

NASDAQ:BLZE Q2 2025 Earnings Call Transcript

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Danica | Conference Operator:

Thank you for standing by. My name is Danica, and I will be your conference operator today. At this time, I would like to welcome everyone to the Backblaze second quarter 2025 earnings call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star, followed by the number one on your telephone keypad. If you would like to withdraw your question, press star one again. Thank you. I would now like to turn the call over to Mimi Kong, head of IR.

Mimi Kong | Head of Investor Relations:

Please go ahead. Thank you. Good morning, and welcome to Backblaze's second quarter of 2025 earnings call. On the call with me today are Gleb Budman, co-founder, CEO, and chairperson of the board, and Mark Sweetan, chief financial officer. Today, Backblaze will discuss the financial results that were distributed earlier. Statements on this call include forward-looking statements about our future financial results, the impact of our go-to-market transformation, sales and marketing initiatives, cost saving initiatives, results from new features, the impact of price changes, our ability to compete effectively and manage our growth, and our strategy to acquire new customers, retain and expand our business with existing customers. These statements are subject to risks and uncertainties that could cause actual results to differ materially, including those described in our risk factors that are included in our quarterly report on Form 10Q and our other financial filings. You should not rely on our forward-looking statements as predictions of future events. All forward-looking statements that we make on this call are based on assumptions and beliefs as of today, and we undertake no obligation to update them except as required by law. Our discussion today will include non-GAAP financial measures. These non-GAAP measures should be considered in addition to and not as a substitute for our GAAP results. Reconciliation of GAAP to non-GAAP results may be found in our earnings release, which was furnished with our Form 8K file today with the SEC. You can also find a slide presentation related to our comments in the webcast, which will be posted to our Investor Relations page after the call. Please also see our press release or presentation for definitions of additional metrics, such as NRR, gross customer retention rate, and adjusted free cash flows. And finally, we will be participating in the Oppenheimer Technology Internet and Communications Conference on August 11th. Thank you for joining us, and I would now like to turn the call over to Gilles.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Thank you, Mimi. Good morning, and thank you, everyone, for joining us today. SACWISE delivered a strong Q2, exceeding both the revenue and adjusted EBITDA guidance for the second quarter in a row. Total revenue was \$36.3 million, up 16% year-over-year, B2 revenue was \$19.8 million, up 29% year over year. Adjusted EBITDA margin doubled year over year to 18%. As we outlined last year, our focus has been to accelerate B2 growth and become adjusted free cash flow positive. We've accelerated year over year B2 growth from 22% at the end of last year to 29% this past quarter, and we remain on course to be adjusted free cash flow positive in Q4. This marks an important step as we continue our progress towards becoming a profitable Rule of 40 company. Now, what's behind these numbers is the value we provide to customers, our increased pace of innovation, our go-to-market transformation, and our incredible opportunity with AI. Regarding the customer value we provide, a recently published report we commissioned from independent analyst firm Enterprise Strategy Group found that Backblaze B2 is up to three times more cost efficient and

takes up to 92% less time to manage data compared with competitors. Up to three times more cost efficient and up to 92% less time to manage. That is significant customer value. We also continue to hear from customers frustrated with other cloud providers for their surprise fees. In fact, over 80% of organizations using competitors report unexpected storage charges. In today's cost-conscious environment, can you imagine having to explain to your CEO, CFO, or board that you had significant cost overruns because your cloud provider has surprise storage charges? At Backblaze, Our predictable pricing and ease of use consistently set us apart. It's a key reason customers switch to us and stay with us. Now let's talk about our increased pace of innovation. On our last earnings call, we introduced B2 Overdrive, which delivers the highest throughput performance per dollar in the market. In early Q3, just two months after launch, we've already signed our first six-figure B2 Overdrive customer, a clear indicator of its strong product market fit, and we're thrilled to help customers with their high-throughput performance needs. We also announced a suite of new tools to help customers protect and manage their data. Anomaly Alerts uses AI to detect suspicious data transfers, helping customers spot potential data exfiltration or ransomware early. Enterprise Web Console with role-based access controls makes it easier for larger companies to manage access and stay aligned with zero trust principles. Finally, bucket access logs gives customers detailed visibility into how their data is used and accessed. As we move up market, These features continue the BackWay's tradition of making it astonishingly easy for customers to use and protect their data. These innovations provide customers a unique combination of performance and security, further differentiating BackWay as the leading cloud storage innovator. Now let me update you on our go-to-market transformation. We are seeing great results, as demonstrated by our B2 growth accelerating to 29% in Q2. The number of customers generating over \$50,000 in ARR hit 150, a 30% year-over-year increase, thanks to our upmarket focus. We added yet another seven-figure customer. This marks the fourth quarter in a row where we have highlighted a customer of this scale. Compared to our average \$270 per year customer, this speaks to our dramatic upmarket shift. Our pipeline has grown significantly year over year, and we've had a steadily growing increase in six-figure opportunities enter the pipeline quarter over quarter, a sign that the machine is gaining momentum. Some of the changes we made in our go-to-market include rebuilding account-based marketing, which requires significant systems and process work, but now enables us to more precisely target organizations for whom we should be an ideal fit when they're in market and to the broader buying committee. We also revamped our approach to customer success to better identify and expand use cases with existing customers. We added a field enablement function to further uplevel the sales team We deployed AI in various activities across the go-to-market motion, and of course, much more. The accelerated growth and upmarket momentum are encouraging results, and we are continuing to refine our go-to-market model to drive even greater growth. Earlier, I mentioned that a mere two months after launching B2 Overdrive, we won our first six-figure customer. Let me share the details behind that win. This customer is a generative AI video company and works with massive volumes of data to train models. They initially came to us because of the egregious egress fees they were incurring from the hyperscaler they were using. As we engaged with them, we learned that in addition to needing a cost-effective solution, they really needed speed, reliability, and availability. And speed is something customers are willing to pay more for, because it unlocks opportunities for them. We introduced B2 Overdrive to provide the high-performance customers like this need, and their excitement around our performance was palpable. We are so happy to be partnering with this cutting-edge AI company and thank them for trusting us to help them scale. This B2 Overdrive customer I just talked about is an AI customer, but they're obviously not the only one. Let me share how impactful AI is to the market we sell into overall, to our products, and to our internal initiatives. To highlight the AI market opportunity for us, one year ago, we had no AI companies in our top 10 customers. In Q2, three of our top 10 customers are AI companies. This quarter, the number of AI customers grew 70%, and data stored by these customers grew 40 times year over year. AI use cases drove the outperformance on our financial metrics this quarter, and this is by far the most data-hungry industry we have witnessed, and we're confident that AI will significantly drive our market opportunity. In our products, we launched V2 Overdrive targeted at AI use cases, and we are using AI to offer new products such as those in our security offerings. Internally, we're actively embracing AI across our organization, not just to drive efficiency, but to unlock new opportunities for innovation and growth. Leading this effort is our Chief Human Resources Officer, which reflects how we see AI as a company-wide culture shift, not just a technology initiative. His role puts him at the heart of how we work, making him

