

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2022

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-40252

DigitalOcean Holdings, Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

45-5207470

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

101 6th Avenue

New York, New York 10013

(Address of principal executive offices and Zip Code)

(646) 827-4366

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common stock, par value \$0.000025 per share	DOCN	The New York Stock Exchange

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 27, 2022, there were 96,297,098 shares of the registrant's common stock, with a par value of \$0.000025 per share, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements about us and our industry that involve substantial risks and uncertainties. All statements other than statements of historical facts contained in this Quarterly Report on Form 10-Q, including statements regarding our future results of operations or financial condition, business strategy and plans and objectives of management for future operations, are forward-looking statements. In some cases, you can identify forward-looking statements because they contain words such as "anticipate," "believe," "contemplate," "continue," "could," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "project," "should," "target," "will" or "would" or the negative of these words or other similar terms or expressions. These forward-looking statements include, but are not limited to, statements concerning the following:

- our expectations regarding our revenue, expenses and other operating results;
- our ability to achieve profitability on an annual basis and then sustain such profitability;
- future investments in our business, our anticipated capital expenditures and our estimates regarding our capital requirements;
- our ability to acquire new customers and successfully engage and expand usage of our existing customers;
- the costs and success of our marketing efforts, and our ability to promote our brand;
- our reliance on key personnel and our ability to identify, recruit and retain skilled personnel;
- our ability to effectively manage our growth;
- our ability to successfully integrate acquired businesses, including Cloudways, and achieve expected synergies and benefits;
- our ability to compete effectively with existing competitors and new market entrants; and
- the growth rates of the markets in which we compete.

You should not rely on forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition and operating results. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties and other factors described in the section titled "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q, as well as Item 1A-Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2021, filed with the SEC on February 25, 2025, and Item 1A-Risk Factors in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2022, filed with the SEC on May 5, 2022, as such factors may be updated from time to time in our periodic filings with the SEC. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. The results, events and circumstances reflected in the forward-looking statements may not be achieved or occur, and actual results, events or circumstances could differ materially from those described in the forward-looking statements.

In addition, statements that "we believe" and similar statements reflect our beliefs and opinions on the relevant subject. These statements are based on information available to us as of the date of this Quarterly Report on Form 10-Q. And while we believe that information provides a reasonable basis for these statements, that information may be limited or incomplete. Our statements should not be read to indicate that we have conducted an exhaustive inquiry into, or review of, all relevant information. These statements are inherently uncertain, and investors are cautioned not to unduly rely on these statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments.

We may announce material business and financial information to our investors using our investor relations website (<https://investors.digitalocean.com/>). We therefore encourage investors and others interested in our company to review the information that we make available on our website, in addition to following our filings with the Securities and Exchange Commission, webcasts, press releases and conference calls.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)
(unaudited)

	September 30, 2022	December 31, 2021
Current assets:		
Cash and cash equivalents	\$ 24,115	\$ 1,713,387
Marketable securities	800,539	—
Accounts receivable, less allowance for doubtful accounts of \$ 6,402 and \$4,212, respectively	52,425	39,619
Prepaid expenses and other current assets	31,277	17,050
Total current assets	<u>908,356</u>	<u>1,770,056</u>
Property and equipment, net	270,985	249,643
Restricted cash	1,935	2,038
Goodwill	315,161	32,170
Intangible assets, net	122,543	42,915
Deferred tax assets	82	88
Other assets	4,625	4,085
Total assets	<u>\$ 1,623,687</u>	<u>\$ 2,100,995</u>
Current liabilities:		
Accounts payable	\$ 11,762	\$ 12,657
Accrued other expenses	36,645	31,907
Deferred revenue	5,476	4,826
Other current liabilities	44,925	8,849
Total current liabilities	<u>98,808</u>	<u>58,239</u>
Deferred tax liabilities	22,107	421
Long-term debt	1,468,393	1,462,676
Other long-term liabilities	4,162	1,462
Total liabilities	<u>1,593,470</u>	<u>1,522,798</u>
Commitments and Contingencies (Note 9)		
Preferred stock (\$0.000025 par value per share; 10,000,000 shares authorized; 0 shares issued and outstanding as of September 30, 2022 and December 31, 2021)	—	—
Common stock (\$0.000025 par value per share; 750,000,000 shares authorized; 96,229,736 and 109,175,863 issued; and 96,229,736 and 107,207,635 outstanding as of September 30, 2022 and December 31, 2021, respectively)	2	2
Treasury stock, at cost (0 shares at September 30, 2022 and 1,968,228 shares at December 31, 2021)	—	(4,598)
Additional paid-in capital	235,278	769,705
Accumulated other comprehensive loss	(4,308)	(374)
Accumulated deficit	(200,755)	(186,538)
Total stockholders' equity	<u>30,217</u>	<u>578,197</u>
Total liabilities and stockholders' equity	<u>\$ 1,623,687</u>	<u>\$ 2,100,995</u>

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
Revenue	\$ 152,115	\$ 111,428	\$ 413,324	\$ 308,899
Cost of revenue	54,536	43,506	148,539	126,195
Gross profit	97,579	67,922	264,785	182,704
Operating expenses:				
Research and development	30,243	29,927	104,440	79,450
Sales and marketing	19,097	13,312	56,360	35,545
General and administrative	38,847	26,354	115,109	68,756
Total operating expenses	88,187	69,593	275,909	183,751
Income (loss) from operations	9,392	(1,671)	(11,124)	(1,047)
Other (income) expense:				
Interest expense	2,127	186	6,281	2,675
Loss on extinguishment of debt	—	—	407	3,435
Other (income) expense, net	(3,274)	140	(6,206)	(157)
Other (income) expense	(1,147)	326	482	5,953
Income (loss) before income taxes	10,539	(1,997)	(11,606)	(7,000)
Income tax expense (benefit)	442	(145)	2,611	378
Net income (loss) attributable to common stockholders	\$ 10,097	\$ (1,852)	\$ (14,217)	\$ (7,378)
Basic and diluted net income (loss) per share	\$ 0.10	\$ (0.02)	\$ (0.14)	\$ (0.08)
Weighted average shares used to compute basic net income (loss) per share	96,559	107,955	102,134	88,265
Weighted average shares used to compute diluted net income (loss) per share	104,931	107,955	102,134	88,265

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands)
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
Net income (loss) attributable to common stockholders	\$ 10,097	\$ (1,852)	\$ (14,217)	\$ (7,378)
Other comprehensive loss:				
Foreign currency translation adjustments, net of taxes	(252)	(73)	(458)	(101)
Unrealized gain (loss) on available-for-sale marketable securities, net of taxes	912	—	(3,476)	—
Comprehensive income (loss)	<u><u>\$ 10,757</u></u>	<u><u>\$ (1,925)</u></u>	<u><u>\$ (18,151)</u></u>	<u><u>\$ (7,479)</u></u>

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share amounts)
(unaudited)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehen- sive Loss		Accumulated Deficit	Total
	Shares	Amount	Shares	Amount					
Balance at June 30, 2022	98,856,183	\$ 2	(1,968,228)	\$ (4,598)	\$ 268,689	\$ (4,968)	\$ (210,852)	\$ 48,273	
Issuance of common stock under equity incentive plan, net of taxes withheld	420,431	—	—	—	(2,894)	—	—	—	(2,894)
Repurchase and retirement of common stock	(1,078,650)	—	—	—	(50,000)	—	—	—	(50,000)
Retirement of treasury stock	(1,968,228)	—	1,968,228	4,598	(4,598)	—	—	—	—
Stock-based compensation	—	—	—	—	24,081	—	—	—	24,081
Other comprehensive loss	—	—	—	—	—	660	—	—	660
Net loss attributable to common stockholders	—	—	—	—	—	—	10,097	—	10,097
Balance at September 30, 2022	96,229,736	\$ 2	—	\$ —	\$ 235,278	\$ (4,308)	\$ (200,755)	\$ 30,217	

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehen- sive Loss		Accumulated Deficit	Total
	Shares	Amount	Shares	Amount					
Balance at June 30, 2021	109,213,693	\$ 2	(1,968,228)	\$ (4,598)	\$ 1,035,514	\$ (273)	\$ (172,561)	\$ 858,084	
Issuance of common stock under equity incentive plan, net of taxes withheld	907,272	—	—	—	3,888	—	—	—	3,888
Exercise of common stock warrants	232,520	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	18,820	—	—	—	18,820
Issuance of common stock for acquisition	636,994	—	—	—	27,566	—	—	—	27,566
Other comprehensive loss	—	—	—	—	—	(73)	—	—	(73)
Net loss attributable to common stockholders	—	—	—	—	—	—	(1,852)	—	(1,852)
Balance at September 30, 2021	110,990,479	\$ 2	(1,968,228)	\$ (4,598)	\$ 1,085,788	\$ (346)	\$ (174,413)	\$ 906,433	

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share amounts)
(unaudited)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehen- sive Loss		Accumulated Deficit	Total
	Shares	Amount	Shares	Amount					
Balance at December 31, 2021	109,175,863	\$ 2	(1,968,228)	\$ (4,598)	\$ 769,705	\$ (374)	\$ (186,538)	\$ 578,197	
Issuance of common stock under equity incentive plan, net of taxes withheld	2,503,828	—	—	—	(14,116)	—	—	—	(14,116)
Issuance of common stock under employee stock purchase plan, net of taxes withheld	144,867	—	—	—	5,244	—	—	—	5,244
Repurchase and retirement of common stock	(13,626,594)	—	—	—	(600,000)	—	—	—	(600,000)
Retirement of treasury stock	(1,968,228)	—	1,968,228	4,598	(4,598)	—	—	—	—
Stock-based compensation	—	—	—	—	79,043	—	—	—	79,043
Other comprehensive loss	—	—	—	—	—	(3,934)	—	—	(3,934)
Net loss attributable to common stockholders	—	—	—	—	—	—	(14,217)	—	(14,217)
Balance at September 30, 2022	<u>96,229,736</u>	<u>\$ 2</u>	<u>—</u>	<u>\$ —</u>	<u>\$ 235,278</u>	<u>\$ (4,308)</u>	<u>\$ (200,755)</u>	<u>\$ 30,217</u>	

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands, except share amounts)
(unaudited)

	Convertible Preferred Stock		Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss		Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount					
Balance at December 31, 2020	45,472,229	\$ 173,074	45,299,339	\$ 1	(1,968,228)	\$ (4,598)	\$ 99,783	\$ (245)	\$ (167,035)	\$ (72,094)	
Issuance of common stock under equity incentive plan, net of taxes withheld	—	—	2,785,069	—	—	—	10,368	—	—	—	10,368
Exercise of common stock warrants	—	—	296,848	—	—	—	—	—	—	—	—
Stock-based compensation	—	—	—	—	—	—	37,966	—	—	—	37,966
Issuance of common stock for acquisition	—	—	636,994	—	—	—	27,566	—	—	—	27,566
Issuance of common stock in connection with initial public offering, net of underwriting discounts and issuance costs	—	—	16,500,000	1	—	—	723,125	—	—	—	723,126
Conversion of convertible preferred stock to common stock in connection with initial public offering	(45,472,229)	(173,074)	45,472,229	—	—	—	173,074	—	—	—	173,074
Conversion of redeemable preferred stock warrants to common stock warrants	—	—	—	—	—	—	13,906	—	—	—	13,906
Other comprehensive loss	—	—	—	—	—	—	—	(101)	—	—	(101)
Net loss attributable to common stockholders	—	—	—	—	—	—	—	—	(7,378)	—	(7,378)
Balance at September 30, 2021	—	\$ —	110,990,479	\$ 2	(1,968,228)	\$ (4,598)	\$ 1,085,788	\$ (346)	\$ (174,413)	\$ 906,433	

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2022	2021
Operating activities		
Net loss attributable to common stockholders	\$ (14,217)	\$ (7,378)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	73,900	64,922
Stock-based compensation	77,758	37,380
Bad debt expense	12,217	6,055
Loss on extinguishment of debt	407	3,435
Net accretion of discounts and amortization of premiums on investments	(3,099)	—
Release of VAT reserve	—	3,188
Non-cash interest expense	5,898	386
Loss on impairment	144	212
Revaluation of warrants	—	(556)
Deferred income taxes	247	—
Other	2,396	477
Changes in operating assets and liabilities, net of acquisition:		
Accounts receivable	(20,270)	(14,462)
Prepaid expenses and other current assets	(4,580)	(134)
Accounts payable and accrued expenses	(5,771)	4,001
Deferred revenue	(364)	263
Other assets and liabilities	5,342	2,587
Net cash provided by operating activities	130,008	100,376
Investing activities		
Capital expenditures - property and equipment	(77,717)	(66,480)
Capital expenditures - internal-use software development	(6,593)	(4,297)
Purchase of intangible assets	(4,915)	(5,636)
Cash paid for acquisition of businesses, net of cash acquired	(305,163)	(5,000)
Cash paid for asset acquisitions	(5,400)	—
Purchase of available-for-sale securities	(1,379,277)	—
Sales of available-for-sale securities	19,992	—
Maturities of available-for-sale securities	558,371	—
Purchased interest on available-for-sale securities	(1,556)	—
Proceeds from interest on available-for-sale securities	1,549	—
Proceeds from sale of equipment	967	209
Net cash used in investing activities	(1,199,742)	(81,204)
Financing activities		
Repayment of notes payable	—	(33,214)
Repayment of term loan	—	(166,813)
Repayment of borrowings under revolving credit facility	—	(63,200)
Payment of debt issuance costs	(1,520)	—
Proceeds related to the issuance of common stock under equity incentive plan	10,352	13,145

