REPORT REPRINT

Datadog plans public offering as interest in monitoring sector hits new heights

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Other rivals have taken other exits, but Datadog's planned trip to Wall Street is likely to prove very rewarding, financially. The fast-growing company, which operates near break-even, will create several billion dollars of market value when it comes to market next month.

Introduction

Datadog is following in the footsteps of Dynatrace, the APM vendor that went public earlier this month and was valued at $7.4bn out of the gate. Combined with Splunk's recent announcement of plans to acquire SignalFx for $1bn, Datadog's recent growth is just the latest indication that the monitoring segment is hot right now.

Snapshot

COMPANY NAME	Datadog
TICKER	DDOG, on NASDAQ
PROJECTED VALUATION, 451 RESEARCH ESTIMATE	$6bn+
REVENUE, TTM ENDED 6/30/19	$266m
NET LOSS, TTM ENDED 6/30/19	$25m
PRINCIPAL SHAREHOLDERS	Index Venture (20%); OpenView Venture Partners (16%); ICONIQ Strategic Partners (11%)

451 TAKE

Datadog entered the market as a cloud-focused infrastructure monitoring vendor, but has been among the most aggressive monitoring vendors at expanding horizontally. While we frequently hear from customers saying that their interest in buying multiple tools from one vendor is primarily to reduce headaches related to managing many vendor relationships, we think there's potential value in correlating and analyzing data that has been historically collected in disparate monitoring tools. Datadog has shown strong growth in selling multiple tools to customers, although we don't have solid insight as to how many customers are buying how many tools, and to what end. Still, we anticipate further interest in the concept of unifying monitoring data, and think Datadog has demonstrated commitment to further developing the potential. We also see evidence that Datadog has attracted larger customers, but think it needs to significantly invest in catering to enterprises (as opposed to large, born-in-the-cloud businesses) to continue driving growth in this important segment.

Financials

In the current spend-big-to-get-big environment for unicorns, Datadog has been positively thrifty in building its business. On its way to creating a company that currently tops more than $250m in trailing revenue, Datadog has accumulated a total deficit of just $120m. (For other free-spending IPO candidates, the relative revenue and deficit figures can easily be flip-flopped compared with Datadog's parsimonious performance. As one extreme example, consider Domo, which went public in 2018. The business intelligence startup piled up a mountainous $800m deficit ahead of its offering, when it was less than $150m in sales.)

Not that Datadog's fiscal conservatism has slowed its growth. In the two quarters it has reported so far this year, revenue has increased a stunning 80%. Assuming that pace holds for the second half of the year, Datadog would put up about $350m in sales in 2019, up from $198m in 2018. (In 2018 Datadog actually posted two profitable quarters, and lost just $11m as it put up just shy of $200m in revenue for the full year.)

Valuation

In some ways, Datadog represents the best of both worlds when it comes to startups-turned-debutants: exceptional growth combined with break-even operations. It is certainly a model that will appeal to Wall Street investors, who have indicated some weariness with the never-ending red ink flowing at companies that have recently raised money through IPOs. (We have noted the discrepancy between the recent offerings by B2B and B2C companies, including Uber's underwater IPO. The ride-hailing company lost a staggering $5bn in its most-recent quarter.)

Also contributing the to the bullishness around the offering, Datadog is going public at time when virtually all enterprise-focused IPOs are garnering double-digit valautions. Rival Dynatrace, which listed at the start of the month, is currently valued at about $6.6bn, or some 15x trailing sales. Other companies have gotten even richer valuations in recent offerings. Both Zoom Video and CrowdStrike are valued at a gravity-defying 60x trailing sales.