uniquely positioned to embed AI into our daily operations and mindset. In closing, I'm so proud of our team's accomplishments. We innovated for our customers with the launch of B2 Overdrive and a suite of security-focused functionality. We made great progress on our go-to-market transformation, which was visible in our accelerated B2 revenue growth. We've leaned into our incredible opportunity with AI. And overall, we delivered strong revenue adjusted EBITDA, and cash flow numbers, putting us well on our way to our Rule 40 target. With that, over to you, Mark.

Mark Sweetan | Chief Financial Officer:

Thank you, Gleb, and good morning, everyone. We are excited by our second quarter results, with both revenue and adjusted EBITDA beating the high end of our guidance. This is the second consecutive quarter of beating guidance on both revenue and adjusted EBITDA. The combination of our zero-based budgeting exercises Our go-to-market transformation and the AI revolution, including a significant AI customer, is driving these strong results. It's hard to believe, but next week marks my one-year anniversary with the company. Looking back, I'm incredibly proud about the results that we have achieved. When I started, I conducted a thorough assessment of the situation, consulted with our leading analysts and with investors, and worked with Gleb and the board to lay the groundwork for, one, solidifying our balance sheet, two, making Backblaze a sustainably profitable company, three, accelerating revenue growth. The good news is we've addressed all three of these objectives at an incredible pace. Here's a quick summary of our achievements. First, on solidifying our balance sheet, we aggressively reduced the cash usage and recapitalized the balance sheet with a secondary offering in November of 2024. We also established a new line of credit this quarter, giving us further financial flexibility. Second, on being a sustainably profitable company, we shifted our focus from adjusted EBITDA to adjusted free cash flow, which incorporates your capital expenditures. We conducted a zero-based budgeting exercise, freeing up \$8 million in expenses for 2025 and strategically redeploy nearly half of those funds to drive more productive growth. We remain on track to achieve our guidance of becoming free cash flow positive in Q4 of this year. Our subsequent aim will be to achieve GAAP net income positivity as operating leverage kicks in. Third, on accelerating revenue growth, we launch a go-to-market transformation. This has resulted in two consecutive quarters of increased B2 revenue growth including a significant 600 basis points acceleration in Q2 over Q1. While these are phenomenal results, I consider this just the first phase of our transformation with plenty more to come. We're continuing to focus on growing B2 in the future and are incredibly proud of the team's success in moving the needle so quickly. These pillars of our transformation set the foundation for Backblaze to become a rule of 40 company. Now, turning to our results for the quarter. Revenue finished strong at \$36.3 million, a 16% year-over-year increase. B2 revenue growth climbed to 29% as we continue our momentum with another quarter of increased growth. This outperformance was driven by solid direct sales bookings bolstered by strong AI tailwinds, including a significant AI customer. Our Q2 investor presentation, available on the IR website, outlines the four drivers behind the B2 revenue growth, which comes from net organic data growth, direct sales cross and up selling, new logos from self-serve, and new logos from direct sales. This chart provides clarity on what drives our revenue growth. Computer backup revenue grew 4% year over year, driven by the October 2023 price increase, of which the benefit has largely ended. In the second half of 2025, we see computer backup declining in the low to mid single digits on a quarterly basis. We continue to see areas for growth and are exploring options to improve the business, but at this point, we feel it is prudent to provide this outlook. Moving on to Net Revenue Retention, or NRR, for the quarter, overall NRR was 109% versus 114% the same period last year. For B2 Cloud Storage, NRR was 112% compared to 126% the prior year and 117% in the prior quarter. As a reminder, the decline is mainly due to the price increase lapping, and it will continue to roll off the next quarter as we calculate the NRR with a trailing four-quarter average. Computer backup NRR is 106% compared to 105% in the prior year. Gross customer retention continues to be strong at about 90% across B2 and computer backup. Gross margin improved to 63% from 55% in the prior year. As we disclosed last quarter, we evaluated the estimated useful life of our fixed assets based on more recent operational data and found that our hardware lasts an estimated six years instead of the three to five years estimate that we previously were using. This change better reflects our business operations and accounts for most of the