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)
 (unaudited)

Proceeds from the issuance of common stock under employee stock purchase plan	5,245	—
Employee payroll taxes paid related to net settlement of equity awards	(24,618)	(2,777)
Proceeds from initial public offering, net of underwriting discounts and commissions and other offering costs	—	723,126
Repurchase and retirement of common stock	(600,000)	—
Net cash (used in) provided by financing activities	(610,541)	470,267
(Decrease) increase in cash, cash equivalents and restricted cash	(1,680,275)	489,439
Cash, cash equivalents and restricted cash - beginning of period	1,715,425	102,537
Cash, cash equivalents and restricted cash - end of period	\$ 35,150	\$ 591,976
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 349	\$ 2,248
Cash paid for taxes (net of refunds)	1,669	541
Non-cash investing and financing activities:		
Capitalized stock-based compensation	\$ 1,285	\$ 587
Property and equipment received but not yet paid, included in Accounts payable and Accrued other expenses	19,964	14,291
Costs related to initial public offering included in accounts payable and accrued liabilities	—	27,566

See accompanying notes to condensed consolidated financial statements

DIGITALOCEAN HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share amounts)

Note 1. Nature of the Business and Organization

DigitalOcean Holdings, Inc. and its subsidiaries (collectively, the "Company", "we", "our", "us") is a leading cloud computing platform offering on-demand infrastructure and platform tools for developers, start-ups and small-to-medium size businesses. The Company was founded with the guiding principle that the transformative benefits of the cloud should be easy to leverage, broadly accessible, reliable and affordable. The Company's platform simplifies cloud computing, enabling its customers to rapidly accelerate innovation and increase their productivity and agility. The Company offers mission-critical infrastructure solutions across compute, storage and networking, and also enables developers to extend the native capabilities of the Company's cloud with fully managed application, container and database offerings.

The Company has adopted a holding company structure and the primary operations are performed globally through our wholly-owned operating subsidiaries.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") and include accounts of the Company and all wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, which include normal recurring adjustments, necessary for a fair statement of the Company's financial position as of September 30, 2022, results of operations for the three and nine months ended September 30, 2022 and 2021, cash flows for the nine months ended September 30, 2022 and 2021, and stockholders' equity for the three and nine months ended September 30, 2022 and 2021.

Use of Estimates

The preparation of these condensed consolidated financial statements in conformity with U.S. GAAP requires management to make, on an ongoing basis, estimates, judgments and assumptions that affect the amounts reported and disclosed in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Such estimates include, but are not limited to, those related to revenue recognition and allowance for doubtful accounts, useful lives and realizability of long-lived assets, capitalized internal-use software development costs, accounting for stock-based compensation, valuation allowances against deferred tax assets, fair value of marketable securities, the fair value and useful lives of tangible and intangible assets acquired and liabilities assumed resulting from business combinations. Management bases its estimates on historical experience and on various other assumptions which management believes to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Restricted Cash

The following table reconciles cash, cash equivalents and restricted cash per the Condensed Consolidated Statements of Cash Flows:

	September 30,	
	2022	2021
Cash and cash equivalents	\$ 24,115	\$ 589,750
Restricted cash included in Prepaid expenses and other current assets ⁽¹⁾	9,100	—
Restricted cash ⁽²⁾	1,935	2,226
Total cash, cash equivalents and restricted cash	\$ 35,150	\$ 591,976

(1) Includes contingent compensation related to the Cloudways acquisition.

(2) Includes deposits in financial institutions related to letters of credit used to secure lease agreements.

Marketable Securities

The Company's marketable securities consist of commercial paper, U.S. treasury securities and commercial debt securities. The Company determines the appropriate classification of its marketable securities at the time of purchase and reevaluates such designation at each balance sheet date. The Company has classified and accounted for its marketable

securities as available-for-sale securities as the Company may sell these securities at any time for use in its current operations or for other purposes, even prior to maturity. As a result, the Company classifies its marketable securities within Current assets on the Condensed Consolidated Balance Sheets.

Available-for-sale securities are recorded at fair value each reporting period. Premiums and discounts are amortized or accreted over the life of the related available-for-sale security as an adjustment to yield using the effective interest method. Interest income is recognized when earned. Unrealized gains and losses on these marketable securities are presented net of tax and reported as a separate component of Accumulated other comprehensive loss until realized. Realized gains and losses are determined based on the specific identification method and are reported in Other (income) expense, net in the Condensed Consolidated Statements of Operations.

The Company periodically evaluates its marketable securities to assess whether an investment's fair value is less than its amortized cost basis and if the decline in the fair value is attributable to a credit loss. Declines in fair value judged to be related to credit loss are reported in Other (income) expense, net in the Condensed Consolidated Statements of Operations.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable primarily represents revenue recognized that was not invoiced at the balance sheet date and is primarily billed and collected in the following month. Trade accounts receivable are carried at the original invoiced amount less an estimated allowance for doubtful accounts based on the probability of future collection. Management determines the adequacy of the allowance based on historical loss patterns, the number of days that customer invoices are past due and an evaluation of the potential risk of loss associated with specific accounts. When management becomes aware of circumstances that may further decrease the likelihood of collection, it records a specific allowance against amounts due, which reduces the receivable to the amount that management reasonably believes will be collected. The Company records changes in the estimate to the allowance for doubtful accounts through bad debt expense and reverses the allowance after the potential for recovery is considered remote.

The following table presents the changes in our allowance for doubtful accounts for the period presented:

	Amount
Balance as of December 31, 2021	\$ 4,212
Bad debt expense, net of recoveries	12,217
Additions from Cloudways acquisition	691
Write-offs	(10,718)
Balance as of September 30, 2022	<u>\$ 6,402</u>

Deferred Revenue

Deferred revenue was \$5,476 and \$4,826 as of September 30, 2022 and December 31, 2021, respectively. Revenue recognized during the three months ended September 30, 2022 and 2021 was \$246 and \$259, respectively, and \$2,750 and \$2,618 during the nine months ended September 30, 2022 and 2021, respectively, which was included in each deferred revenue balance at the beginning of each respective period.

Business Combinations

The Company recognizes assets acquired, liabilities assumed, and any contingent consideration related to business combinations based on estimates of their respective fair values on the date of acquisition. The purchase price is allocated to the identifiable net assets acquired, including intangible assets and liabilities assumed, based on estimated fair values at the date of acquisition. The excess of the purchase price over the amount allocated to the identifiable assets and liabilities, if any, is recorded as goodwill. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates, or actual results. All subsequent changes to the estimated fair values of the acquired assets and liabilities assumed that occur within the measurement period and are based on facts and circumstances that existed at the acquisition date are recognized as an adjustment to goodwill.

Determining the fair value of assets acquired and liabilities assumed requires significant judgment, including the selection of valuation methodologies, estimates of future revenue and cash flows and discount rates in determining the fair value of intangible assets acquired and liabilities assumed. The assets purchased and liabilities assumed have been reflected on the Company's Consolidated Balance Sheets, and the results are included on the Consolidated Statements of Operations and Consolidated Statements of Cash Flows from the date of acquisition.

Acquisition-related transaction costs, including legal and accounting fees and other external costs directly related to the acquisition, are recognized separately from the acquisition and expensed as incurred in General and administrative on the Consolidated Statements of Operations.

Asset Acquisition

The Company applies the principles provided in ASC 805, Business Combinations ("ASC 805") to determine whether a transaction involves an asset or a business. If it is determined an acquisition is an asset acquisition, the purchase consideration (which will include certain transaction costs) is allocated to the acquired assets and liabilities based on their relative fair values.

Segment Information

The Company's chief operating decision maker, the chief executive officer, reviews discrete financial information presented on a consolidated basis for purposes of regularly making operating decisions, allocation of resources, and assessing financial performance. Accordingly, the Company has one operating and reporting segment.

Geographical Information

Revenue, as determined based on the billing address of the Company's customers, was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
North America	38	%	38	%
Europe	30		28	
Asia	22		24	
Other	10		10	
Total	100	%	100	%
			100	%
			100	%

Revenue derived from customers in the United States was 31% of total revenue for the three and nine months ended September 30, 2022 and 2021.

No country outside of the United States had revenue greater than 10% of total consolidated revenue in any period presented.

Property and equipment located in the United States was 48% and 50% as of September 30, 2022 and December 31, 2021, respectively, with the remainder of net assets residing in international locations, primarily in the Netherlands, Singapore and Germany.

Concentration of Credit Risk

The amounts reflected in the Condensed Consolidated Balance Sheets for cash and cash equivalents, marketable securities, restricted cash, and trade accounts receivable are exposed to concentrations of credit risk. Although the Company maintains cash and cash equivalents with multiple financial institutions, the deposits, at times, may exceed federally insured limits. The Company believes that the financial institutions that hold its cash and cash equivalents are financially sound and, accordingly, minimal credit risk exists with respect to these balances.

The Company's customer base consists of a significant number of geographically dispersed customers. No customer represented 10% or more of accounts receivable, net as of September 30, 2022 and December 31, 2021. Additionally, no customer accounted for 10% or more of total revenue during the three and nine months ended September 30, 2022 and 2021.

Sublease

Under ASC 840, Leases, a sublease liability is recorded when the Company ceases to use leased space, which is included in Other current liabilities and Other noncurrent liabilities on the Condensed Consolidated Balance Sheets. A sublease loss is calculated as the present value of lease payments, net of expected sublease income, and other costs that do not have future economic benefit to the Company. The sublease loss is included in General and administrative on the Condensed Consolidated Statements of Operations.

Recent Accounting Pronouncements – Pending Adoption

The following effective dates represent the requirements for private companies which the Company has elected as an emerging growth company.

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2016-02, Leases (Topic 842), and additional changes, modifications, clarifications, or interpretations related to this guidance thereafter ("ASU 2016-02"). ASU 2016-02 requires a reporting entity to recognize right-of-use assets and lease liabilities on the balance sheet for operating leases to increase transparency and comparability. ASU 2016-02 is effective for fiscal years beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022 with early adoption permitted. The Company expects to elect the package of transition practical expedients, which allows it to carry forward its historical assessment of (1) whether contracts are or contain leases, (2) lease classification, and (3) initial direct costs. In addition, the Company expects to elect the practical expedient that allows lessees the option to account for lease and non-lease components together as a single component for all classes of underlying assets.

The Company has made substantial progress in executing its implementation plan. It is in the process of revising its controls and processes to address the lease standard and is in the process of completing the implementation and data input for the lease accounting software tool that it will use post-adoption. ASU 2016-02 also requires expanded disclosure regarding the amounts, timing and uncertainties of cash flows related to a company's lease portfolio. The Company is evaluating these disclosure requirements and is incorporating the collection of relevant data into its existing financial reporting processes. While the Company expects the adoption of this standard to result in an increase to the reported assets and liabilities, the Company is currently evaluating the impact of adoption on the condensed consolidated financial statements.

In October 2021, the FASB issued ASU 2021-08, Business Combinations (Topic 805) Accounting for Contract Assets and Contract Liabilities from Contracts with Customers ("ASU 2021-08"), to improve the accounting for acquired revenue contracts with customers in a business combination by addressing diversity in practice and inconsistency related to the recognition of an acquired contract liability and to payment terms and their effect on subsequent revenue recognized by the acquirer. The amendments in ASU 2021-08 require that an entity (acquirer) recognize and measure contract assets and contract liabilities acquired in a business combination in accordance with Topic 606. At the acquisition date, an acquirer should account for the related revenue contracts in accordance with Topic 606 as if it had originated the contracts. This amendment will be effective for public entities with fiscal years beginning after December 15, 2022, and for all other entities with fiscal years beginning after December 15, 2023, with early adoption permitted. While the Company is continuing to assess the timing of adoption and the potential impacts of ASU 2021-08, it does not expect ASU 2021-08 to have a material effect on its consolidated financial statements and disclosures.

