ray approach fog with a request to migrate from SNC and incorporate Jovan security into their system. This strategic move aims to streamline their solutions and enhance capabilities, especially in sectors like cod scanning within the JFrog Software supply chain platform.

Clalit Security Product Manager, (inaudible) said, "Integrating additional security features within a single reliable source of proofs like Artifactory aligns with our strategy to centralize our operations on one software supply chain platform, leading to cost savings and improved scalability and development efficiency. The JFrog platform with Artifactory at its core that seamlessly integrates with JFrog Security effectively fulfill these objectives".

CIOs and CISOs are seeking to streamline the complexity costs by numerous tools and point solutions, which not only duplicate each other's functions, but also fail to provide end-to-end visibility across the software supply chain.

Our customers tell us that those tools must integrate with binary repositories like JFrog Artifactory to safeguard and effectively trace their binaries. We believe the trend of security tool

consolidation in a single platform will continue, with JFrog uniquely providing an end-to-end solution covering from a developer's environment to production, creating a holistic DevSecOps toolset.

Third, I want to address growth in the enterprise adoption of the JFrog platform.

The move toward a unified universal platform for the enterprise is not only a technology or tool initiative, but also a change we see in how companies are being structured to streamline digital deliveries. We see words like CIOs and CISOs becoming one and cloud migration projects targeting multiple aspects like tooling consolidations to achieve speed and trust throughout the software flow.

One example of a visionary company Vimeo, a leading video platform provider boasting 300 million global users. As part of their digital transformation initiatives, Vimeo recently took a step forward in their journey, moving from a self-hosted artifactory-only subscription to an enterprise-level cloud subscription. This upgrade positions Vimeo to effectively scale their DevOps and DevSecOps initiatives across their global teams in a single platform, ensuring the secure and timely delivery of updates to cater to their vast customer base.

Mark Arthur, the Chief Information Security Officer of Vimeo emphasized their commitment to providing top-notch digital experiences to their users while prioritizing the highest levels of security in the software development pipeline. It stated The JFrog platform's cloud offering empowers businesses like Vimeo to rapidly expand, reduce maintenance overhead and offload management costs. It meets the evolving needs of our growing audience.

JFrog's software supply chain platform infuses confidence by serving as a single source of record with Artifactory at the center and providing visibility across Vimeo's DevSecOps walk-through. Our portfolio contains thousands of companies like Vimeo that started with Artifactory only. The story gives us confidence that the adoption of an end-to-end software supply chain platform is not an option for the enterprise, but an imperative to support modern business needs.

We look forward to assisting these portfolio companies as their maturing needs drive them toward cloud and higher-value subscriptions. Now I want to address opportunities in MLOps and MLSecOps within the JFrog platform. As we continue to observe the rapid adoption of AI and ML technologies across the market, many of the same enterprise software pains remind us of the early days of open source as developers are running quickly in a machine learning and AI

gold rush, companies are telling us that they have similar feels from 20 years ago. What's in that artifact? How does it comply with business policies?

How do we track which model is being used? How do we know who brought the model into the organization and more? We believe the MLOps market is in the very early days. And as it matures, JFrog is well positioned to deliver unique value that addresses these familiar pain focusing on the main ML assets yet another binary, cashing, versioning, hosting, storing, training, securing and more are outperformed on ML models. Companies that blindly adopt AI technology without this binary discipline will be challenged to keep up with innovation while possibly exposing themselves to a higher risk and complexity at scale.

As an example, following our support for the cashing, malicious model scanning and license compliance features for the popular ML model repository hugging phase, we recently announced a partnership with AWS to integrate the JFrog platform with their ML development and deployment solutions, SageMaker.

Our customers ask JFrog and AWS to meet two critical requirements, integrate a leading tool for building and training models from AWS and the ability to host, manage and secure those models as part of the software supply chain flow through JFrog. We remain in the early stages of standard building around AI and ML technologies and look forward to driving further JFrog platform extension into the MLOps area.

Finally, I would like to add a few words about the enterprise go-to-market changes we have successfully applied. AT&T, Vimeo, IVU Technologies and Clalit are all demonstrating what we have shared as our go-to-market strategy over the past few years.