gross margin improvements this quarter. The remainder of the margin expansion was from our technical operations team, driving more benefits of scale across our infrastructure. As a result, adjusted gross margin improved to 79% from 78% last year. Our operating expenses continue to decrease as a percentage of revenue as operating leverage kicks in. Operating expenses improved to 82% as a percent of revenue from 86% in the prior year. We expect continued improvement as we scale further. Q2 adjusted EBITDA margin doubled over the prior year to 18% and beat the high end of guidance of 16% by 200 basis points. Adjusted free cash flow for the quarter came in at negative 11%, a 1,000 basis points improvement from negative 21% a year ago. We are on track to be adjusted free cash flow positive in the fourth quarter. Both adjusted EBITDA and adjusted free cash flow margins benefited from stronger revenue performance and robust cost controls. Looking at the balance sheet, we ended the quarter with \$50.5 million in cash and marketable securities. In June, we announced a new \$20 million line of credit with Citizens Bank. This new facility comes with industry standard covenants related to EBITDA attainment and maximum debt leverage ratios. We plan to use this facility for equipment capital expenditures outside the U.S., where leasing rates are comparatively much higher, resulting in interest expense savings. Last quarter, we outlined steps to reduce our rate of equity dilution through RSU net cash settlement. This quarter, we are announcing an additional initiative. Our board has approved a stock repurchase program of up to \$10 million over the next 12 months. The proceeds for this buyback will come from exercise stock options and the employee stock purchase plan. This cash neutral move will help us improve our dilution trajectory. Our combined actions are expected to reduce our projected path of stock-based compensation dilution by approximately 15 to 25%. Until our cash flows permit, this is a cost-effective way to manage equity dilution. Over the long term, Our goal is to reduce dilution from stock-based compensation down to zero. Before discussing our guidance, I'd like to provide some color around B2 revenue growth for the back half of the year. As mentioned, our Q2 beat was helped by a large AI customer who ramped up data storage in a short period of time. But we want to be mindful of the potential variability. Regardless, I'd like to reiterate that we continue to expect B2 revenue growth to exit the year with at least 30%. Looking ahead, we are guiding Q3 2025 revenues to be in the range of \$36.7 to \$37.1 million, with B2 revenue growing in the range of 28% to 30%. For adjusted EBITDA margins, we are guiding Q3 to be in the range of 17% to 19%. For the year, we are raising our revenue guidance to be in the range of \$145 to \$147 million from the previous range of \$144 to \$146 million. This is due to better than expected B2 performance. As for adjusted EBITDA guidance, we reiterate the 17 to 19% range. To wrap up, in Q2, we continue to accelerate revenue growth while also delivering operating efficiency gains. Looking forward, We believe that we are well positioned to continue delivering durable and efficient B2 revenue growth as we set the course to being a Rule of 40 company. Now, I would like to turn it over to the operator so we can open it up for questions.

Danica | Conference Operator:

At this time, I'd like to remind everyone in order to ask a question, press star then the number one on your telephone keypad. Your first question comes from the line of Jeff Van Ree with Craig Hallam. Please go ahead.

Jeff Van Ree | Analyst, Craig-Hallum Capital:

Great. Thanks. Good morning, guys. Just two or three for me, if I could. I'm the seven-figure customer that you talked about in the quarter. Just curious, a little more background on that deal. Was that a displace? And if it was, who was it? Maybe just a little more color there. And then secondarily, on the B2 overdrive, maybe you could just expand a little bit, obviously quick out of the gate to get a six-figure customer. Can you put a little finer point on kind of how that pipeline is building any quantitative measures?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, thanks, Jeff. Appreciate the question. So on the seven-figure customer, they were an existing customer that was smaller before. They've been with us for a handful of quarters at this point. And effectively, their data has been just growing very significantly. And it's an AI company. It's greenfield data. It's data that didn't exist before. And we're seeing this with more AI companies that the data is actually getting created for them. So we're absolutely doing displacements. The B2 Overdrive is an example of a displacement where we took the data away from a hyperscaler. But in the case of a lot of the A companies, they're actually creating new data, whether it's for model building or because of the generative nature of AI. In terms of the Overdrive customer, so this was a customer that we actually connected with before we announced Overdrive. They had been with a hyperscaler, they were getting killed by egress fees, and they started looking for an alternative where they could save costs on their data storage for their usage, especially because they were doing model building and they needed to move the data from where it was being stored to one of the NeoCloud providers in order to build their models. When we announced OverDrive, just shortly after we started engaging with them, they got very excited and said they actually need more performance if it's available, and they decided to test it and do a proof of concept. Their eyes lit up, and they just started testing and got very, very excited very quickly and moved forward because with the AI companies, the GPUs are very expensive and time is money, and so being able to use B2 Overdrive for that performance is very impactful for them. Yeah, that's great. Great coming out of the gate that strong. And then you, Jeff, you, sorry, I think you also asked about the pipeline. So what I would say is, you know, it's a new product, right? So it's still quite early, but we've got about a dozen companies who we're in pretty good discussions with at this point around overdrive use cases. And, you know, what I would say is, you know, obviously we have about half a million customers. So on the one hand, a dozen doesn't sound like a lot. On the other hand, Every one of these has to be a multi-petabyte size customer and at a more premium pricing.