In June 2016, the FASB issued ASU 2016-13, with subsequent amendments, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments ("ASU 2016-13"). ASU 2016-13 requires immediate recognition of management's estimates of current expected credit losses. ASU 2016-13 is currently effective for public business entities, and effective for private companies with annual reporting periods beginning after December 15, 2022, and interim periods within annual periods beginning after December 15, 2023, with early adoption permitted. The Company is currently evaluating the impact of adoption on the condensed consolidated financial statements.

Recent Accounting Pronouncements – Adopted

In December 2019, the FASB issued ASU 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes ("ASU 2019-12"). ASU 2019-12 eliminates certain exceptions in FASB Topic 740: Income Taxes ("ASC 740") related to the approach for intra-period tax allocation, the methodology for calculating income taxes in an interim period, and the recognition of deferred tax liabilities for outside basis differences. It also clarifies and simplifies other aspects of the accounting for income taxes. ASU 2019-12 is effective for annual reporting periods beginning after December 15, 2021, and interim periods within fiscal years beginning after December 15, 2022, with early adoption permitted. The Company adopted the new standard and there was an immaterial impact to the condensed consolidated financial statements and related disclosures.

Note 3. Acquisitions

Cloudways Ltd.

On September 1, 2022 ("Acquisition Date"), the Company acquired 100% of the outstanding equity interests of Cloudways, Ltd. ("Cloudways") pursuant to a Share Purchase Agreement, dated as of August 19, 2022. This acquisition has been accounted for as a business combination. The results of Cloudways' operations have been included in the accompanying condensed consolidated financial statements since the Acquisition Date. The acquisition of Cloudways, a leading managed cloud hosting and software-as-a-service provider for small to medium-sized businesses, strengthens the Company's ability to simplify cloud computing by enabling customers to launch a business and scale it effortlessly. Cloudways was a customer of the Company prior to the acquisition, and the Company recognized revenue of approximately \$6,000 from Cloudways from January 1, 2022 through the Acquisition Date. All intercompany transactions will be eliminated upon the consolidation of Cloudways.

The acquisition purchase consideration, in accordance with ASC 805, totaled \$311,237 and was paid in cash. The acquisition purchase consideration is subject to certain adjustments for working capital, cash, transaction expenses, accrued liabilities and indebtedness. The Share Purchase Agreement includes customary representations and warranties and covenants of the parties. The Company contributed \$42,000 to an escrow account on the Acquisition Date to support certain post-closing indemnification obligations.

The initial accounting for the business combination is incomplete at the time of this filing due to the limited amount of time between the Acquisition Date and the date that these financial statements are issued. The Company has performed a preliminary valuation analysis of the fair market value of the assets and liabilities of the Cloudways business. The final purchase price allocation will be determined when the Company has completed its evaluation of the valuation analysis. The final allocation could differ materially from the preliminary allocation. The final allocation may include changes in allocations to acquired intangible assets as well as goodwill and other changes to assets and liabilities including deferred tax liabilities. The estimated useful lives of acquired intangible assets are also preliminary. Measurement period adjustments, if any, will be recognized in the reporting period in which the adjustment amounts are determined within twelve months from the Acquisition Date.

The following table sets forth the components and the allocation of the purchase price for the business combination and summarizes the preliminary fair values of the assets acquired and liabilities assumed at the Acquisition Date:

Total consideration:		
Cash paid to Cloudways sellers	\$	278,187
Cash contributed to escrow accounts		42,000
Other expenses		150
Less: Cash pre-funded from contingent compensation		(9,100)
Total consideration paid	\$	311,237
Cash and cash equivalents	\$	5,827
Accounts receivable		4,753
Prepayments and other current assets		547
Other long term assets		9
Identifiable intangible assets		72,000
Accounts payable		(1,820)
Accrued expenses		(957)
Deferred revenue		(1,013)
Deferred tax liabilities		(21,686)
Other current liabilities		(29,660)
Net identifiable assets acquired		28,000
Goodwill		283,237
Total fair value of net assets acquired	\$	311,237

The Company amortizes its intangible assets assuming no residual value over periods in which the economic benefit of these assets is consumed (the useful life). The preliminary fair values allocated to the identifiable intangible assets and their estimated useful lives are as follows:

Intangible assets	Preliminary Fair Value	Weighted Average Useful Life in Years
Trade name	\$ 9,500	10
Developed technology	31,500	5
Customer relationships	31,000	7
Total identifiable intangible assets	\$ 72,000	

Cloudways' assets and liabilities were measured at estimated fair values on September 1, 2022. Estimates of fair value represent management's best estimate and require a complex series of judgments about future events and uncertainties. Third-party valuation specialists were engaged to assist in the valuation of these assets and liabilities.

The goodwill is attributable primarily to the revenue synergies expected from combining the operations of both entities, and intangible assets that do not qualify for separate recognition, including the existing workforce acquired through the acquisition. None of the goodwill is expected to be deductible for income tax purposes.

Acquisition related costs consist of miscellaneous professional service fees and expenses for acquisition related activities. The Company recognized approximately \$2,139 of acquisition related costs that were expensed in the current period. These costs are shown primarily as part of general and administrative expenses in the accompanying condensed consolidated statements of operations.

The amount of Cloudways' revenue and net loss included in the Company's condensed consolidated statements of operations from the Acquisition Date through September 30, 2022, was \$4,923 and \$(3,581), respectively. The \$4,923 does not include the impact of the elimination of \$765 related to DO intercompany revenue with Cloudways.

Contingent compensation

Contingent compensation costs relate to payments due to a Cloudways seller for \$ 38,830, of which \$16,851 is earned on September 1, 2023, and \$7,326 is earned on each of March 1, 2024, September 1, 2024 and March 1, 2025. Contingent compensation represents compensation for post-combination services because the payments are contingent on continuing employment of the Cloudways seller, with limited exceptions, at each payment date. For the nine months ended September 30, 2022, the Company recorded an acquisition related compensation expense of \$2,361 related to estimated compensation earned by the Cloudways seller to date. This expense is shown as part of General and administrative in the accompanying condensed consolidated statements of operations.

Unaudited Pro Forma Financial Information

The unaudited pro forma information below summarizes the combined results of the Company and Cloudways as if the Company's acquisition of Cloudways closed on January 1, 2021 but does not necessarily reflect the combined actual results of operations of the Company and Cloudways that would have been achieved, nor are they necessarily indicative of future results of operations. The unaudited pro forma information reflects certain adjustments that were directly attributable to the acquisition of Cloudways, including additional amortization adjustments for the fair value of the assets acquired and liabilities assumed and other adjustments the Company believes are reasonable for the pro forma presentation. The pro forma net income (loss) for the three months ended September 30, 2022 was adjusted to exclude nonrecurring acquisition related costs of \$2,139.

	Pro Forma Three Months Ended September 30,		Pro Forma Nine Months Ended September 30,	
	2022	2021	2022	2021
Pro-forma revenue	\$ 160,457	\$ 119,703	\$ 444,193	\$ 330,993
Pro-forma net income (loss)	10,010	(9,713)	(24,837)	(31,593)

Other Asset Acquisitions

In March 2022, the Company acquired the assets of the CSS Tricks website ("CSS Tricks") from Midwest Coast Studios LLC for total purchase consideration of \$4,000. The intangible assets will be amortized over 3 to 5 years. In June 2022, the Company acquired intangible assets from JournalDev IT Services Private Limited for total purchase consideration of \$1,400 to be amortized over 3 years.

Nimbella

The Company finalized and adjusted the purchase price for the Nimbella acquisition to reflect a decrease of \$ 247 to Goodwill related to the final 2021 pre-acquisition tax return.

Note 4. Marketable Securities

The following is a summary of available-for-sale marketable securities, excluding those securities classified within cash and cash equivalents, on the Condensed Consolidated Balance Sheets as of September 30, 2022. The Company did not hold any available-for-sale marketable securities as of December 31, 2021.

	September 30, 2022			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. treasury securities	\$ 568,706	\$ 14	\$ (2,342)	\$ 566,378
Corporate debt securities	35,032	—	(340)	34,692
Commercial paper	200,276	2	(809)	199,469
Total Marketable securities	<u>\$ 804,014</u>	<u>\$ 16</u>	<u>\$ (3,491)</u>	<u>\$ 800,539</u>

Interest income from investments was \$3,309 and \$27 for the three months ended September 30, 2022 and 2021, respectively, and \$ 6,899 and \$36 for the nine months ended September 30, 2022 and 2021, respectively. As of September 30, 2022, all of the Company's available-for-sale short-term investments were due within one year.

The Company does not believe that any unrealized losses are attributable to credit-related factors based on its evaluation of available evidence. To determine whether a decline in value is related to credit loss, the Company evaluates, among other factors: the extent to which the fair value is less than the amortized cost basis, changes to the rating of the security by a rating agency and any adverse conditions specifically related to an issuer of a security or its industry. Unrealized gains and losses on marketable securities are presented net of tax.

Note 5. Fair Value Measurements

The fair value of our financial assets measured on a recurring basis is as follows:

	September 30, 2022				
	Level I		Level II		Total
Cash and cash equivalents:					
Cash	\$	23,436	\$	—	\$ 23,436
Money market funds		679		—	679
Total Cash and cash equivalents	\$	24,115	\$	—	\$ 24,115
Marketable securities:					
U.S. treasury securities	\$	566,377	\$	—	\$ 566,377
Corporate debt securities		—		34,692	34,692
Commercial paper		—		199,470	199,470
Total Marketable securities	\$	566,377	\$	234,162	\$ 800,539

	December 31, 2021				
	Level I		Level II		Total
Cash and cash equivalents:					
Cash	\$	1,093,425	\$	—	\$ 1,093,425
Commercial paper		—		269,945	269,945
Certificate of deposits		—		350,017	350,017
Total Cash and cash equivalents	\$	1,093,425	\$	619,962	\$ 1,713,387

The Company classifies its highly liquid money market funds and U.S. treasury securities within Level 1 of the fair value hierarchy because they are valued based on quoted market prices in active markets. The Company classifies its commercial paper, corporate debt securities and certificates of deposit within Level 2 because they are valued using inputs other than quoted prices that are directly or indirectly observable in the market, including readily available pricing sources for the identical underlying security which may not be actively traded. The Company had no Level 3 financial assets as of September 30, 2022 and December 31, 2021.

Financial Instruments Not Recorded at Fair Value on a Recurring Basis

The Company reports financial instruments at fair value, with the exception of the 0% Convertible Senior Notes due December 1, 2026 ("Convertible Notes"). Financial instruments that are not recorded at fair value on a recurring basis are measured at fair value on a quarterly basis for disclosure purposes. The carrying values and estimated fair values of financial instruments not recorded at fair value are as follows:

	September 30, 2022		December 31, 2021	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible Notes	\$ 1,468,393	\$ 1,099,185	\$ 1,462,676	\$ 1,462,676

The carrying value of the Convertible Notes as of September 30, 2022 and December 31, 2021 was net of unamortized debt issuance costs of \$31,607 and \$37,324, respectively.

The total fair value of the Convertible Notes was determined based on the closing trading price as of the last day of trading for the period. The Company considers the fair value to be a Level 2 valuation due to the limited trading activity.

Note 6. Balance Sheet Details

Property and equipment, net

Property and equipment, net consisted of the following:

	September 30, 2022	December 31, 2021
Computers and equipment	\$ 566,749	\$ 487,484
Furniture and fixtures	1,511	1,511
Leasehold improvements	6,820	6,820
Internal-use software	75,992	68,321
Property and equipment, gross	\$ 651,072	\$ 564,136
Less: accumulated amortization	\$ (58,410)	\$ (49,268)
Less: accumulated depreciation	(321,677)	(265,225)
Property and equipment, net	\$ 270,985	\$ 249,643

Depreciation expense on property and equipment for the three months ended September 30, 2022 and 2021 was \$ 20,982 and \$18,969, respectively, and \$62,009 and \$54,359 for the nine months ended September 30, 2022 and 2021, respectively.

The Company capitalized costs related to the development of computer software for internal use of \$ 7,879 and \$4,884 for the nine months ended September 30, 2022 and 2021, respectively, which is included in internal-use software costs within Property and equipment, net. Amortization expense related to internal-use software for the three months ended September 30, 2022 and 2021 was \$2,983 and \$3,245, respectively, and \$9,205 and \$10,245 for the nine months ended September 30, 2022 and 2021, respectively.

The Company recorded an impairment loss of \$24 and \$144 related to software that is no longer being used during the three and nine months ended September 30, 2022, respectively. The Company recorded an impairment loss of \$212 for the three and nine months ended September 30, 2021. This impairment loss is included in Cost of revenue and Research and development on the Condensed Consolidated Statements of Operations.