JFrog not only built and expanded our technology offering, but also moved from inbound bottom-up sales processes to enterprise top-down motion. We best serve the enterprise, and we strive to build value around enterprise pains.

Therefore, our team was focusing 2023 on extending our customer portfolio with companies that meet this profile and lend with a higher ASP and a higher propensity to expand faster. With this approach in mind, in fiscal 2023, we were pleased to extend our customer count to approximately 7,400 versus 7,200 in the prior year.

With that, I will turn the call over to our CFO, Ed Grabscheid, who will provide an in-depth recap of Q4 financial results and update you on our outlook for both Q1 and fiscal year 2024.

Ed?

Ed Grabscheid^ Thank you, Shlomi. And good afternoon, everyone.

During the fourth quarter of 2023, total revenues were $97.3 million, up 27% year-over-year. For the full fiscal year 2023, revenues were $349.9 million, up 25% year-over-year. As noted by Shlomi, we saw continued reacceleration in cloud customer usage during the fourth quarter. with revenues equaling $36 million, up 59% year-over-year and representing 37% of total revenues, first 30% in the prior year.

For fiscal year 2023, our cloud revenues equaled $119.3 million, up 50% year-over-year and equaled 34% of total revenues versus 28% in the prior year.

During the fourth quarter, we saw six points of onetime growth year-over-year or roughly $1.5 million within our cloud revenues. The majority of onetime contributions came from higher than typical revenue true-ups. The growth above our guidance of a rate in the mid-40s for our cloud business in 2023 is driven by increasing customer usage trends and strong growth within our greater than $1 million customer cohort. Self-managed revenues or on-prem were $61.3 million, up 14% year-over-year during the fourth quarter.

For the full year 2023, self-managed revenues increased 15% compared to the prior year. We expect the trend of slower expansion within our self-hosted business to continue through 2024 as more new customers land and expand in our cloud solutions. Net dollar retention for the four trailing quarters has stabilized as projected at 119%, a decline of nine points year-over-year due to macro headwinds and slower cloud migration trends. Our gross retention rate remained at 97%.

During 2023, we saw another year of strong customer adoption of the complete JFrog platform driven by customers looking to consolidate and secure their software supply chain.

In Q4, 49% of total revenues came from Enterprise Plus subscriptions, up from 43% in Q4 2022. Driven by the strong execution of our top-down go-to-market strategy and platform consolidation, revenue contribution from ePlus subscriptions grew 50% year-over-year in 2023.

Now I'll review the income statement in more detail. Gross profit in the quarter was $82.3 million, representing a gross margin of 84.6% compared to 83.7% in the year ago period. The increase in gross margin relative to the year-ago period is attributable in part to optimization within our cloud hosting costs and ongoing cost discipline efforts.

We expect annual gross margins will remain between 83% and 84% in the near future and then trend towards the low 80s aligned with our long-term model as cloud revenues become a greater portion of our total revenue. Operating expenses for the fourth quarter were $66.1 million, up $3.9 million sequentially, equaling 68% of revenues, up from $62.5 million or 82% of revenues in the year ago period. We continue to remain focused on expense discipline while investing and scaling our enterprise sales team and channel partner ecosystem. Our operating profit in Q4 was $16.2 million or 16.6% operating margin compared to an operating profit of $1.6 million or 2.1% operating margin in the year ago period, a 14.5% improvement in operating margin. In 2023, we delivered another year of non-GAAP net income profitability with earnings per share of $0.51 based on approximately 109 million weighted average diluted shares compared to $0.04 per share in the prior year and 105 million weighted average diluted shares.

Turning to the balance sheet and cash flow. We ended the year with $545 million in cash and short-term investments, up from $443.2 million as of December 31, 2022. Cash flow from operations was $32.6 million in the quarter. After taking into consideration our CapEx requirements, free cash flow was $32 million or 33% free cash flow margin, representing a quarterly record for JFrog. For the full fiscal year 2023, we generated $74.2 million in operating cash flow and $72.2 million in free cash flow or 21% margin, a free cash flow annual record.