B2B IPO activity

Source: 451 Research, LLC

PagerDuty	Public offering, April 10, 2019
Tufin Software	Public offering, April 10, 2019
Zoom Video	Public offering, April 17, 2019
Fastly	Public offering, May 17, 2019
CrowdStrike	Public offering, June 12, 2019
Slack	Public offering, June 20, 2019
Medallia	Public offering, July 19, 2019
Dynatrace	Public offering, August 1, 2019
Cloudflare	Public filing, August 16, 2019
Ping Identity	Public filing, August 23, 2019
Datadog	Public filing, August 23, 2019

We suspect that Datadog may not join the ranks of high-fliers, but it will almost certainly enjoy a premium to the valuation of its just-listed rival, Dynatrace. But to get probably the most useful comparison for Datadog, we actually have to look back to the October 2018 IPO of Elastic. The two companies are roughly the same size (trailing sales of about $270m) and post similar growth rates (70% for Elastic, 80% for Datadog). Elastic currently enjoys a market capitalization of about $6bn, or 22x trailing sales. In the case of the search company, investors have been willing to look through rather substantial losses as it puts up its enviable growth. There's no such tradeoff at Datadog, which we would suggest merits the company a premium over Elastic.

Profile

Datadog has had dramatic growth over the past couple of years, with solid metrics around revenue, acquisitions of larger customers and sales of multiple products. As of June 30, 590 customers had an annual run-rate revenue of $100,000 or more, up from 240 in 2017. Datadog now has 42 customers with ARR of $1m or more, up from 12 in 2017.

We think that the growth in the number of large deals demonstrates that Datadog has done well in its attempts to move upmarket. While Datadog has been known for enabling customers to easily and independently get started using the product, enterprises often require more support, and Datadog indicates that it plans to continue to invest in meeting such demands. Executing an evolution toward better serving enterprises is a tricky proposition, and one that Datadog will need to get right in order to continue driving growth.

We've heard some criticism of Datadog for being unable to serve very large environments, but we spoke with some very large customers at the recent Datadog Dash customer event, and they were pleased with the vendor's ability to scale to their needs. Datadog says it can process 10 trillion events per day. We've also heard some complaints from customers about bill shock, but new approaches to pricing that Datadog introduced at Dash may help.

Datadog has been rapidly expanding horizontally and marketing the value of being able to correlate data collected by infrastructure monitoring, distributed tracing and logging – often referred to as three pillars of observability. It recently moved into synthetic monitoring and network performance monitoring, as well. It has seen good growth in sales of some of these adjacent offerings, with 35% of new ARR in the first half of this year coming from APM and logging, up from around 10% in the same period a year earlier. As of the first half, 40% of customers were using more than one product, up from 10% a year earlier. Among new customers in the first half, 60% landed with more than one product, up from 15% a year earlier.

Vendors across the monitoring sector are similarly expanding horizontally, such as with Splunk's planned $1bn acquisition of SignalFx to offer customers multiple well-integrated monitoring tools. Our recent 451 Research Market Monitor report on the application and infrastructure monitoring performance market revealed that the top 10 vendors in the market could conceivably compete directly, with nine of the top 10 offering APM and all offering infrastructure monitoring. While the vendors promote benefits of analyzing data collected by previously disparate tools, we think the simpler benefits related to easing headaches involved with managing multiple vendor relationships is currently a big driver.

Datadog customers also expand their usage of the product over time. Over the past couple of years, dollar-based net retention rate has been around or slightly under 150%, indicating that customers spend significantly more each year.

Competition

Elastic is an important rival to Datadog since it also offers logging, infrastructure monitoring and APM under one roof. Elastic's open source Elastic Stack, in particular, appeals to businesses that lean toward building their own tools and platforms, a customer base that Datadog sometimes converts. Sematext also provides all three capabilities.

New Relic, Dynatrace and AppDynamics are all best known for their APM products, and as such represent the strongest competition for Datadog's APM offering. The three have also done some horizontal expansion, although their infrastructure monitoring products aren't as strong as Datadog's, just as Datadog's APM isn't as comprehensive as theirs.

In logging, Sumo Logic, Devo and SolarWinds are competitive, as is Splunk. Once it completes and integrates SignalFx, Splunk will represent even stronger competition to Datadog.

While Datadog says legacy vendors, including IBM, Micro Focus, BMC and Broadcom (via its CA acquisition), are competitive in monitoring on-premises infrastructure, we view Datadog as strong in cloud-native environments but weaker in more traditional, on-premises monitoring. However, as more enterprises embrace cloud-native technologies, they must decide between legacy vendors that tend to be stronger in traditional on-premises environments and weaker in cloud-native environments, or younger vendors like Datadog that represent the reverse.