Jeff Van Ree | Analyst, Craig-Hallum Capital:

Very helpful. Last one for me then maybe on the channel front. Just any update on channel efforts? I know you were leaning in there, making some moves to get a little deeper, get a little tighter. Just where are you there and how's that mapping to your expected progress?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, the, on the channel side of things, you know, we're seeing a consistently increasing number and value of both leads and then, and then closed ARR business. It's, you know, we, we've, we, um, focused in, as we talked about before on, on a smaller number of channel partners to drive more meaningful business with, and that's been working as a good strategy. I will say that because the AI companies tend to buy direct, a lot of the bigger opportunities have actually been through the direct side of things, but the channel has been an important component for us.

Jeff Van Ree | Analyst, Craig-Hallum Capital:

Yeah, great. Real nice quarter. Thanks, guys.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Thank you.

Danica | Conference Operator:

Our next question comes from the line of Etow Kidron with Oppenheimer. Please go ahead.

Etow Kidron | Analyst, Oppenheimer & Co.:

Thanks, guys. Nice quarter as well. Maybe you were running too far ahead here, Glib, but what percent of your B2 customers do you think can be overdrive customers?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, it's a good question. I think that one of the things that we see, obviously, is that AI use cases we think are going to continue to increase and become a bigger and bigger part of the overall. There's no reason why the AI alone at some point isn't a billion dollar opportunity for storage. A lot of those AI companies need the performance because the GPUs are so expensive that the faster they can get the data to the GPUs when they're actually ready, it makes sense. I think that any of the companies who are building models, OverDrive is a good value for them. We also see other use cases where they're doing high performance computing and some of the media workflows where moving lots of data is also important. So I think at this point, OverDrive is only being offered for multi-petabyte customers, so that's got to be on the larger set. But in general, we think that OverDrive is potentially available for anybody who's doing significant AI workload. And as you can imagine, AI is potentially a huge opportunity for us.

Etow Kidron | Analyst, Oppenheimer & Co.:

that makes a lot of sense. I guess, you know, I'm just kind of eyeballing your website, for example, right now, and the pricing is more than double for overdrive, so clearly this is a huge opportunity for you. But I guess it also begs the question on whether you should have another price tier somewhere in the middle for hybrid, you know, just in a way to touch on a broader set of your customers faster. Does that make any sense? Is there a way to better, not maybe better, but add tiers to your current pricing plans to kind of better peel out more value out of your customers?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, I mean, I think that, you know, as we go forward, we're going to try to keep that good balance of providing a lot of value to the customers, but also keeping things simple. And so, you know, one of the areas that we've won historically with customers is that some of our competitors have, you know, eight different pricing tiers and 13-page pricing documents in six-point font. And, you know, you need a PhD to understand what you're going to get charged, which is part of why they also get these, you know, why we said 80% of customers get these surprise storage fees. So we want to make sure that we keep things simple for companies. At the same time, you know, we are listening to customers to hear what needs do they have. And so, you know, OverDrive came because, We heard from customers saying, you know, I love the performance. I love the durability. I love the availability. By the way, the GPUs are so expensive. If we could get the data there even faster, we'd pay more for that. So we'll listen to the customers and see what it is that we can do to provide value. But I think that there's certainly opportunities for us to introduce other things for them to subdivide and support their workloads.

Etow Kidron | Analyst, Oppenheimer & Co.:

That's great. Last one for me, Mark, on the computer backup. Solid quarter, actually. And you have very good retention rates. I hear your guidance now that we're lapping the price increase. I guess the question is, with good gross retention here, how do you think about the puts and takes in a decision whether to raise price again or just keep things as is and let this slightly decline over time. Help me think about your thought process here. What are the triggers to think about over the next 12 months in this business?

Mark Sweetan | Chief Financial Officer:

Yeah, good morning, Itai. So what I would say is we really focused on B2 growth. I mean, we doubled down on that, and we said we're going to get it up to 30% by the end of the year.

Danica | Conference Operator:

It looks like we lost the speaker audio line. Just give us one second.

Mark Sweetan | Chief Financial Officer:

Can you hear me, Itai? Now I can, yes.

Danica | Conference Operator:

We're back. Thank you.

Mark Sweetan | Chief Financial Officer:

All right. All right. So, you know, what I was saying, Itai, is our first phase was really to grow B2. And now that we got B2 well on track to get to 30% by the end of the year, we feel that's the new baseline for B2. Now we're able to work on two things, which is both see where do we take B2 from there, but also put more attention and focus on backup. But until we materialize more our actions on the backup side, and Gleb could elaborate what can we do on that front, we thought it'd be prudent to say there's nothing that new, right? Two quarters ago, we said the customer count is declining by low single digits. And what you're seeing is we'll have the price increase that coming through. But glad we'll elaborate on potential actions. Once those actions materialize, we'll start changing our views on the guidance for backup.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, I think Mark's correct on all that. And I think what I would say is, in terms of things that we're doing, we spent a good chunk of time and focus on the go-to-market transformation for B2. We're taking some of those learnings and then applying them to the computer backup side to drive the business opportunity there. The other thing is in early in the year, we launched Enterprise Control, which was an upgraded functionality for computer backup. And then we just launched a feature that was the single most requested feature by larger companies for computer backup, which is Legal Hold. And so with those two components combined with the learnings from our go-to-market transformation, we put a tiger team internally on computer backup. And so there's focus on getting that business to be a kind of steady business. There's no current plan to do a price increase with that. But as you know, we've done a few in the past, so it's not out of the question. But we want to make sure we provide a lot of value to customers as with all our offerings.