We remain committed to our free cash flow margin targets provided within our long-term model, implying an estimated midpoint of 28% over the coming years. As of December 31, 2023, our remaining performance obligation totaled $259.8 million. Now I'd like to speak about our outlook and guidance for the first quarter and full year of 2024. Our outlook for 2024 implies continued strength within our cloud business, driven by expectations for increasing customer usage along with stable growth and migrations similar to the second half of 2023. We estimate fiscal 2024 baseline cloud growth around the mid-40s for the full year.

Given the dynamics of our self-hosted and cloud business in 2023, we now expect our net dollar retention ratio to be in the high teens exiting the fiscal year 2024.

We will continue to expand operating expenses on a dollar basis during 2024 but see continued room for operating leverage driven by ongoing cost optimization offset by investment in strategic sales and channels, combined with targeted R&D spending on future growth opportunities.

For Q1, we expect revenues to be between $98 million and $99 million, equaling around 23% year-over-year growth at the midpoint, with non-GAAP operating profit between $12.5 million to $13.5 million and non-GAAP earnings per diluted share of $0.13 to $0.15, assuming a share count of approximately 113 million shares.

For the full year of 2024, we anticipate a revenue range between $424 million and $428 million.

Non-GAAP operating income is expected to be between $56 million and $58 million and non-GAAP earnings per diluted share of $0.58 to $0.60, assuming a share count of approximately 116 million shares.

Now I'll turn the call back to Shlomi for some closing remarks before we take your questions.

Shlomi Haim^ Thank you, Ed. Less than a week ago, Israeli observed their annual family day a day to acknowledge and express gratitude for the family members in their lives. It has been over four months since many families were torn apart by the brutality of the terror organization Hamas. As we speak, over 130 postages including infants, mothers, are individuals and civilians are still being held in underground pages in Gaza.

We pay for a fast and safe return of the hostages to their loved ones, to their families, and we stand in solidarity with Israel, hoping for a peaceful future in the region.

To the JFrog team, your results and resilience amid these challenges are unmatched, and I'm proud to represent your hard work in 2023. You exceeded our commitment to the market and delivered in a challenging macroeconomic and geopolitical environment. My team, you have the spirit of lions and heart of frogs, I can't wait to win 2024 with you. To our shareholders, we continue to believe that JFrog is well positioned to achieve success as we focus on sustainable growth drivers across DevOps, security and MLOps, all delivered to the enterprise by our software supply chain platform. We are committed to the long-term model shared with you early last year and are happy to report on the solid execution in 2023.

Our performance is the result of (inaudible) us. Thanks for attending our call today. Happy Valentine's Day and may the force be with you. Operator, we are now open to take questions.

Operator^ (Operator Instructions) Our first question comes from the line of Sanjit Singh with Morgan Stanley.

Sanjit Singh^ I guess one word, wow, spectacular quarter, particularly the cloud results. And so let me start with the cloud business. I don't think I've seen acceleration in the cloud business, particularly in Q4 in a number of years. And so, some was hoping if you could give me some detail on why you saw the inflection that you did by our mass sort of incremental dollar adds or up well over 200% year-over-year. And so, it seems like a pretty major inflection when a lot of other cloud consumption companies have a seasonally weak December, those types of dams, you guys didn't see that.

So I would just love to better understand underneath the covers, what's driving the acceleration?

Shlomi Haim^ Sanjit, thank you for the kind feedback. Yes. We performed very well on the last quarter, especially in the cloud with 59% year-over-year growth. And what we have seen is what we projected in the second half of 2023. Unlike the freezing momentum we had in the beginning of the year, we started to see our customers, especially the enterprise helping to climb back up with the consumption.

While migration to the cloud is still coming with some hesitation, consumption is back, especially around the infrastructure and especially when you bet your software delivery and software supply chain security and DevOps on the cloud infrastructure, we were very happy to see this coming back as projected.

And as we guided for the next year, we are seeing this momentum in consumption keeps happening.