Prepaid expenses and other current assets

Prepaid expenses and other current assets consisted of the following:

	September 30, 2022	December 31, 2021
Prepaid expenses	\$ 13,884	\$ 11,473
Restricted cash	9,100	—
VAT and sales tax receivable	7,328	5,116
Other current expenses	965	461
Total prepaid expenses and other current assets	\$ 31,277	\$ 17,050

Other current liabilities

Other current liabilities consisted of the following:

	September 30, 2022	December 31, 2021
Accrued taxes	\$ 39,822	\$ 6,755
Contingent compensation	1,404	—
ESPP withholding	2,682	1,495
Sublease liability	725	—
Other current liabilities	292	599
Total other current liabilities	\$ 44,925	\$ 8,849

Note 7. Debt

Credit Facility

In February and March 2020, the Company entered into and subsequently amended a second amended and restated credit agreement with KeyBank National Association as administrative agent. In November 2021, the Company further amended such credit agreement to revise certain covenants that restricted the incurrence of indebtedness to permit the issuance of the convertible notes discussed below. In March 2022, the Company entered into a third amended and restated credit agreement (the "Credit Facility") to, among other modifications, (i) remove the term loan component of the existing credit facility which had been previously repaid in full; (ii) increase the maximum borrowing limit of the revolving credit facility from \$150,000 to \$250,000; (iii) extend the maturity date; (iv) replace the existing maximum total net leverage ratio financial covenant with a maximum senior secured net leverage ratio financial covenant; (v) eliminate the financial covenant requirement of maintaining a minimum debt service coverage ratio; (vi) reduce the interest rates applicable to any principal amounts outstanding on the revolving credit facility as well as the annual commitment fee for unused amounts on the revolving credit facility; and (vii) replace the benchmark reference rate for U.S. Dollar loans from LIBOR to the forward-looking term rate based on the secured overnight financing rate plus a customary adjustment ("Adjusted Term SOFR").

At September 30, 2022, the Company had available borrowing capacity of \$ 250,000 on the Credit Facility. The Credit Facility will mature on the earlier of (a) March 29, 2027 and (b) 90 days before the maturity date applicable to any outstanding convertible notes issued by the Company in an aggregate principal amount equal to or greater than \$100,000.

The Credit Facility is secured by a first-priority security interest in substantially all of the assets of the Company. The Credit Facility contains certain financial and operational covenants, including a maximum senior secured net leverage ratio financial covenant of 3.50x. As of September 30, 2022, the Company was in compliance with all covenants under the Credit Facility.

The per annum interest rate applicable to any principal amounts outstanding under the Credit Facility for U.S. Dollar loans will be equal to (i) Adjusted Term SOFR plus (ii) an applicable margin varying from 1.25% to 2.00%, subject to a pricing grid based on the senior secured net leverage ratio. The Credit Facility provides for an annual commitment fee varying from 0.20% to 0.30%, also subject to a pricing grid based on the senior secured net leverage ratio, applied to the average daily unused amount of the revolving credit facility. The Company incurred commitment fees on the unused balance of the Credit Facility of \$128 and \$96 for the three months ended September 30, 2022 and 2021, respectively, and \$ 349 and \$266 for the nine months ended September 30, 2022 and 2021, respectively.

In connection with the Credit Facility, the Company incurred \$ 1,295 of additional debt issuance costs which, together with \$ 662 of the then unamortized financing fees, will be amortized over the remaining term of the facility. The Company recognized a loss on extinguishment of debt of \$407 for the nine months ended September 30, 2022. The loss on extinguishment of debt represent a non-cash adjustment to reconcile net income to net cash provided by operating activities within the Condensed Consolidated Statements of Cash Flows.

Amortization of deferred financing fees for the three months ended September 30, 2022 and 2021 was \$ 106 and \$90, respectively, and \$293 and \$2,153 for the nine months ended September 30, 2022 and 2021, respectively.

Convertible Notes

In November 2021, the Company issued \$1,500,000 aggregate principal amount of Convertible Notes in a private offering, including the exercise in full of the over-allotment option granted to the initial purchasers of \$200,000. The Convertible Notes are senior unsecured obligations of the Company and do not bear regular interest, and the principal amount of the Convertible Notes does not accrete. The Convertible Notes will mature on December 1, 2026 unless earlier converted, redeemed, or repurchased. The net proceeds from this offering were \$1,461,795 after deducting underwriting fees, expenses and commissions. Amortization of deferred financing fees for the three and nine months ended September 30, 2022 was \$1,874 and \$5,605, respectively.

Each \$1,000 of principal of the Convertible Notes will initially be convertible into 5.6018 shares of the Company's common stock, which is equivalent to an initial conversion price of approximately \$178.51 per share, subject to adjustment as set forth in the indenture governing the Convertible Notes. Holders of these Convertible Notes may convert their Convertible Notes at their option at any time prior to the close of the business day immediately preceding June 1, 2026, only under the following circumstances:

1. during any calendar quarter commencing after the calendar quarter ending on March 31, 2022, if the last reported sale price of the Company's common stock exceeds 130% of the conversion price for each of at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter on each applicable trading day;
2. during the five business day period after any ten consecutive trading day period (such ten consecutive trading day period, the "measurement period") in which the trading price of the Convertible Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price per share of the common stock on such trading day and the conversion rate on such trading day;
3. if the Company calls such Convertible Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; and
4. upon the occurrence of specified corporate events or distributions on the common stock.

As none of the above circumstances have occurred as of September 30, 2022, the Convertible Notes were not convertible for the fiscal quarter ending September 30, 2022.

On or after June 1, 2026 until the close of business on the scheduled trading day immediately preceding the maturity date, holders may convert all or any portion of their Convertible Notes at the option of the holder regardless of the foregoing circumstances.

Upon conversion of the Convertible Notes, the Company will pay or deliver, as the case may be, cash, shares of common stock or a combination of cash and shares of common stock, at the Company's election. It is the Company's current intent to settle the principal amount of the Convertible Notes with common stock.

The Company may redeem for cash all or any portion of the Convertible Notes, at its option, on or after December 2, 2024 and on or before the 25th scheduled trading day immediately before the maturity date, if the last reported sale price per share of the Company's common stock exceeds 130% of the conversion price then in effect on each of at least 20 trading days (whether or not consecutive) during the 30 consecutive trading days ending on, and including, the trading day immediately preceding the date on which the Company provides a notice of redemption at a redemption price equal to 100% of the principal amount of the Convertible Notes to be redeemed, plus any accrued and unpaid special interest and additional interest, if any, to, but excluding, the redemption date.

Upon the occurrence of a fundamental change (as defined in the indenture governing the Convertible Notes), subject to certain conditions, holders may require the Company to repurchase all or a portion of the Convertible Notes for cash at a price equal to 100% of the principal amount of the Convertible Notes to be repurchased, plus any accrued and unpaid special interest and additional interest, if any, to, but excluding, the fundamental change repurchase date.

Note 8. Operating Leases

The Company leases data center facilities and office space under generally non-cancelable operating lease agreements, which expire at various dates through 2027. Facility leases generally include renewal options and may include escalating rental payment provisions. Additionally, the leases may require us to pay a portion of the related operating expenses. Rent expense related to these operating leases for the three months ended September 30, 2022 and 2021 was \$15,356 and \$12,798, respectively, and \$40,187 and \$37,128 for the nine months ended September 30, 2022 and 2021, respectively.

The Company entered into separate sublease agreements related to its New York office space effective as of March 2022 and June 2022, respectively. As defined within the lease and sublease agreements, the Company remains primarily liable to the landlord for the performance of all obligations in the event that the sublessees do not perform their obligations under their respective leases. As a result of the sublease arrangements, future minimum rental commitments under operating leases will be offset by sublease amounts to be paid by the sublessees. The Company recognized a loss on the sublease of \$1,471 for the nine months ended September 30, 2022. The total of minimum sublease amounts to be received in the future under non-cancelable subleases is \$5,496 as of September 30, 2022.

Future minimum payments under operating lease agreements, net of sublease payments, as of September 30, 2022, were as follows:

2022 (three months remaining)	\$	13,600
2023		66,467
2024		74,689
2025		40,847
2026		28,067
Thereafter		32,017
Total minimum operating lease payments	\$	255,687

Note 9. Commitments and Contingencies

Purchase Commitments

As of September 30, 2022, the Company had long-term commitments for bandwidth usage with various networks and internet service providers and entered into purchase orders with various vendors. The Company's purchase commitments have not materially changed since December 31, 2021.

Letters of Credit

In conjunction with the execution of certain office space operating leases, letters of credit in the aggregate amount of \$ 1,935 and \$2,038 were issued and outstanding as of September 30, 2022 and December 31, 2021, respectively. No draws have been made under such letters of credit. These funds are included as Restricted cash on the Condensed Consolidated Balance Sheets as they are related to long-term operating leases and are included in beginning and ending Cash, cash equivalents and restricted cash in the Condensed Consolidated Statements of Cash Flows. Certain of the letters of credit can be reduced on an annual basis until the end of 2022, at which point the deposit required will similarly reduce to meet minimum threshold requirements.

Legal Proceedings

The Company may be involved in various legal proceedings and litigation arising in the ordinary course of business. While it is not feasible to predict or determine the ultimate disposition of any such litigation matters, the Company believes that any such legal proceedings will not have a material adverse effect on its condensed consolidated financial position, results of operations, or liquidity.

Note 10. Stockholders' Equity

Common Stock

The Company's amended and restated certificate of incorporation authorizes the issuance of common and preferred stock. Holders of common stock are entitled to one vote per share.

As of September 30, 2022 and December 31, 2021, the Company was authorized to issue 750,000,000 shares of common stock with a par value of \$0.000025 per share.

Preferred Stock

In connection with our initial public offering in March 2021 ("IPO"), the Company's amended and restated certificate of incorporation became effective, which authorized the issuance of 10,000,000 shares of preferred stock with a par value of \$ 0.000025 per share with rights and preferences, including voting rights, designated from time to time by the Company's Board of Directors. No shares of preferred stock were issued or outstanding as of September 30, 2022 or December 31, 2021.

Share Buyback Program

On February 23, 2022, the Company's Board of Directors approved the repurchase of up to an aggregate of \$ 300,000 of the Company's common stock throughout fiscal year 2022 ("Previous Program"). As of May 16, 2022, the Company repurchased shares representing the entire amount available under the Previous Program. On May 23, 2022, the Company's Board of Directors approved a new stock repurchase program authorizing the repurchase of up to an additional \$300,000 of its common stock throughout fiscal year 2022 (the "Current Program"). As of August 19, 2022, the Company repurchased shares representing the entire amount available under the Current Program.

The Company repurchased and retired 1,078,650 and 13,626,594 shares of common stock in the open market for an aggregate purchase price of \$50,000 and \$600,000 during the three and nine months ended September 30, 2022, respectively. All purchased shares were retired and are reflected as a reduction of Common stock for the par value of shares, with the excess applied to Additional paid-in capital.

Treasury Stock

The Company records treasury stock at the cost to acquire shares and is included as a component of Stockholders' equity. The Company's Board of Directors approved the retirement of the balance of treasury stock as of August 1, 2022. At December 31, 2021, the Company had 1,968,228 shares of treasury stock which were carried at its cost basis of \$4,598 on the Condensed Consolidated Balance Sheets.

Note 11. Stock-Based Compensation

Equity Incentive Plan

In March 2021, the Company's Board of Directors adopted, and the stockholders approved, the 2021 Equity Incentive Plan. The 2021 Equity Incentive Plan is a successor to and continuation of the 2013 Stock Plan. The 2021 Equity Incentive Plan became effective on the date of the IPO with no further grants being made under the 2013 Stock Plan, however, awards outstanding under the 2013 Stock Plan will continue to be governed by their existing terms. The 2021 Equity Incentive Plan provides for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, restricted stock awards, restricted stock units awards ("RSUs"), performance awards, and other awards to employees, directors, and consultants up to an aggregate of 36,290,381 shares of common stock as of September 30, 2022. Shares issued pursuant to the exercise of these awards are transferable by the holder.

Stock Options

Stock options granted have a maximum term of ten years from the grant date, are exercisable upon vesting and vest over a period of four years. Stock option activity for the nine months ended September 30, 2022 was as follows:

	Number of Options Outstanding	Weighted-Average Exercise Price	Weighted-Average Remaining Life in Years	Aggregate Intrinsic Value
Outstanding at January 1, 2022	12,434,159	\$ 7.19	7.64	\$ 909,494
Exercised	(1,656,764)	6.25		
Forfeited or cancelled	(423,967)	9.46		
Outstanding at September 30, 2022	10,353,428	7.24	6.46	299,478
Vested and exercisable at September 30, 2022	6,929,561	6.32	6.15	206,875
Vested and unvested expected to vest at September 30, 2022	9,637,482	\$ 7.00	6.39	\$ 281,090

The aggregate intrinsic value represents the difference between the fair value of common stock and the exercise price of outstanding in-the-money options. The aggregate intrinsic value of exercised options for the nine months ended September 30, 2022 and 2021 was \$78,012 and \$98,724, respectively.