Etow Kidron | Analyst, Oppenheimer & Co.:

Got it. Work in progress. Understood. I appreciate it, guys. Good luck. Thanks. Thank you.

Danica | Conference Operator:

Our next question comes from the line of Simon Leopold with Raymond James. Please go ahead.

Simon Leopold | Analyst, Raymond James:

Thank you very much for taking the question. First one really to follow up on the backup trending. I guess there was a messaging that the outlook is trying to be conservative. What is your understanding of why the customer count is going lower on the backup portion of the business? In other words, is it that customers are price sensitive or are you losing to competitors? Could you help us understand the rationale for why you've lost or expect to lose customers?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Hey, Simon. This is Gleb. So, I mean, first of all, the gross customer retention rate on computer backup is 90%. which has been pretty consistent for a long time. So 90% gross customer retention is actually a pretty industry-leading metric, especially for consumer and small to medium business metrics. And so we continue to see that. So it follows that trend line. I think in the consumer side of the business, it's a secular decline business that's slow secular decline, right? And that's in part because people aren't doing backups of their laptops and desktops as much as they used to because there's a lot more streaming and mobile devices and the like. On the business side of that, I think we actually have more opportunity, and that's, as I mentioned, with the new functionality that we launched with enterprise control and with legal hold and with the learnings from our go-to-market transformation, That's where we get to put some weight behind the business side of the computer backup offering.

Simon Leopold | Analyst, Raymond James:

Thanks. That's helpful. And then pivoting to the B2 opportunities, in the past you've talked about some of your alliance partners and how they've played into, I'd say, the value offered to your business-oriented customers. Uh, in light of, of some of the trends you have, particularly around AI, can you update us on how you see, uh, the featured Alliance partners? I'm thinking about sort of the companies like Dean and Fastly and how that to the strategy. Thank you.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, it's a good question. And I would say that Alliance has continued to be a really important part of our strategy. Some of the types of companies that are becoming Alliance partners are shifting. We, uh, some of the providers of GPUs are leaning in with us more because the customers need a lot of storage. They need the storage to go, uh, hand in hand with the GPUs and, and they, they go, they're a natural fit together. So some of the area that we're seeing more engagement in is around that part, but overall, uh, you know, storage, the great thing about storage is it's a key part of almost everything that everyone does. At the same time, a lot of what we're trying to do is help people solve an entire solution. So if we're looking to help them solve their virtual machine backup needs, then partnering with virtual machine backup companies like Beam, where they're the software and where the cloud storage is good. If we're looking to solve an AI data pipeline, then partnering with the various Neo clouds that they do that with in the modeling and the inferencing is a

good solution. So we try to work with partners in order to solve the actual full-end solution for customers.

Simon Leopold | Analyst, Raymond James:

Thanks. And then just one last one is maybe if you could shed some light on your priorities in terms of internal investment, basically how to divvy up your spending growth between sales and marketing versus R&D. Thank you.

Mark Sweetan | Chief Financial Officer:

Hi, Simon. This is Mark. So R&D, if you, our R&D as a percent of revenue, when you take the R&D expense line and the R&D that's capitalized is consistently going down as a percentage of revenue because we're benefiting from our scale, right? Not because we want to invest us in innovation, because if anything, you just saw this past quarter, we had several major releases. On the sales and marketing side, what we're focused on is productivity of our investments there. And what you saw is B2 net new ARR went up by 6.9 million, which is a record for us in quarterly net new ARR. Additionally, if you look at B2 growth, if you factor out the price increase, this was the record growth at 29% in seven quarters. So sales marketing is all about productivity. I mean, there's different ratios of what you aim for there. And R&D at this point, I would say for us, is really absolute dollars, kind of keep, not let it grow more than mid-single digits in absolute dollars, but as a percentage of revenue, it will continue to benefit from a scale that will come down every year. Thank you.

Danica | Conference Operator:

Our next question comes from the line of Eric Martinuzzi with Lake Street Capital Markets. Please go ahead.