Ed Grabscheid^ Yes, Q4 is a seasonably high renewal quarter for us. So some cloud customers at the end of those contract terms may require revenue true-ups based on their differences between the actual data consumption and contractual commitments to those true-ups that we discussed, the majority of those are happening because of the circumstance. It hasn't been material in the past, but we thought we called them out in this call.

Sanjit Singh^ And just sort of as a follow-up to that, any way to like quantify those true-ups and those impacts in Q4? And then looking more broadly into 2024, it seems like we're on the custom of a new sort of innovation cycle. And given the way sort of JFrog prices its solutions and now you have a growing cloud business, if software development projects are coming back in a meaningful way this year, how does that sort of impact JFrog from a financial revenue top line growth perspective, if you could sort of draw on improving potential budget environment, software development projects coming back? How does that -- how do you expect that to influence the numbers going into 2024 and beyond.

Shlomi Haim^ So the -- right now, what we see is that consumption continues to have improvements. And we saw that in the second half of this year, and we anticipate that to be the same through 2024. Migrations have not increased, although we saw a slight increase in the second half of 2023, we anticipate stabilization of those large customer migrations in 2024. We're certainly not back to the same levels that we saw during 2022. We see a broadening of the budget, then we may see improvements in the large customer migrations, and that could potentially increase.

But for now, we're staying tactically cautious, and we're seeing our cloud in the mid-40s growth.

Operator^ Our next question comes from the line of Pinjalim Bora with JPMorgan.

Unidentified Participant^ This is [Racha] on for Pinjalim. Can you help us understand the puts and take about the advanced security and the curation and how you're thinking about it in terms of the contribution for 2024?

Shlomi Haim^ This is Shlomi. I'll take this one. Security is embedded in our platform.

During 2023, we started to release quarter-by-quarter, more and more solutions around the (inaudible) to secure the software supply chain. JFrog van Security was the first copulation then follow.

There are more to come. And we see customers now looking to consolidate point solutions around one platform. So as we guided the market, we assume that security will become a material part of our revenue in 2024.

Operator^ Our next question comes from the line of Mike Cikos with Needham & Company.

Michael Cikos^ If I could come back to -- I think it was building all from your response to Sanjit's second question regarding what's in the guidance here. And so, I know that you guys are saying, hey, consumption continues to show these improvements. We've seen it in the second half of calendar '23, we expect that to persist in '24. That I understand. I think will confuse me, and this might have been your comment, and I really just want to crystallize this year, but I think the comment was migration saw a slight increase in 2H CY '23 but we anticipate stabilization in '24.

And I just -- can you better contextualize that for me? Like are we expecting stabilization of that secondhand base? Or are we just assuming that the migrations continue to remain almost a little bit more head when thinking about customers' propensity to go through that migration.

Shlomi Haim^ What we see in the cloud is a result of two avenues of gold. Avenue number 1 is the consumption, more data transfer more storage and our customers are going with us, those that are already in the cloud. What happened in the beginning of 2023, the end of 2022, is that some of the strategic migration projects were put on hold by the customers, our on-prem customers and prospects in the market kind of delayed workload migration to the cloud. And while we started to see a momentum of coming back with the consumption with those that are already in the cloud, we didn't see kind of the same calls on the migration project that we released to start moving to the cloud. Now why is that?

Mainly because of the fact that if you strategically took a decision to move to the cloud and you didn't start yet, you want the macro economy to stabilize and then you will kick off the project again. If you are already in the cloud, it's easier for you to scale with the consumption. What we assume is that in 2024, we will see more projects of cloud migration happening and still the same momentum of consumption. And therefore, we wanted to stay conservative with how we project the growth in 2024 and guided to mid-40% again.

Michael Cikos^ Understood. Thank you for laying that some. I really do appreciate it. And I also just wanted to come back -- in your prepared remarks, I know you cited the customer count, which we get on an annual basis, and I appreciate we're a 7,400 now. And a year ago, we were at 7,200.

But I was interested, there was a specific comment that you had in relation to the customer count, which said these newer customers you're adding to the portfolio are coming on with

higher ASP lands and a higher propensity to expand. And I wanted to get some more color on those two dynamics as well. Could you either give some more color or detail regarding those ASP lanes that you're seeing? It makes sense intuitively just given the expansion of the platform that we have, where we are today versus just a year ago, but wanted to see if we could get something more on that dynamic.