No options were granted during the nine months ended September 30, 2022 and 2021. The aggregate estimated fair value of stock options granted to participants that vested during the nine months ended September 30, 2022 and 2021 was \$13,452 and \$15,402, respectively.

As of September 30, 2022, there was \$19,329 of unrecognized stock-based compensation related to outstanding stock options granted that is expected to be recognized over a weighted-average period of 1.77 years.

RSUs

RSUs granted vest over four years. RSU activity for the nine months ended September 30, 2022 was as follows:

	Shares	Weighted-Average Fair Value
Unvested balance at January 1, 2022	3,334,137	\$ 45.74
Granted	2,774,362	45.73
Vested	(1,107,936)	44.11
Forfeited or cancelled	(329,516)	47.09
Unvested balance at September 30, 2022	4,671,047	46.02
Vested and expected to vest at September 30, 2022	2,946,410	\$ 46.39

As of September 30, 2022, there was \$125,828 of unrecognized stock-based compensation related to outstanding RSUs granted that is expected to be recognized over a weighted-average period of 3.06 years.

PRSUs

The Company issued performance-based restricted stock units ("PRSUs") which will vest based on the achievement of each award's established performance targets. PRSU activity for the nine months ended September 30, 2022 was as follows:

	Shares	Weighted-Average Fair Value
Unvested balance at January 1, 2022	578,949	\$ 48.04
Granted	436,387	60.72
Vested	(207,001)	47.58
Forfeited or cancelled	(30,497)	41.24
Adjusted by performance factor	(89,769)	41.24
Unvested balance at September 30, 2022	688,069	\$ 56.94

At the end of each reporting period, the Company will adjust compensation expense for the PRSUs based on its best estimate of attainment of the below specified performance metrics. The cumulative effect on current and prior periods of a change in the estimated number of PRSUs that are expected to be earned during the performance period will be recognized as an adjustment to earnings in the period of the revision.

Compensation cost in connection with the probable number of shares that will vest will be recognized using the accelerated attribution method. As of September 30, 2022, the Company determined that it was not probable that the Long Term Incentive Plan ("LTIP") PRSUs granted to certain executives of the Company with respect to the Company's 2022 financial performance, and the other PRSU awards would vest. There is \$1,714 of unrecognized stock-based compensation that is expected to be recognized over a weighted-average period of 0.94 years in regards to the 2021 LTIP PRSUs with respect to the Company's 2021 performance.

LTIP PRSUs

The Company grants LTIP PRSUs to certain executives of the Company during the first fiscal quarter. A percentage of the LTIP PRSUs will become eligible to vest based on the Company's financial performance level at the end of each fiscal year. The financial performance level is determined as the percentage equal to the sum of the revenue growth percentage and profitability percentage.

The number of LTIP PRSUs received will depend on the achievement of financial metrics relative to the approved performance targets. Depending on the actual financial metrics achieved relative to the target financial metrics throughout the defined performance period of the award, the number of LTIP PRSUs that vest could range from 0% to 200% of the target amount, and are subject to the Board of Director's approval of the level of achievement against the approved performance targets.

Assuming the minimum performance target is achieved, one-third of the aggregate number of the LTIP PRSUs shall vest on the later of (i) March 1 or (ii) two trading days following the public release of the Company's financial results, and the remainder shall vest in eight equal quarterly installments subject, in each case, to the individual's continuous service through the applicable vesting.

On February 24, 2022, the financial performance of the LTIP PRSUs granted in 2021 was determined to be achieved at 155% of the target amount. This resulted in a performance factor reduction of 89,769 shares from the original maximum shares achievable of 398,949.

On March 1, 2022, the Company granted an LTIP PRSU award with a maximum shares achievable of 436,387, subject to the above actual financial metrics achieved relative to the target financial metrics for fiscal year 2022.

Other PRSUs

In addition to the above awards, certain other PRSUs have been awarded subject to other various performance measures including the achievement of revenue targets and product launches.

On May 24, 2022, the financial performance of one of the Company's other PRSUs was determined to be achieved at 100% of the target amount due to a successful product launch. On June 1, 2022, all 60,000 shares were fully vested.

MRSUs

On July 27, 2021, the Company's Board of Directors granted a market-based restricted stock unit ("MRSU") award for 3,000,000 shares of the Company's common stock to the Company's Chief Executive Officer, Yancey Spruill, which will vest upon the satisfaction of certain service conditions and the achievement of certain Company stock price goals, as described below.

The MRSU, which has a grant date fair value of \$ 75,300 derived by using a discrete model based on multiple stock price-paths developed through the use of a Monte Carlo simulation, is divided into five tranches that will be earned based on the achievement of stock price goals, measured based on the average of the Company's closing stock price over a consecutive ninety (90) trading day period during the performance period as set forth in the table below.

Tranche	Company Stock Price Target	Number of Eligible MRSUs
1	\$93.50	475,000
2	\$140.00	575,000
3	\$187.00	650,000
4	\$233.50	650,000
5	\$280.50	650,000

To the extent earned based on the stock price targets set forth above, the MRSU will vest over a seven-year period beginning on the date of grant in annual amounts equal to 14%, 14%, 14%, 14%, 14%, 15% and 15%, respectively, on each anniversary of the date of grant.

MRSU activity for the nine months ended September 30, 2022 was as follows:

	Shares	Weighted-Average Fair Value
Unvested balance at January 1, 2022	3,000,000	\$ 25.12
Granted	—	—
Unvested balance at September 30, 2022	3,000,000	\$ 25.12

As of September 30, 2022, there was \$54,817 of unrecognized stock-based compensation related to the MRSUs granted that is expected to be recognized over a weighted-average period of 3.76 years.

ESPP

In March 2021, the Company's Board of Directors adopted, and the stockholders approved, the 2021 Employee Stock Purchase Plan ("ESPP"). Eligible employees enroll in the offering period at the start of each purchase period, whereby they may purchase a number of shares at a price per share equal to 85% of the lesser of (1) the stock price at the employee's first participation in the offering period or (2) the fair market value of the Company's common stock on the purchase date. After the end of an offering period, a new offering will automatically begin on the date that immediately follows the conclusion of the preceding offering. The ESPP provides for the grant of up to an aggregate of 3,272,076 shares of common stock as of September 30, 2022.

2021 Offering

The initial offering period commenced on the IPO date and consisted of two purchase periods, the first of which had a purchase date of November 19, 2021 and the second and final purchase period had a purchase date of May 20, 2022 (the "2021 Offering").

In connection with the purchase period that ended on November 19, 2021, there were 117,996 shares of common stock, net of shares withheld for taxes, purchased by employees at a price of \$39.95. In connection with the purchase period that ended on May 20, 2022, there were 144,867 shares of common stock, net of shares withheld for taxes, purchased by employees at a price of \$36.26.

2022 Offering

A new offering period commenced on May 23, 2022 and will consist of two purchase periods, the first of which will have a purchase date of November 18, 2022 and the second and final purchase will have a purchase date of May 19, 2023 (the "2022 Offering"). Under the terms of the ESPP, in the event that the Company's stock price on the first day of the purchase period beginning on November 21, 2022 is lower than the stock price at the beginning of the offering, the current offering will terminate immediately and a new 12 month offering will automatically begin with purchase dates on May 19, 2023 and November 20, 2023. As of September 30, 2022, 3,009,213 shares of common stock remain available for issuance under the ESPP.

During the three and nine months ended September 30, 2022, the Company recorded stock-based compensation associated with the ESPP of \$902 and \$3,441, respectively, and \$186 and \$2,108 for the three and nine months ended September 30, 2021. As of September 30, 2022, \$ 2,682 has been withheld on behalf of employees.

Restricted Shares

In connection with the acquisition of Nimbella, the Company issued 200,204 shares of restricted stock for \$63.11 per share for a total value of \$12,635 to the founders of Nimbella. These shares vest equally on March 1, 2023 and September 1, 2024 and are expensed on a straight line basis over 36 months. The restricted stock is subject to forfeiture and dependent upon each founder's continuous service on the vesting date. Total stock-based compensation for the three and nine months ended September 30, 2022 was \$1,053 and \$3,159, respectively, and \$346 for the three and nine months ended September 30, 2021. As of September 30, 2022, there was \$8,081 of unrecognized stock-based compensation related to outstanding restricted shares granted that is expected to be recognized over a weighted-average period of 2.20 years.

Stock-Based Compensation

Stock-based compensation was included in the Condensed Consolidated Statements of Operations as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Cost of revenue	\$ 492	\$ 196	\$ 1,405	\$ 797
Research and development	8,236	6,099	28,617	13,794
Sales and marketing	3,356	2,582	10,553	5,621
General and administrative	11,510	9,678	37,183	17,168
Total	\$ 23,594	\$ 18,555	\$ 77,758	\$ 37,380

Note 12. Net Loss per Share Attributable to Common Stockholders

The following table presents the calculation of basic and diluted net loss per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2022	2021	2022	2021
Basic net income (loss) per share:				
Net income (loss) attributable to common stockholders	\$ 10,097	\$ (1,852)	\$ (14,217)	\$ (7,378)
Weighted average shares used to compute net income (loss) per share, basic and diluted	96,559	107,955	102,134	88,265
Basic net income (loss) per share	<u>\$ 0.10</u>	<u>\$ (0.02)</u>	<u>\$ (0.14)</u>	<u>\$ (0.08)</u>
Diluted net income (loss) per share:				
Net income (loss) attributable to common stockholders	\$ 10,097	\$ (1,852)	\$ (14,217)	\$ (7,378)
Number of shares used in basic calculation	96,559	107,955	102,134	88,265
Weighted-average effect of diluted securities:				
Stock Options	8,008	—	—	—
RSUs	275	—	—	—
PRSUs	89	—	—	—
Number of shares used in diluted calculation	104,931	107,955	102,134	88,265
Diluted net income (loss) per share	<u>\$ 0.10</u>	<u>\$ (0.02)</u>	<u>\$ (0.14)</u>	<u>\$ (0.08)</u>

The effect of the Convertible Notes and ESPP were excluded from the calculation of diluted net income per share for the three months ended September 30, 2022 as the effect would have been anti-dilutive.

Potentially dilutive securities that were not included in the diluted per share calculations because they would be anti-dilutive were as follows:

	As of September 30,	
	2022	2021
Stock Options	10,353,428	13,451,177
RSUs	4,671,047	3,104,367
PRSUs	688,069	578,949
MRSU	3,000,000	3,000,000
ESPP	217,126	253,768
Convertible Notes	8,402,700	—
Total	27,332,370	20,388,261

Note 13. Income Taxes

The computation of the provision for or benefit from income taxes for interim periods is determined by applying the estimated annual effective tax rate to year-to-date income (loss) before tax and adjusting for discrete tax items recorded in the period, if any.

For the three and nine months ended September 30, 2022, the Company recorded a tax expense of \$ 442 and \$2,611, respectively. The effective tax rate for the three and nine months ended September 30, 2022 was 4.2% and (22.5)%, respectively. The effective tax rate differs from the statutory rate primarily as a result of not recognizing deferred tax assets for U.S. losses due to a full valuation allowance against the U.S. deferred tax assets, and excess tax benefits from stock-based compensation.

For the three and nine months ended September 30, 2021, the Company recorded a tax benefit of \$ 145 and a tax expense of \$378, respectively. The effective tax rate for the three and nine months ended September 30, 2021 was 7.3% and (5.4)%, respectively. The effective tax rate differs from the statutory rate primarily as a result of not recognizing

deferred tax assets for U.S. losses due to a full valuation allowance against the U.S. deferred tax assets, and excess tax benefits from stock-based compensation.

The provision for income taxes consists primarily of income taxes related to international jurisdictions in which the Company conducts business. Based on the available supporting evidence, including the amount and timing of future taxable income, the Company has concluded that it is more likely than not that a significant portion of the deferred tax assets will not be realized. As such, the Company maintains a full valuation allowance on its U.S. deferred tax assets.