Eric Martinuzzi | Analyst, Lake Street Capital Markets:

The enterprise security suite was just hoping to get a sense of the potential uplift for a typical enterprise account. If someone's using you for a storage situation, whether it's computer backup or B2, what does the uplift What is the uplift potential if they decide to sign up for the security suite?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, Eric, thanks for asking. So I'll break it down in a couple little pieces. So first of all, Enterprise Web Console with the role-based access control helps them manage larger numbers of people interacting with it. And it's really targeted at ease of use. So there's not an extra charge for that. It's part of the offering. But as it's been rolled out in private preview with customers, the sales team has talked about how they've absolutely loved the functionality. And so I see that as a customer adoption and customer retention and customer satisfaction functionality. On the bucket access logs, it's functionality that enables them to keep in track all of their data that they've used. So they, and all the ways and operations and everything. So it depends on the size of the data they pay for the amount of data that gets stored. The anomaly alerts is a fee per, for the amount of data that's being analyzed as part of that. And so it's not a, It's not a large dollar amount per terabyte, but if they're protecting a lot of data, then that can be an interesting material uplift. So we're in the early stages of testing some of the pricing pieces of that one as we want to really show that there's a lot of value to customers. And I think that there really is going to be data exfiltration, Ransomware, you know, these are issues that organizations are dealing with all the time. And, you know, some of these organizations are ending up paying 10 2030, you know, million dollars to deal with some of these implications for them. So there's a lot of value if we can help detect that early before they've had to before they've had a major breach.

Eric Martinuzzi | Analyst, Lake Street Capital Markets:

Okay, my second question is on the kind of a macro-related question. Obviously, you had a good quarter and a good outlook, but it's in part driven by the better-than-expected traction on the AI front. As far as your SMB-sized customer, what's the health there? Typically, you've seen in times where SMB is softer, you've seen the amount of data being stored start to tail off of a trend line. Have you seen anything there on the SMB side?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

You know, Simon, I think that the core business continues to be strong and the AI is an accelerant. So, you know, as I was looking through the deals that we won last quarter, just, you know, kind of eyeballing through them, right? I mean, there's MSPs, there's K through 12 schools and colleges and universities, there's cities, there's counties. There are software companies, media companies, ad agencies. They're companies across the board adopting Backboys. If you look at the gross customer retention metrics, they continue to be strong. The net revenue retention metrics continue to be strong. And so the core business, it's not like Patrick Corbett- backups are no longer important or media content is not getting generated or or application storage use cases like surveillance and streaming are shrinking so all of those are still continue to be growing areas. Patrick Corbett- But you know Ai is big and so we're we're leaning into that opportunity for us, I think you know just looking at it, I mean. You know, going from, you know, zero to three of our top 10 customers, you know, being AI companies and the 40X growth rate and data, it's where we're putting an increasing amount of focus because of the size of that opportunity. But the core business continues to be strong.

Mark Sweetan | Chief Financial Officer:

Yeah. Another way to evidence that, Eric, good morning, it's Mark. Slide 13, we posted a new slide into our quarterly earnings deck that breaks up what's driving our growth. And you can see that all four categories of our revenue driver growth are improving. That includes net organic growth, so existing customer base organically growing. It includes cross-selling and up-selling by our direct sales team. It includes new self-serve, thousands that show up every quarter and sign up, and new direct sales booking. So it's pretty well diversified. That really sets us up to get to that 30% quarterly growth rate and really makes that our new baseline from thereafter. That's the momentum we carry forward from there.

Eric Martinuzzi | Analyst, Lake Street Capital Markets:

Got it. Thanks.

Danica | Conference Operator:

Our next question comes from the line of Jason Adder with William Blair. Please go ahead.

Jason Adder | Analyst, William Blair:

Yeah, good morning. Thanks, guys. Wanted to ask on the B2NRR, can you just talk about some of the puts and takes there and just maybe an outlook for the back half of the year for just B2NRR?

Mark Sweetan | Chief Financial Officer:

Hi, Jason. It's Mark. The 112% coming down 500 basis points from the previous quarter, that's all the price increase lapping and the trailing four-quarter impact. Our actual NRR, if you look at that slide 13, those first two categories at the bottom pretty much represent NRR and actually improved in Q2 over Q1. The improvement was driven by Gleb referenced a large customer, I referenced a large customer, they were with us before. So that big ramp up fed into Q2, but you could also see all variables of that growth rate improved. As for the rest of the year, I would say on a reported basis, it was a trailing four-quarter average. You'll probably have another quarter of that lapping price increase impact us. but then it should stabilize. And then as we improve our customer success, I think there'll be more into 2026. You'll start seeing improvements from there. Yeah.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

And Jason, I would just say one example for me of that improvement in customer success. So, you know, we talked about earlier this year that we brought on a leader for the customer success organization. She's been doing a fabulous job of revamping how we engage with our customers. really focused on both getting significant value to them and making sure that they're getting full value of the platform and also looking at what opportunities we have to expand with them and one thing that happened uh this quarter was uh we had a customer that had been a roughly 15 000 a year customer and when our customer success team engaged with them and really uh and showed them kind of the value that they could get, that customer grew from 15K for a one-year deal to becoming a 500K TCY over a three-year deal. So I think that there's a lot of that type of opportunity in a customer base of 500,000 customers.

Jason Adder | Analyst, William Blair:

Gotcha. So we take out the impact of price, and we take out the impact of the single big AI customer that was in the numbers a year ago. Was there, I guess, was there expansion on the existing base? So did the NRR actually improve if you adjust for those two items?

Mark Sweetan | Chief Financial Officer:

If you adjust for those two items, I would say it's more in the stable range. Because if you remember in Q1, we talked about a customer, a large customer that went away. In Q2, we talked about this new customer coming in. When you put all these, it all nets out to a very stable number. And then, like we said, once this customer success motion kicks in, that's when you'll start seeing it go up in a healthy way.