Ed Grabscheid^ Yes, Mike, well, you followed JFrog for quite some while. You remember today that the bottom-up inbound sales was 90% of our revenue. And we slowly in the past three years, a shift from a bottom up from developers up to a top-down outbound mechanism. Part of what we have done, we also identified what logos we want to go after. And you cannot treat the $1 million land the same as you will do with the $1,000 logo, the plans and expand floor -- so we and our team towards this direction.

We aimed our solutions, technologies and platform towards this direction. We started to work with partners in China towards this direction and still scale 200 net new customer logos within our portfolio. What we see with this logo is that they are not only lending with a higher ASP, they also go faster than the logos that started from free tier or from open source and slowly group. Now this is not to say that we are dropping the ball on the SMB. But when I guide the team, I need to make sure that they are focused not only on what logo we are after, but also what value can we bring to the enterprise versus what value can we bring to the S&P.

Therefore, I'm very pleased with this result, and this would be the focus moving forward as well.

Operator^ Our next question comes from the line of Koji Ikeda with Bank of America.

Koji Ikeda^ Just a couple for me here. I wanted to ask a question on optimization. In the prepared remarks in the guidance, there was a mention of optimization. I just wanted to be very clear here. Are you calling out that some companies might still be having optimizations?

Is that more or less what's going on? Do you anticipate optimizations to continue? Does the guidance incorporate a fair amount of optimization assumptions? Or did I just completely mishear that? And are optimizations more or less in the rearview mirror for you guys?

Ed Grabscheid^ Koji, this is Ed. No. The comment was not about optimization from customers. This is more internal and the optimizations that we have internally to drive leverage in our P&L.

Koji Ikeda^ Got it. And then I wanted to have a follow-up on the net revenue retention. Clearly, here at 119%, it looks like it's stabilized. Is it safe to say it's bottomed and it should expand from here? And just to really think it through, if it were to dip again, what would be the causes of that?

Ed Grabscheid^ Yes. So Koji, we feel that the net dollar retention rate has stabilized, and we're saying we'll be within the high teens, the high teens means between $1.17 to $1.19, but we feel like we've stabilized net dollar retention at this point.

Operator^ Our next question comes from the line of Ittai Kidron with Oppenheimer.

Ittai Kidron^ I'm kind of tying some of the points that Arista mentioned on the call. I'd love to get more better understanding is the relative contribution of migrations versus new to your cloud business. Can you give us a little bit more quantitative, if not qualitative assessment of the relative contribution of those two to the growth? And related to (inaudible), I know your focus has been clearly on expanding customers. But if cloud, if cells is self-serve, is there no room for better or faster new customer additions.

It feels like the technical complexity of ramping is a new customer should be significantly lowered. Why should that not unlock by still faster new customer additions?

Shlomi Haim^ You have a very good question. It's not just consumption versus migration. It's also migration and prospects in the cloud. So what I would say to that point is that the majority of our prospects are not even considering self-hosted. It's not the 10 years ago market that it was a debate.

Most of our prospects will start in the cloud unless they are in a highly regulated environment, and therefore, they will look for self-hosted solutions. So new customers will usually land in the cloud. We provide a multi-cloud solution; we provide a hybrid solution. It gives them all the options. Regarding the new lower account, well, listen, this is a company that builds the platform and added technologies and new persona entered new addressable market moved from open source bottom up, down enterprise sales.

I committed to you guys that we will be focused on a very strong execution and deliveries of what we promise. And in order to do that, we have to choose our bottles. And in order to choose but I'm asking my team, what is it that you have in your pipeline, and we have to choose

from the pipeline, what we'll deliver on the results that would be aligned with the guidance and the long-term model. So maybe in the future, we will invest more, but there is that much we can do without distracting the company anything we chose well.

Ittai Kidron^ Okay. Very good. And then as a follow-up, I can't help but feel somehow that the tone in the call now is a little bit different than what it was in the last 2, three quarters in the sense that through '23, you were very much focused on security and clearly rolling out advanced security and curations. And while you did mention DevSecOps currently on this earnings call, it wasn't what you've kind of led with, which was the case 2, three quarters ago. And so, I want to make sure I'm not missing anything here.