For the three and nine months ended September 30, 2022, uncertain tax positions recorded by the Company resulted in an expense of \$ 866 and \$1,042, respectively. For the three and nine months ended September 30, 2021, uncertain tax positions recorded by the Company resulted in an expense of \$206 and \$340, respectively. To the extent the remaining uncertain tax positions are ultimately recognized, the Company's effective tax rate may be impacted in future periods. The Company's policy is to recognize interest and penalties related to uncertain tax positions in income tax expense.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our audited consolidated financial statements and the related notes and the discussion under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2021, filed with the SEC on February 25, 2022. This discussion, particularly information with respect to our future results of operations or financial condition, business strategy, plans and objectives of management for future operations, includes forward-looking statements that involve risks and uncertainties as described under the heading "Special Note Regarding Forward-Looking Statements" in this Quarterly Report on Form 10-Q.

Overview

DigitalOcean is a leading cloud computing platform offering on-demand infrastructure and platform tools for developers, start-ups and small and medium-sized businesses, or SMBs. We were founded with the guiding principle that the transformative benefits of the cloud should be easy to leverage, broadly accessible, reliable and affordable. Our platform simplifies cloud computing, enabling our customers to rapidly accelerate innovation and increase their productivity and agility. Individual and business customers, including software engineers, researchers, data scientists, system administrators, students and hobbyists, use our platform to build, deploy and scale software applications. Our customers use our platform across numerous industry verticals and for a wide range of use cases, such as web and mobile applications, website hosting, e-commerce, media and gaming, personal web projects, and managed services, among many others. We believe that our focus on simplicity, community, open source and customer support are the four key differentiators of our business, driving a broad range of customers around the world to build their applications on our platform.

Improving the developer experience and increasing developer productivity are core to our mission. Our developer cloud platform was designed with simplicity in mind to ensure that software developers can spend less time managing their infrastructure and more time turning their ideas into innovative applications to grow their businesses. Simplicity guides how we design and enhance our easy-to-use-interface, the core capabilities we offer our customers and our approach to predictable and transparent pricing for our solutions. We offer mission-critical infrastructure solutions across compute, storage and networking, and we also enable developers to extend the native capabilities of our cloud with fully managed application, container and database offerings. In just minutes, developers can set up thousands of virtual machines, secure their projects, enable performance monitoring and scale up and down as needed.

In September 2022, we acquired Cloudways, a leading managed cloud hosting and software-as-a-service (SaaS) provider for SMBs, which allows for simple onboarding and day-to-day management that is purpose-built for SMBs looking to offload the complexities of cloud infrastructure so they can spend more time running and scaling their businesses.

We generate revenue from the usage of our cloud computing platform by our customers, including but not limited to compute, storage and networking services. We recognize revenue based on the customer utilization of these resources. Our pricing is consumption-based and billed monthly in arrears, making it easy for our customers to track usage on an ongoing basis and optimize their deployments. The pricing for each of our products is available on our website.

We have historically generated almost all of our revenue from our efficient self-service customer acquisition model, which we complement with a targeted sales force focused on inside sales, outside sales and partnership opportunities to drive revenue growth. Our model enables customers to get started on our platform very quickly and without the need for assistance. We focus heavily on enabling a self-service, low-friction model that makes it easy for users to try, adopt and use our products. For the three months ended September 30, 2022 and 2021, our sales and marketing expense was approximately 13% and 12% of our revenue, respectively. The efficiency of our go-to-market model and our focus on the needs of the individual and SMB markets have enabled us to drive organic growth and establish a truly global customer base across a broad range of industries.

Our customers are spread across over 185 countries and approximately two-thirds of our revenue has historically come from customers located outside the United States. For the three months ended September 30, 2022, 38% of our revenue was generated from North America, 30% from Europe, 22% from Asia and 10% from the rest of the world. Excluding Cloudways, revenue from customers paying more than \$50 per month as a percentage of total revenue grew from 83% in the quarter ended September 30, 2021 to 86% in the quarter ended September 30, 2022.

Our average revenue per customer, or ARPU, has increased significantly from \$61.97 in the quarter ended September 30, 2021 to \$79.22 in the quarter ended September 30, 2022. We had no material customer concentration as our top 25 customers made up approximately 9% and 10% of our revenue in the three months ended September 30, 2022 and 2021, respectively. We have experienced strong and predictable growth in recent periods. Our annual run-rate revenue, or ARR, as of September 30, 2022 was \$641 million, up from \$455 million as of September 30, 2021. ARR as of the end of each month represents total revenue for that month multiplied by 12.

Our larger customers paying more than \$50 per month drive the great majority of our revenue and are an important measure of our growth. We have a growing number of these customers with higher spending levels and these larger customers are expanding their business with us at a faster rate than our overall customer base. We had approximately 142,000 customers paying more than \$50 per month as of September 30, 2022, up from approximately 95,000 as of September 30, 2021.

Impact of Russia-Ukraine Conflict

In February 2022, Russian military forces invaded Ukraine. In response, Ukrainian military personnel and civilians are actively resisting the invasion and a variety of responsive economic sanctions and export controls measures aimed at Russia, Belarus, and certain regions of Ukraine have been imposed by countries and governmental bodies around the world, including the United States and the European Union. These measures prohibit or restrict dealings with certain entities and individuals, including banks and financial institutions, in the target countries and territories.

We are committed to conducting our activities in compliance with applicable sanctions laws and regulations issued by countries in which we do business. We do not currently have employees or direct operations in Russia, Belarus or Ukraine, nor do we engage in activities with sanctioned parties; however, certain of our customers conduct business in these countries and regions. Recent sanction measures, including those targeting major Russian banks and financial institutions and the removal of certain Russian banks from the SWIFT messaging system, have impacted our ability to receive payments involving parties located in Russia. Aggregate revenue from our customers with business activities in Russia, Belarus and Ukraine was approximately 2.1% and 3.6% of our total revenue for the three months ended September 30, 2022 and 2021, respectively. As the situation continues to evolve, further sanctions actions may be forthcoming and could continue to impact the revenues received from certain customers.

The full impact of the conflict on our business operations and financial performance remains uncertain and will depend on future developments, including the severity and duration of the conflict and its impact on our customers and third-party providers, as well as regional and global economic conditions. We will continue to monitor and assess the situation and pursue prudent decisions for our team members, customers, and business.

Key Business Metrics

We utilize the key metrics set forth below to help us evaluate our business and growth, identify trends, formulate financial projections and make strategic decisions. We are not aware of any uniform standards for calculating these key metrics, and other companies may not calculate similarly titled metrics in a consistent manner, which may hinder comparability.

	Three Months Ended September 30,	
	2022	2021
Customers paying more than \$50 per month	142,000	95,000
ARPU	\$ 79.22	\$ 61.97
ARR (in millions)	\$ 641	\$ 455
Net dollar retention rate	118	%
	116	%

Customers

The number and growth of our larger customers is of particular importance to us as these customers represent a significant majority of our revenue and revenue growth, and they are more representative of the SMB customers that grow on our platform and use multiple products. We define customers paying more than \$50 per month as customers having generated an invoice of greater than \$50 for that period.

ARPU

We believe that our average revenue per customer, which we refer to as ARPU, is a strong indication of our ability to land new customers with higher spending levels and expand usage of our platform by our existing customers. We calculate ARPU on a monthly basis as our total revenue in that period divided by the number of customers determined as of the last day of that period. For a quarterly or annual period, ARPU is determined as the weighted average monthly ARPU over such three or 12-month period.

ARR

Given the renewable nature of our business, we view annual run-rate revenue as an important indicator of our current progress towards meeting our revenue targets and projected growth rate going forward. We calculate ARR at a point in time by multiplying the latest monthly period's revenue by 12.

Net Dollar Retention Rate

Our ability to maintain long-term revenue growth and achieve profitability is dependent on our ability to retain and grow revenue from our existing customers. We have a history of retaining customers for multiple years and in many cases increasing their spend with us over time. To help us measure our performance in this area, we monitor our net dollar retention rate. We calculate net dollar retention rate monthly by starting with the revenue from the cohort of all customers during the corresponding month 12 months prior, or the Prior Period Revenue. We then calculate the revenue from these same customers as of the current month, or the Current Period Revenue, including any expansion and net of any contraction or attrition from these customers over the last 12 months. The calculation also includes revenue from customers that generated revenue before, but not in, the corresponding month 12 months prior, but subsequently generated revenue in the current month and are therefore reflected in the Current Period Revenue. We include this group of re-engaged customers in this calculation because our customers frequently use our platform for projects that stop and start over time. We then divide the total Current Period Revenue by the total Prior Period Revenue to arrive at the net dollar retention rate for the relevant month. For a quarterly or annual period, the net dollar retention rate is determined as the average monthly net dollar retention rates over such three or 12-month period.

Components of Results of Operations

Revenue

We provide cloud computing services, including but not limited to compute, storage and networking, to our customers. We recognize revenue based on the customer utilization of these resources. Customer contracts are primarily month-to-month and do not include any minimum guaranteed quantities or fees. Fees are billed monthly, and payment is typically due upon invoicing. Revenue is recognized net of allowances for credits and any taxes collected from customers, which are subsequently remitted to governmental authorities. We may offer sales incentives in the form of promotional and

referral credits and grant credits to encourage customers to use our services. These types of promotional and referral credits typically expire in two months or less if not used. For credits earned with a purchase, they are recorded as contract liabilities when earned and recognized at the earlier of redemption or expiration. The majority of credits are redeemed in the month they are earned.

Cost of Revenue

Cost of revenue consists primarily of fees related to operating in third-party co-location facilities, personnel expenses for those directly supporting our data centers and non-personnel costs, including amortization of capitalized internal-use software development costs and depreciation of our data center equipment. Third-party co-location facility costs include data center rental fees, power costs, maintenance fees, network and bandwidth. Personnel expenses include salaries, bonuses, benefits, and stock-based compensation.

We intend to continue to invest additional resources in our infrastructure to support our product portfolio and scalability of our customer base. The level, timing and relative investment in our infrastructure could affect our cost of revenue in the future.

Operating Expenses

Research and Development Expenses

Research and development expenses consist primarily of personnel costs including salaries, bonuses, benefits and stock-based compensation. Research and development expenses also include amortization of capitalized internal-use software development costs for research and development activities, which are amortized over three years, and professional services, as well as costs related to our efforts to add new features to our existing offerings, develop new offerings, and ensure the security, performance, and reliability of our global cloud platform. We expect research and development expenses to increase in absolute dollars as we continue to invest in our platform and product offerings.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of personnel costs of our sales, marketing and customer support employees including salaries, bonuses, benefits and stock-based compensation. Sales and marketing expenses also include costs for marketing programs, advertising and professional service fees. We expect sales and marketing expenses to continue to increase in absolute dollars as we enhance our product offerings and implement new marketing strategies.

General and Administrative Expenses

General and administrative expenses consist primarily of personnel costs of our human resources, legal, finance, and other administrative functions including salaries, bonuses, benefits, and stock-based compensation. General and administrative expenses also include bad debt expense, software, payment processing fees, business insurance, depreciation and amortization expenses, rent and facilities costs, loss on sublease, and other administrative costs. We expect to incur significant additional legal, accounting and other expenses to support our operations as a public company, including costs associated with our compliance with the Sarbanes-Oxley Act. We also expect general and administrative expenses to increase in absolute dollars as we continue to grow our business.

Other (Income) Expense

Other (income) expense consists primarily of interest expense on our convertible notes and existing credit facility, loss on extinguishment of debt, accretion/amortization of premium/discounts and interest income from our available-for-sale investments, and gains or losses on foreign currency exchange.

Income Tax Expense (Benefit)

Income tax expense (benefit) consists primarily of income taxes in certain foreign and state jurisdictions in which we conduct business. We maintain a full valuation allowance on our U.S. federal and state deferred tax assets as we have concluded that it is more likely than not that the deferred assets will not be realized.