Jason Adder | Analyst, William Blair:

Okay, great. And then, Gleb, just one for you. You know, and I'm hung up on this question. I think I've asked it on a number of different earnings calls, but can you just explain and help people understand why you guys are not at a disadvantage on the AI storage side by not having compute and GPUs in your offering?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Yeah, it's actually, I think we're at an advantage. So one of the things is that the GPUs in storage, there are two pieces of it, but GPUs service two concrete parts of the overall AI workflow, the model building and the inferencing. The overall data pipeline for AI is actually five stages. It's data collection. It's data processing, where you do all the labeling. It's the model training. It's the inference. And then it's the monitoring. And so we

get to play...

Danica | Conference Operator:

Looks like we lost the speaker audio once again. Just give us one moment, please.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Can you hear us again?

Danica | Conference Operator:

Yes, I can hear you now. Thank you.

Jason Adder | Analyst, William Blair:

Excellent. I think, Cleve, you were on stage, maybe stage four or something. Stage four.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

So just kind of the five stages of the pipeline, right? So stage one is where you collect all the data, you ingest it, and you get it ready. Stage two is where you label the data. Stage three is you build the models. Stage four is you run inferencing on it. And stage five is you monitor it. And so the GPUs are great for the model training and the inference. But backwards, we get to participate at all five of these stages and help customers at each one. And so for the data collection part of it and the ingest, That is all about having a really affordable, highly durable place to store a lot of data that scales. GPUs have no role in that, but we play a key role in that. Stage two, where you have the data and you label all of it. Again, GPUs aren't really a significant portion of that, but the data needs to be stored in a place where you can do that with. Stage three for the model training, the GPUs play a big role in this, but it's really important to have high performance, high throughputs. data storage where you can get it to the GPUs because a lot of times the customers will sign, for example, a 90-day contract for access to their GPUs. Once they have all the data collected and labeled, they want to get it to those GPUs as fast as possible so that they're not wasting any of that time. That B2 overdrive offering that we introduced is perfect for that. Once it's done with the model training, you have the inference. This is our more classic application storage type use case where you're running the models on top of it. Again, it's really important to have durable, available, high performance and affordable data storage for that. And then the last part of it is the monitoring of it, where you, again, you don't need much in the way of GPUs for that, but you absolutely want to keep the data. So one of the things I think that's also interesting is that GPU usage is spiky, but storage is sticky. So even though you may ramp up your GPUs and shut them down, you're not going to get rid of that data. And so we get to participate in all parts of the AI workflow. We get to keep the data, even though the GPUs go up and down. And because there are more and more places where you can get GPU availability, right? There are all these Neo clouds popping up. We're increasingly seeing customers who want to make sure that their data is outside of the traditional hyperscalers who try to lock you in because they want access to have their data go to whichever neocloud provider they want to use. So we're really building this storage platform for the next era of the way that technology is built when it's not just locked inside of the hyperscalers.

Etow Kidron | Analyst, Oppenheimer & Co.:

Thank you.

Danica | Conference Operator:

Our next question comes from the line of Zach Cumins with B Reilly Securities. Please go ahead.

Zach Cumins | Analyst, B. Riley Securities:

Yeah, thanks. Good morning. I appreciate you taking my questions. Mark, I know you've really focused on this go-to-market transformation here over the last several quarters, bringing in new leadership and building out additional teams there. Can you kind of give us a sense, maybe in a baseball analogy, kind of what entering we're in in terms of building out the actual teams and functionalities versus actually having everyone in place and really just executing against the plan now?

Mark Sweetan | Chief Financial Officer:

Zach, good morning. We're probably midway. I'll give you the, you know, crawl, walk, run, right? We're clearly no longer crawling. I mean, this is the best quarter factory price increase in seven quarters. We're not running. So that puts us at that 30% mark. We got, you know, we got to build it out to be more than that. But that's when we get to the running stage. So we're not ready to share anything on that front. The team's largely in place, but, you know, you got to build the processes, the systems around them, train people. So, yeah, it's all coming together well.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Zach, I'll say I'm glad that you asked Mark that question, not me, because I'm not sure that I could give you a baseball analogy of any kind. Not quite my world. But what I will say is that, you know, the pipeline has doubled year over year. So I think the demand gen function has improved significantly. The types of deals in that pipeline, the number of six-figure opportunities has scaled quarter over quarter over quarter. So that really speaks to, I think, the demand gen function is starting to work well. If you look at the direct sales, Jason and team have upskilled the organization and added a lot of processes in how the system works. That has resulted in us having the 150 companies that are over 50K. If you think about each of the last four quarters, we've announced a seven-figure size deal. In the history of the company before that, we only had one seven-figure deal in the prior 15-plus years, and we've been able to announce one every single quarter over the last four quarters. So I think that there's – like Mark said, I think we still absolutely want to continue to improve, pick up the pace, and drive the opportunity even bigger. Fundamentally, like – Even without AI, the core market just servicing the ransomware protection and backups and archives and media and all the different companies that need the base functions is so large. Adding AI on top of that, we believe it is just this massive opportunity. And so we want to go and chase that faster. I think we've made great strides over the last few quarters, and I think we have a lot of opportunity left.

Zach Cumins | Analyst, B. Riley Securities:

Understood. That's helpful. And just my one follow-up question is maybe just around the updated guidance. Next is the continued outperformance here in the first half. Are there any incremental investments that are contemplated in the current guide in the second half? Just curious on the puts and takes of how we should think about the ongoing margin progression.