As I think about ‰ыч24 and perhaps even a little peak into '25. When you look at your growth drivers, is cloud/pushing customers into the enterprise plus here, a bigger driver to you than what security-like -- how should we qualify how big of a contributor do you think about -- do you think security is for you over the next year or 2? Is it a small driver or a big driver? I just want to make sure I'm not losing focus here.

Shlomi Haim^ Thank you for this question. Security was in our focus for the past two years since we acquired Vimeo. We built a full security suite with epoetin security with copulation with a static analysis. We started to migrate customers from point solutions to our security solution, but it was only released two quarters ago, as you remember. Now security is embedded into our platform.

And the main differentiator that JFrog brings to the market as a security provider is that we also bring it with the Artifactory in the center with a single source of record. We protect your assets from the get-go all the way through the releases. So for sure, security is a very important piece when we are offering our customers to upgrade to higher subscription and price ends and enterprise flats. Still, cloud growth is a very important item in our cost planning and having cloud growing not only on DevOps, but with security, I think we will see other numbers in consumption, and we might even see companies coming to JFrog because of security first, although it's still not the majority of our revenue, not in '24, but not in '25. It will become material, but not the majority of our revenue.

Operator^ Our next question comes from the line of Miller Jump with Truist.

Miller Jump^ And I'll echo my congrats on the strong results. I guess just starting customers over $1 million in ARR really picked up steam in the second half. Given the go-to-market investments that you saw driving this, is this something that you all feel you actually might have the ability to accelerate with more investment there? Or is it a matter of customers getting more mature and demanding the full platform?

Ed Grabscheid^ So it's really -- at this point, it's difficult to know. This is a customer decision, and it requires commitments to budgets and resources. And at this point, it's unknown. We have good line of sight in the first half of the year. But in terms of the second half, we don't have as much visibility.

So it's really, at this point, difficult for us to know if that accelerates.

Jacob Shulman^ Then I will add to -- Miller - sorry, this is Shulman. I just want to add to it. We are looking at the customers over $1 million, obviously, outstanding results, and we built this momentum throughout the year. But there is also a growth in the over $100,000 customers.

And these customers are slowly climbing. There are still a lot of customers that are falling between 0.5 million to $999 million that we are not reporting. So we need to bring more value to let them kind of embrace the food solution from JFrog. And then I think you will see this momentum keep happening.

Miller Jump^ Definitely. That's helpful, and we're looking forward to the continued execution there. I guess maybe one more for Ed. Just on the cloud side. Could you just remind us what you're seeing in terms of growth characteristics from your cloud customer base versus self-managed customers in terms of maybe like a net retention basis and how that could impact the model as we get more mix shifted to cloud.

Ed Grabscheid^ Yes. So we have significantly higher net dollar retention rates coming from our cloud versus our self-hosted. This is the reason why we continue to invest in the cloud and the migrations from self-host to the cloud because we see better outcomes in terms of our growth and the net dollar retention rates on the cloud side.

Operator^ Our next question comes from the line of Mark Bachner with Stifel.

Mark Bachner^ I think on security, you guys talked about it being material after releasing a few quarters ago. So just hoping to get sort of a comparison on MLOps and where you guys see that the early [POC] activity and how you see that maturing in comparison to how security has matured over the last few quarters?

Shlomi Haim^ So regarding security in the world of MLOps, what we call MLSecOps, what we see now the quarter after we released the support for having phase and the native support in Artifactory and x-ray on scanning malicious models is that no enterprise, no enterprise ignore the revolution that AI brings. So they all try to set some sunup policies around what is the right and safe way to use ML models within the software supply chain. Artifactory serve as the package motor the package, yet another binary and therefore, x-ray can them. So we know already that our customers are setting the single source of record for MLOps with what we released. What you should expect in the future during '24 and '25, the extension of the MLOps and MLSecOps solution coming from JFrog.