Results of Operations

The following table sets forth our results of operations for the periods presented:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
(in thousands)				
Revenue	\$ 152,115	\$ 111,428	\$ 413,324	\$ 308,899
Cost of revenue ⁽¹⁾	54,536	43,506	148,539	126,195
Gross profit	97,579	67,922	264,785	182,704
Operating expenses:				
Research and development ⁽¹⁾	30,243	29,927	104,440	79,450
Sales and marketing ⁽¹⁾	19,097	13,312	56,360	35,545
General and administrative ⁽¹⁾	38,847	26,354	115,109	68,756
Total operating expenses	88,187	69,593	275,909	183,751
Income (loss) from operations	9,392	(1,671)	(11,124)	(1,047)
Other (income) expense	(1,147)	326	482	5,953
Income (loss) before income taxes	10,539	(1,997)	(11,606)	(7,000)
Income tax expense (benefit)	442	(145)	2,611	378
Net income (loss) attributable to common stockholders	\$ 10,097	\$ (1,852)	\$ (14,217)	\$ (7,378)

(1) Includes stock-based compensation as follows:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
(in thousands)				
Cost of revenue	\$ 492	\$ 196	\$ 1,405	\$ 797
Research and development	8,236	6,099	28,617	13,794
Sales and marketing	3,356	2,582	10,553	5,621
General and administrative	11,510	9,678	37,183	17,168
Total	\$ 23,594	\$ 18,555	\$ 77,758	\$ 37,380

The following table sets forth our results of operations as a percentage of revenue for the periods presented:

	Three Months Ended				Nine Months Ended			
	September 30,				September 30,			
	2022	2021	2022	2021	2022	2021	2022	2021
Revenue	100	%	100	%	100	%	100	%
Cost of revenue	36		39		36		41	
Gross profit	64		61		64		59	
Operating expenses:								
Research and development	20		27		25		26	
Sales and marketing	13		12		14		12	
General and administrative	26		24		28		22	
Total operating expenses	59		63		67		60	
Income (loss) from operations	5		(2)		(3)		(1)	
Other (income) expense	(1)		—		—		2	
Income (loss) before income taxes	6		(2)		(3)		(3)	
Income tax expense (benefit)	—		—		1		—	
Net income (loss) attributable to common stockholders	6	%	(2)	%	(4)	%	(3)	%

Comparison of the Three Months Ended September 30, 2022 and 2021

Revenue

	Three Months Ended September 30,			
	2022		2021	
	(in thousands)			
Revenue	\$ 152,115	\$ 111,428	\$ 40,687	37 %

Revenue increased \$40.7 million, or 37%, for the three months ended September 30, 2022, including a \$4.1 million net revenue contribution from the Cloudways acquisition, compared to the three months ended September 30, 2021, primarily due to a 28% increase in ARPU to \$79.22 from \$61.97 and an increase of 50% in the number of customers who spend more than \$50 per month. The increase in ARPU was primarily driven by continued adoption of our products by our customers leading to higher average usage on our platform.

Cost of Revenue

	Three Months Ended September 30,			
	2022		2021	
	(in thousands)			
Cost of revenue	\$ 54,536	\$ 43,506	\$ 11,030	25 %

Cost of revenue increased \$11.0 million, or 25%, for the three months ended September 30, 2022 compared to the three months ended September 30, 2021, primarily due to higher depreciation and co-location and ancillary costs of our network equipment to support the growth in our business, as well as costs associated with our revenue share programs. Gross profit increased to 64% for the three months ended September 30, 2022 from 61% for the three months ended September 30, 2021, primarily due to a decline in depreciation as a percentage of revenue and lower colocation and maintenance costs as a percentage of revenue.

Operating Expenses

	Three Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Research and development	\$ 30,243	\$ 29,927	\$ 316	1 %
Sales and marketing	19,097	13,312	5,785	43 %
General and administrative	38,847	26,354	12,493	47 %
Total operating expenses	\$ 88,187	\$ 69,593	\$ 18,594	27 %

Research and development expenses increased \$0.3 million, or 1%, for the three months ended September 30, 2022 compared to the three months ended September 30, 2021, primarily due to higher stock-based compensation.

Sales and marketing expenses increased \$5.8 million, or 43%, for the three months ended September 30, 2022 compared to the three months ended September 30, 2021, primarily due to higher stock-based compensation, increases in advertising costs and amortization of acquired intangible assets.

General and administrative expenses increased \$12.5 million, or 47%, for the three months ended September 30, 2022 compared to the three months ended September 30, 2021, primarily due to higher stock-based compensation, and increases in VAT and other foreign non-income taxes, bad debt expense and transaction related expenses.

Other (Income) Expense

	Three Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Other (income) expense	\$ (1,147)	\$ 326	\$ (1,473)	(452)%

Other (income) expense decreased 452% for the three months ended September 30, 2022 compared to the three months ended September 30, 2021, primarily due to interest income and accretion from our marketable securities, partially offset by amortization expense from our convertible notes.

Income Tax Expense (Benefit)

	Three Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Income tax expense (benefit)	\$ 442	\$ (145)	\$ 587	(405)%

Income tax expense (benefit) decreased \$0.6 million, or (405)%, for the three months ended September 30, 2022 compared to the three months ended September 30, 2021, primarily due to income taxes related to international jurisdictions in which we conduct business.

Comparison of the Nine Months Ended September 30, 2022 and 2021

Revenue

	Nine Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Revenue	\$ 413,324	\$ 308,899	\$ 104,425	34 %

Revenue increased \$104.4 million, or 34%, for the nine months ended September 30, 2022, including a \$4.1 million net revenue contribution from Cloudways, compared to the nine months ended September 30, 2021, primarily due to a 27% increase in ARPU to \$73.36 from \$57.95 and an increase of 50% in the number of customers who spend more than \$50 per month. The increase in ARPU was primarily driven by continued adoption of our products by our customers leading to higher average usage on our platform.

Cost of Revenue

	Nine Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Cost of revenue	\$ 148,539	\$ 126,195	\$ 22,344	18 %

Cost of revenue increased \$22.3 million, or 18%, for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021, primarily due to higher co-location costs and depreciation of our network equipment to support the growth in our business, as well as costs associated with our revenue share programs. Gross profit increased to 64% for the nine months ended September 30, 2022 from 59% for the nine months ended September 30, 2021, primarily due to a decline in depreciation as a percentage of revenue and lower colocation and maintenance costs as a percentage of revenue.

Operating Expenses

	Nine Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Research and development	\$ 104,440	\$ 79,450	\$ 24,990	31 %
Sales and marketing	56,360	35,545	20,815	59 %
General and administrative	115,109	68,756	46,353	67 %
Total operating expenses	\$ 275,909	\$ 183,751	\$ 92,158	50 %

Research and development expenses increased \$25.0 million, or 31%, for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021, primarily due to higher personnel costs and stock-based compensation.

Sales and marketing expenses increased \$20.8 million, or 59%, for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021, primarily due to higher personnel costs and stock-based compensation, and increases in advertising costs.

General and administrative expenses increased \$46.4 million, or 67%, for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021, primarily due to higher personnel costs and stock-based compensation, and increases in bad debt expense, insurance and software licensing fees, professional service fees, transaction related expenses, foreign taxes and loss on sublease.

Other (Income) Expense

	Nine Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Other (income) expense	\$ 482	\$ 5,953	\$ (5,471)	(92) %

Other (income) expense decreased \$5.5 million, or 92%, for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021, primarily due to lower interest expense due to the payoff of the term loan and notes payable in the first quarter of 2021, interest income from our marketable securities for the current period, and a loss on extinguishment of debt in the prior period, partially offset by amortization expense from our convertible notes.

Income Tax Expense

	Nine Months Ended September 30,		\$ Change	% Change
	2022	2021		
	(in thousands)			
Income tax expense	\$ 2,611	\$ 378	\$ 2,233	591 %

Income tax expense increased \$2.2 million, or 591%, for the nine months ended September 30, 2022 compared to the nine months ended September 30, 2021, primarily due to income taxes related to international jurisdictions in which we conduct business.

Liquidity and Capital Resources

We have funded our operations since inception primarily with cash flow generated by operations, private offerings of our securities, borrowings under our existing credit facility and capital expenditure financings. In March 2021, we consummated our IPO of 16.5 million shares of our common stock at an offering price of \$47.00 per share resulting in aggregate net proceeds to us of \$723.0 million after deducting the underwriting discounts and commissions and offering expenses payable by us.

In November 2021, we issued \$1.50 billion aggregate principal amount of our Convertible Notes in a private offering. The Convertible Notes will mature on December 1, 2026, unless earlier converted, redeemed or repurchased.

In February 2022, our Board of Directors approved the repurchase of up to an aggregate of \$300.0 million of our common stock throughout fiscal year 2022 ("Previous Program"). As of May 16, 2022, we repurchased the shares representing the entire amount available under the Previous Program. On May 23, 2022, our Board of Directors approved a new stock repurchase program authorizing the repurchase of up to an additional \$300.0 million of our common stock throughout fiscal year 2022 (the "Current Program"). As of August 19, 2022, we repurchased the shares representing the entire amount available under the Current Program. As of September 30, 2022, we repurchased and retired 13.6 million shares of common stock at an average price of \$44.03 per share for an aggregate purchase price of \$600.0 million, representing the entire amount available under the Previous Program and the Current Program.

In March 2022, we entered into a third amended and restated credit facility to increase our borrowing capacity from \$150.0 million to \$250.0 million. As of September 30, 2022, we had not drawn on the credit facility.

As of September 30, 2022, we had \$24.1 million in cash and cash equivalents and \$800.5 million in marketable securities. Our cash and cash equivalents primarily consist of money market funds and commercial paper. Our marketable securities consist of U.S. treasury securities, commercial debt securities, and commercial paper.

We believe our existing cash and cash equivalents, marketable securities, cash flow from operations, and availability under our credit facility will be sufficient to support working capital and capital expenditure requirements and our outstanding contractual commitments for at least the next 12 months.

The following table summarizes our cash flows for the periods presented:

<i>(In thousands)</i>	Nine Months Ended September 30,	
	2022	2021
Net cash provided by operating activities	\$ 130,008	\$ 100,376
Net cash used in investing activities	(1,199,742)	(81,204)
Net cash (used in) provided by financing activities	(610,541)	470,267
(Decrease) increase in cash, cash equivalents and restricted cash	(1,680,275)	489,439

Operating Activities

Our largest source of operating cash is cash collections from sales to our customers. Our primary uses of cash from operating activities are for personnel costs, data center co-location expenses, marketing expenses, payment processing fees, bandwidth and connectivity, server maintenance and software licensing fees.

Net cash provided by operating activities was \$130.0 million and \$100.4 million for the nine months ended September 30, 2022 and 2021, respectively, for which the increases in each year were primarily driven by an increase in cash collections from higher revenues, partially offset by an increase in cash expenses for personnel related costs.

Investing Activities

Net cash used in investing activities was \$1.2 billion for the nine months ended September 30, 2022 compared to \$81.2 million for the nine months ended September 30, 2021. The increase was driven by our investment in available-for-sale marketable securities of \$1.4 billion, the acquisition of Cloudways of \$305.2 million and purchase of intangible assets of \$4.9 million, partially offset by maturities of available-for-sale marketable securities of \$558.4 million.

Financing Activities

Net cash used in financing activities of \$610.5 million for the nine months ended September 30, 2022 was primarily due to the repurchase and retirement of our common stock for \$600.0 million.

Net cash provided by financing activities of \$470.3 million for the nine months ended September 30, 2021 was primarily due to net proceeds from our IPO of \$723.0 million, partially offset by repayments on the credit facility and notes payable of \$263.2 million.

Contractual Obligations and Commitments

We have various contractual obligations and commitments, such as long-term leases, purchase commitments and long-term debt, that are disclosed in the footnotes to the condensed consolidated financial statements. See Note 7. Debt, Note 8. Operating Leases, and Note 9. Commitments and Contingencies to our Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information regarding these commitments.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

There have been no material changes to our critical accounting policies as compared to those disclosed in the Annual Report on Form 10-K for the fiscal year ended December 31, 2021.

Recently Adopted Accounting Pronouncements

See Note 2, Summary of Significant Accounting Policies, in our Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for a discussion of recent accounting pronouncements.

Emerging Growth Company Status

We are an emerging growth company, as defined under the JOBS Act. The JOBS Act provides that an emerging growth company may take advantage of the extended transition period provided in Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. Therefore, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to use the extended transition period under the JOBS Act until the earlier of the date we (1) are no longer an emerging growth company or (2) affirmatively and irrevocably opt out of the extended transition period provided in the JOBS Act. As a result, our financial statements may not be comparable to companies that comply with new or revised accounting pronouncements as of public company effective dates.

Based on the market value of our common equity held by non-affiliates as of June 30, 2022 (the last business day of our most recently completed second fiscal quarter), we will cease to qualify as an emerging growth company as of the end of the fiscal year ending December 31, 2022. As a result, we will no longer be able to take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. In addition, we will no longer be able to use the extended transition period for complying with new or revised accounting standards available to emerging growth companies and will be required to adopt new or revised accounting standards as of the effective dates for public companies.

Non-GAAP Financial Measures

To supplement our consolidated financial statements, which are prepared and presented in accordance with generally accepted accounting principles in the United States, or GAAP, we provide investors with non-GAAP financial measures including: (i) adjusted gross profit and adjusted gross margin; (ii) non-GAAP income from operations and non-

GAAP operating margin; (iii) non-GAAP net income and non-GAAP diluted net income per share; and (iv) free cash flow and free cash flow margin. These measures are presented for supplemental informational purposes only, have limitations as analytical tools and should not be considered in isolation or as a substitute for financial information presented in accordance with GAAP. In particular, free cash flow is not a substitute for cash used in operating activities. Additionally, the utility of free cash flow as a measure of our financial performance and liquidity is further limited as it does not represent the total increase or decrease in our cash balance for a given period. Our calculations of each of these measures may differ from the calculations of measures with the same or similar titles by other companies and therefore comparability may be limited. Because of these limitations, when evaluating our performance, you should consider each of these non-GAAP financial measures alongside other financial performance measures, including the most directly comparable financial measure calculated in accordance with GAAP and our other GAAP results. A reconciliation of each of our non-GAAP financial measures to the most directly comparable financial measure calculated in accordance with GAAP is set forth below.