Mark Sweetan | Chief Financial Officer:

Yeah, Zach. With the launch of Overdrive, we are accelerating a bit of CapEx, but I would say it's mainly pulling it from Q4 to Q3. So it doesn't impact the whole year. Just pulls it in so we could get more of our data centers up to overdrive performance because we're just getting a lot of interest. And when the interest comes in, they got to test and run POCs. So that's what's happening on that front. Otherwise than that, I think we're well on track to get to free cash flow positive in Q4. Thereafter, operating leverage kicks in, and that's where we've been really focused on building a fiscally responsible financial model with faster growth, with less spend, and driving free cash flows. That's why also we announced the share buyback. It's not a big one, but we felt like now that we got the growth going, Now that we're clearly six weeks away from free cash flow positive, we could start – we talked last quarter about equity dilution. Now we could further dig into it as we set the journey to, over time, eliminate equity dilution.

Zach Cumins | Analyst, B. Riley Securities:

Understood. Well, thanks for taking my questions, and best of luck with the rest of the quarter.

Danica | Conference Operator:

All right, our next question comes from the line of Mike Sikos with Needham. Please go ahead.

Jeff Hopson | Analyst, Needham & Company (for Mike Sikos):

Hi, this is Jeff Hopson on for Mike Sikos. Thanks for getting me in here. Are you guys seeing the length of sales cycles for AI companies coming in shorter, as I would kind of expect them to see the large cost and performance advantages much quicker than others, or Do they still tend to be a little bit longer as you kind of move up market?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Jeff, thanks for the question. You're absolutely right. We're actually seeing some of the companies moving really fast. I mean, you saw that with our B2 Overdrive note, right? So they came in and within two months of B2 Overdrive launching, they signed a six-figure deal. So a lot of these companies, they're newer companies. And they are just accustomed to themselves moving very quickly. And the needs that they have are significant. So some of them, I will say, are more hesitant to sign long-term contracts. In which case, our ability to have our consumption-based model actually works great for them, and we're thrilled to have them on our consumption-based model. But they definitely seem to be moving faster than some of the other more traditional organizations.

Jeff Hopson | Analyst, Needham & Company (for Mike Sikos):

Got it. Makes sense. And maybe just one more quickly. I know you guys are lapping price increases now, but What is kind of the methodology for if or when you'd implement future price increases on B2, considering you guys are still substantially cheaper than your competition?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

You know, we don't have any plan to do additional price increases on B2. We obviously, you know, always evaluate what we should be charging for the different services in the market. But we want to provide a lot of value to the customers. That's kind of rule number one. So we'll continue to evaluate, but there's no intention or no plan to at this point. What we did was we launched B2 Overdrive, which solves a different need for them, and that starts at \$15 per terabyte, and it goes up from there depending on the performance that they want because that service, we can offer up to a terabit per second of performance for that, which is just, I mean, it's hard to wrap your head around how fast that is and how much data that can move. And so with that type of performance, you know, it would price it still for providing a lot of value, but it's certainly a significantly higher price point.

Mark Sweetan | Chief Financial Officer:

Yeah, and the starting price for that is 250% above our current standard price. So that's how we monetize more, right, giving more value to our customers. And everything we're launching, we're aiming to make it either gross margin neutral or accretive to our current model. So we'll slowly see ongoing hopefully improvements in our gross margin. Perfect. Thanks again.

Danica | Conference Operator:

Our final call comes from Rustem Conga with Citizens. Please go ahead.

Rustem Conga | Analyst, Citizens Bank:

All right. Thanks for squeezing me in here, guys. And congrats on the outperformance of B2 relative to the prior expectations. Just one for me. It looks like there's a solid drumbeat of innovation with several announcements for your security features. I understand some of these are in private preview. It looks like Legal Hold has a complimentary trial phase. Gleb, I know you touched on the monetization there. I just wanted to ask, big picture, to what extent do you think these enhancements sort of naturally help bolster the shift of market?

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Thanks. Yeah, thanks for the question, Russ. So we've focused on functionality for performance, functionality for security, functionality for AI. These are definitely supporting that upmarket momentum. So event notifications, which we launched in the past few quarters, that was to enable organizations to actually build their applications and integrate us better into all their workflows, legal hold, supports organizations. It was literally the number one most requested feature from the larger companies for computer backup. Bucket access logs was something that customers were asking for because we became an increasingly strategic part of their fundamental infrastructure and so they wanted to plug that in to the insights they were getting around how their the security um was uh of the overall environment so these are these are both natural and helping us uh close those those bigger opportunities And like I said, enterprise web console with role-based access control, when that was previewed to customers, what I heard from the sales team was basically, wow, customers loved it. I think the go-to-market transformation that we're doing helps us make sure that our teams and process infrastructure are better able to sell to larger organizations, and these tools and functionalities give them the features and products to make that easier.

Danica | Conference Operator:

All right. I will pass it back to Gleb Bedman for closing remarks.

Gleb Budman | Co-founder, CEO and Chairperson of the Board:

Thank you everybody for joining today. We delivered a strong quarter financially and we delivered for our customers. This is an exciting opportunity for our company as we lean in to help customers with their data needs around AI, cybersecurity and more. I want to thank our team for collaborating to make this happen and thank you to our customers partners, and investors for your trust in us as we continue to build the core storage platform for the Cloud 2.0 era. Operator, you may now end the call.