It goes hand-in-hand, security and ML-model ML hosting in the platform. So that's how we plan to extend our solution for MLOps and not just DevOps.

Operator^ Our next question comes from the line of Kingsley Crane with Canaccord.

Kingsley Crane^ Congrats on the fantastic quarters. So Shlomi, I want to start with you. I appreciated your comments about how you're helping customers build with Inala -- within the DevOp space, I think you're relatively unique in that you're more highly concentrated in really large enterprises. Just curious what you're seeing in terms of AI, ML developer activity, how much that has changed in the past year? Trying to get a better sense of how much of this is concentrated within large enterprises versus some of these newer found companies in the past 2, three years?

Shlomi Haim^ Yes. That's a great question. Some of it will come from our very early experience in the world of MLOps, some of it from the service we are leading and customers' consultation. It is very clear now that the DevOps service providers within the organization, the security service providers within the organization will also cover the service that is required to support the adoption of MOpPs and MLSecOps. Therefore, Artifactory is playing a key role as a repository for model and proxy and cashing for model and X-ray and our security solutions are covering the aspects of MLSecOps to secure it while using it. So I think that what we should

expect is DevOps engineers and ML engineers becoming one to provide services to the consumers with inside their organization, data scientists, piton developers and so on.

With regard to what we hear from the customers is that they are planning -- AI is running 1,000x faster than this option we saw in the past. And they are planning to have some of these assets in production during 2024. Therefore, we were early in 2023, starting to work on it, release it to GA in the last quarter of the year. And now our platform is getting more and more mature to support the demand that is coming from our own customers at have ops engineers that are not supporting the MLS initiative.

Kingsley Crane^ That's really great to hear and really helpful. And so just add 1 million customers and 100,000 customers, they're both progress really nicely in this past year. Just want to hear more thoughts about what you think is the biggest unlock for you? And then how much could be attributed to an increase in development activity versus just maybe vendor consolidation?

Ed Grabscheid^ So really, as Shlomi mentioned previously on the call that we have quite a bit of customers that are sitting between that $0.5 million to $999 $900,000. This really becomes an unlock through technology, so developing technology, adding new features and then being able to increase ASPs to drive above $1 million. So we see opportunity there. in terms of driving that increase to the $1 million customer. In addition to that, we talked about as we build our top-down model and we invest in the enterprise in the go-to-market, we're landing at a much higher ASP, and we're bringing in better quality customers, and those customers have more durable growth.

That will get us to the $100 million customer quicker.

Shlomi Haim^ Yes. And to add to it, when we are building the plans for 2024, I think that the momentum that we would see from one quarter to another will be similar because customers are also starting the year, starting to plan the budget. Not everyone jumps and spend it all on the first quarter. So we built this alongside with our product and R&D road map to make sure that when the value is there, they will not hesitate to take the best with progress they did in 2023.

Operator^ Our next question comes from the line of Yi Fu Lee with Cantor Fitzgerald.

Yi Fu Lee^ Congrats on the strong finish to 2023. First one for Shlomi. In terms of your cash down, great to see that you went from about $400 million to over $500 million right now. Any thoughts of like large M&As or even tuck-ins to like further enhance the platform? And then I have one for Ed.

A quick follow-up for Ed.

Shlomi Haim^ That's a great question. I don't know what large M&A means every time I hear a --

Yi Fu Lee^ Tuck-ins.

Shlomi Haim^ M&A are part of our strategy. We have a full team that set the radar for the next few years as we discuss our M&A strategy. As you know, JFrog acquired nine companies in the past years. And we plan to grow inorganically as well. Some areas that we are looking at obviously reinforce our security to the left and to the right, and also to shorten the time to market with MLOps, MLSecOps and AI initiatives.

I'm saying shorten the time to market because as you probably know, every two days, there is a new company that claims that they have at the next AI company, and we want to make sure what we bring in, it's not just the talent, but also the technology that will support our enterprise demand.

Yi Fu Lee^ And a quick follow-up on the financial side with Ed. In terms of the linearity for the quarter, can you just kind of discuss like how did the quarter trended and what you are seeing so far year-to-date? That's it for me.

Ed Grabscheid^ Sorry, I didn't quite understand the question at first. The linear do you --

Yi Fu Lee^ Like I was wondering if you could count on the linearity for the quarter. How did it trend from October to November from to December? It didn't sound like there was any drop-off like even though there was a holiday in December. And then if you could comment on the so far year-to-date, the performance until early of February.

Ed Grabscheid^ Thank you for the clarification. From a linearity perspective, we didn't see first of all, December seasonably is a drop off, and we did see some drop up. But for the most part,

we saw a pretty straight linearity for the quarter. We haven't seen much change in January at this point, but we're not going to comment on Q1.

Operator^ Our next question comes from the line of Rob Owens with Piper Sandler.

Robbie Owens^ Just one for me. Curious on sales and marketing as we think about 2024 and just sales capacity additions, especially with the top-down selling motion, just how aggressive are you going to be to add sales staff moving forward and also what you're doing from a partnering perspective.

Shlomi Haim^ Yes. So thank you all. As you remember, we discussed it multiple times. We are hiring enterprise experienced sales representatives together with the right executive on the marketing side, customer success. It's a full cycle.

It's not just the sales account manager. In addition to that, we invest a lot in increasing our partners and China of the ecosystem, not just our partnership with AWS, GCP and Azure, but also stand-alone companies that are promoting our solutions and active channels. On top of that, we also are increasing the number of the number of power overlay reps that can bring the security experience to the market. So expert- sales representatives that are coming from security background, this is -- these are all additions to the strategic sales team that we discussed before and to the entire enterprise sales team that we built together now.

Operator^ Our next question comes from the line of Nick Altmann with Scotiabank.

Nicholas Altmann^ Awesome. Earlier, you guys had made some comments on how customers are landing at higher ASPs, and you're actually seeing sort of greater expansion motions from some of these customers. Can you just maybe talk about sort of what's driving that? And when you look over the next several years, how durable is that trend? Or do you think it's kind of more of a near-term trend that you're just kind of seeing over the last couple of quarters here?

Shlomi Haim^ Thank you, Nick. What really drives the higher ASP, especially when you set to technologies, technologies, they are allergic to fluff values. If they are not solid in concrete, they would not respond to it. So what really drives that is that you answer their pain. And from the outside in, the pain that we hear about is help me to consolidate the numerous tools that we currently use in order to run one delivery process.

So having consolidations of tool in one platform is one reason for customers to lend higher. The second reason is that when they move from another tool to JFrog, they are already educated with what they want to achieve. They already know how they've told, how security work. And when they move to JFrog, most cases, it will come with the expectation to scale. So they are willing to commit to higher numbers, they are willing to commit to a higher volume.

They know that JFrog is unlike the other tools, and therefore, they lend higher with their ASP. There are other reasons, but these are the main two. And obviously, when it comes with the cloud momentum, the consumption and the commitment for the year is another parameter. But these are the main things.

Nicholas Altmann^ Awesome. And then just another question, kind of building off Rob's earlier question around the go-to-market. I assume you guys recently had your sales kickoff. And I know you're focused on sort of the top-down sales motion. But just coming out of the sales kickoff, what was sort of the messaging?

What go-to-market tweaks are being made, if any? And any meaningful changes to how quota-carrying reps are compensated in 2024?

Shlomi Haim^ Yes. Well, as we speak, so kickoffs are happening all over the world. Our sales team, what they hear is that the geography-based execution coming with a full platform that includes security, having a full platform that can also be hybrid. This is how they should focus their efforts on to the partners and channels team, we are expanding the solution to lend higher with a full holistic solution for DevOps and detect.

But obviously, the focus of JFrog 2024 will be the joint solution of DevOps and security together, and this is what maintain here.

Operator^ There are no further questions at this time.

I'll now turn the call back to Shlomi for closing remarks.

Shlomi Haim^ I'd like to thank you all for joining us today. Happy Valentines.

And may the force be with you. Take care, guys.

JFrog Ltd.

Fourth Quarter Fiscal 2023 Financial Results Conference Call

Operator^ This concludes today's call. Thank you for attending.

You may now disconnect.