Adjusted Gross Profit and Adjusted Gross Margin

We believe adjusted gross profit and adjusted gross margin, when taken together with our GAAP financial results, provides a meaningful assessment of our performance, and is useful for the preparation of our annual operating budget and quarterly forecasts.

We define adjusted gross profit as gross profit exclusive of stock-based compensation, amortization of capitalized internal-use software development costs and depreciation of our data center equipment included within Cost of revenue. We exclude stock-based compensation, which is a non-cash item, because we do not consider it indicative of our core operating performance. We exclude depreciation and amortization, which primarily relates to our investments in our data center servers that are long lived assets with an economic life of five years, because it may not reflect our current or future cash spending levels to support our business. While we intend to spend a significant amount on capital expenditures on an absolute basis in the coming years, our capital expenditures as a percentage of revenue has declined significantly and will continue to decline. We define adjusted gross margin as a percentage of adjusted gross profit to revenue.

The following table presents a reconciliation of gross profit, the most directly comparable financial measure stated in accordance with GAAP, to adjusted gross profit for each of the periods presented:

<i>(In thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,	2022	September 30,	2021
Gross profit	\$ 97,579	\$ 67,922	\$ 264,785	\$ 182,704
Adjustments:				
Depreciation and amortization	23,442	20,838	68,278	60,105
Stock-based compensation	492	196	1,405	797
Adjusted gross profit	\$ 121,513	\$ 88,956	\$ 334,468	\$ 243,606
Gross margin	64 %	61 %	64 %	59 %
Adjusted gross margin	80 %	80 %	81 %	79 %

Non-GAAP Income from Operations and Non-GAAP Operating Margin

We define non-GAAP income from operations as (Loss) income from operations, excluding stock-based compensation, acquisition related compensation, amortization of acquired intangibles, acquisition and integration related costs, loss on sublease, asset impairment, restructuring and severance, and other unusual or non-recurring transactions as they occur. We define non-GAAP operating margin as non-GAAP income from operations as a percentage of revenue. We use non-GAAP income from operations to understand and evaluate our core operating performance and trends and to develop short-term and long-term operating plans. We believe that non-GAAP income from operations facilitates comparison of our operating performance on a consistent basis between periods, and when viewed in combination with our results prepared in accordance with GAAP, helps provide a broader picture of factors and trends affecting our results of operations.

The following table presents a reconciliation of Income (loss) from operations, the most directly comparable financial measure stated in accordance with GAAP, to Non-GAAP income from operations for each of the periods presented:

<i>(In thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
Income (loss) from operations	\$ 9,392	\$ (1,671)	\$ (11,124)	\$ (1,047)
Adjustments:				
Stock-based compensation	23,594	18,555	77,758	37,380
Acquisition related compensation	2,361	—	2,361	—
Amortization of acquired intangibles	1,661	168	2,687	320
Acquisition and integration related costs	2,700	280	2,868	280
Loss on sublease	—	—	1,471	—
Asset impairment	24	212	144	212
Non-GAAP income from operations	\$ 39,732	\$ 17,544	\$ 76,165	\$ 37,145
Operating margin	6 %	(1)%	(3)%	— %
Non-GAAP operating margin	26 %	16 %	18 %	12 %

Non-GAAP Net Income and Non-GAAP Diluted Net Income Per Share

We define non-GAAP net income (loss) as Net loss attributable to common stockholders, excluding stock-based compensation, acquisition related compensation, amortization of acquired intangibles, acquisition and integration related costs, release of VAT reserve, loss on sublease, loss on extinguishment of debt, asset impairment, restructuring and severance expense, revaluation of warrants, and other unusual or non-recurring transactions as they occur. We define non-GAAP diluted net income per share as non-GAAP net income divided by the weighted-average shares including the dilutive effects of our convertible preferred stock, warrants, stock options, RSUs, PRSUs, ESPP and Convertible Notes.

We believe non-GAAP net income per share provides our management and investors consistency and comparability with our past financial performance and facilitates period-to-period comparisons of operations, as this metric generally eliminates the effects of unusual or non-recurring items from period to period for reasons unrelated to overall operating performance.

The following table presents a reconciliation of Net income (loss) attributable to common stockholders, the most directly comparable financial measure stated in accordance with GAAP, to Non-GAAP Net income for each of the periods presented:

(In thousands)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2022	2021	2022	2021
GAAP Net income (loss) attributable to common stockholders	\$ 10,097	\$ (1,852)	\$ (14,217)	\$ (7,378)
Stock-based compensation	23,594	18,555	77,758	37,380
Acquisition related compensation	2,361	—	2,361	—
Amortization of acquired intangible assets	1,661	168	2,687	320
Acquisition and integration related costs	2,700	280	2,868	280
Reclaim of VAT reserve	—	(3,188)	—	(3,188)
Loss on sublease	—	—	1,471	—
Loss on extinguishment of debt	—	—	407	3,435
Asset impairment	24	212	144	212
Revaluation of warrants	—	—	—	(556)
Income tax effects of non-GAAP adjustments ⁽¹⁾	710	(19)	992	90
Non-GAAP net income ⁽²⁾	\$ 41,147	\$ 14,156	\$ 74,471	\$ 30,595
Non-GAAP diluted net income per share ⁽²⁾⁽³⁾	\$ 0.38	\$ 0.12	\$ 0.69	\$ 0.27
Weighted-average shares used to compute Non-GAAP diluted net income per share	113,334	120,854	114,509	114,815

(1) The income tax effects of non-GAAP adjustments are calculated based on the applicable statutory tax rate for the relevant jurisdiction, except for those items which are non-taxable or subject to valuation allowances for which the tax expense (benefit) was calculated at 0%. The tax benefit for amortization is calculated in a similar manner as the tax effects of the non-GAAP adjustments.

(2) Amounts are attributable for both the common and convertible preferred stockholders, treated as one class of stock, for the periods presented for 2021.

(3) Non-GAAP net income has been adjusted for the dilutive impact of deferred financing fees related to the Convertible Notes of \$1,480 and \$4,428 for the three and nine months ended September 30, 2022. The Convertible Notes were issued in November 2021.

Free Cash Flow and Free Cash Flow Margin

Free cash flow is a non-GAAP financial measure that we define as Net cash provided by operating activities less purchases of property and equipment, capitalized internal-use software costs and purchase of intangible assets. Free cash flow margin is calculated as free cash flow divided by total revenue. We believe that free cash flow and free cash flow margin are useful indicators of liquidity that provide information to management and investors about the amount of cash generated from our core operations that, after the purchases of property and equipment, can be used for strategic initiatives, including investing in our business and selectively pursuing acquisitions and strategic investments. We further believe that historical and future trends in free cash flow and free cash flow margin, even if negative, provide useful information about the amount of Net cash provided by operating activities that is available (or not available) to be used for strategic initiatives. For example, if free cash flow is negative, we may need to access cash reserves or other sources of capital to invest in strategic initiatives. One limitation of free cash flow and free cash flow margin is that they do not reflect our future contractual commitments. Additionally, free cash flow does not represent the total increase or decrease in our cash balance for a given period.

The following table presents our cash flows for the periods presented and a reconciliation of free cash flow and free cash flow margin to Net cash provided by operating activities the most directly comparable financial measure calculated in

accordance with GAAP:

<i>(In thousands)</i>	Nine Months Ended	
	September 30,	2021
Net cash provided by operating activities	\$ 130,008	\$ 100,376
Adjustments:		
Capital expenditures - property and equipment	(77,717)	(66,480)
Capital expenditures - internal-use software development	(6,593)	(4,297)
Purchase of intangible assets	(4,915)	(5,636)
Free cash flow	\$ 40,783	\$ 23,963
As a percentage of revenue:		
Net cash provided by operating activities	31 %	32 %
Free cash flow margin	10 %	8 %

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from the information provided in our Annual Report on Form 10-K for the fiscal year ended December 31, 2021.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain "disclosure controls and procedures," as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2022. Based on the evaluation of our disclosure controls and procedures as of September 30, 2022, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in various legal proceedings arising from the normal course of business activities. We are not presently a party to any litigation the outcome of which, if determined adversely to us, would in our estimation, have a material adverse effect on our business, operating results, cash flows or financial condition. Defending such proceedings is costly and can impose a significant burden on management and employees. The results of any current or future litigation cannot be predicted with certainty, and regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

ITEM 1A. RISK FACTORS

Please refer to Item 1A—Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2021 and Item 1A—Risk Factors in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2022 for a description of certain significant risks and uncertainties to which our business, financial condition and results of operations are subject. There have been no material changes to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2021 and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2022, except as set forth below.

If we are unsuccessful at integrating or developing the business of Cloudways, a recent acquisition, we may not be able to achieve our growth objectives.

In September 2022, we acquired Cloudways Ltd., or Cloudways, a leading managed cloud hosting and software-as-a-service provider for small to medium-sized businesses, in order to strengthen our ability to simplify cloud computing and enable customers to launch a business and scale it effortlessly. We have limited experience in operating a managed cloud hosting service, which may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the business, technologies, data, platform, personnel or operations of Cloudways. The integration process may disrupt our business, divert our resources, and require significant management attention that would otherwise be available for development of our existing business. Furthermore, we may find retention or cultural challenges associated with integrating Cloudways' employees into our organization. If we are unsuccessful in integrating Cloudways or grow the business in the coming years, the acquisition may not result in the synergies and other benefits we had expected to achieve, and the revenue and operating results of the combined company could be adversely affected. In addition, the acquisition may not ultimately strengthen our competitive position or could be viewed negatively by our customers, investors or securities analysts.

We could also face risks related to liability for Cloudways' activities before the acquisition, including intellectual property infringement claims, violations of legal, regulatory or compliance requirements, commercial disputes, tax liabilities and other known and unknown liabilities, and litigation or other claims in connection with Cloudways, including claims from users, former stockholders, former employees or other third parties, and our efforts to limit such liabilities could be unsuccessful. We may incur costs and expenses necessary to address any pre-acquisition failure to comply with legal, regulatory or compliance requirements. Cloudways may also need to implement or improve its controls, procedures and policies, and we may face risks if any of those controls, procedures or policies are insufficiently effective. Our failure to address these risks or other problems encountered in connection with the Cloudways acquisition could cause us to fail to realize the anticipated benefits of the acquisition, cause us to incur unanticipated liabilities, and harm our business generally.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) Issuer Purchases of Equity Securities

The following table provides information with respect to repurchases of shares of common stock by the Company during the three months ended September 30, 2022:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program ⁽¹⁾	Approximate Dollar Value (in thousands) of Shares that May Yet Be Purchased Under the Program ⁽¹⁾
July 1-31, 2022	—	\$ —	—	\$ 50,000
August 1-31, 2022	1,078,650	46.35	1,078,650	—
September 1-30, 2022	—	—	—	—
Total	1,078,650	\$ 46.35	1,078,650	

(1) On May 23, 2022, our Board of Directors approved a stock repurchase program authorizing the repurchase of up to \$300.0 million of its common stock throughout fiscal year 2022 (the "Current Program"). As of August 19, 2022, we repurchased the shares representing the entire amount available under the Current Program.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

Incorporated by Reference

Exhibit No.	Exhibit Description	Form	File No.	Exhibit	Filing Date	Filed Herewith
2.1	Share Purchase Agreement, dated as of August 19, 2022, by and among DigitalOcean, LLC, Cloudways Ltd., each of the shareholders of Cloudways identified on the signature pages thereto and Shareholder Representative Services LLC.	8-K	001-40252	2.1	August 23, 2022	
31.1	Certification of Yancey Spruill, Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of William Sorenson, Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1*	Certifications of Yancey Spruill, Chief Executive Officer, and William Sorenson, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
101.INS	Inline XBRL Instance Document					X
101.SCH	Inline XBRL Taxonomy Extensions Schema					X
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase					X
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase					X
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase					X
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase					X
104	Cover Page Interactive File (formatted as Inline XBRL and contained in Exhibit 101)					X

* Furnished herewith and not deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof, regardless of any general incorporation language in such filing.

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by us in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DigitalOcean Holdings, Inc.

Date: November 7, 2022

By: /s/ Yancey Spruill

Yancey Spruill

Chief Executive Officer

(Principal Executive Officer)

Date: November 7, 2022

By: /s/ William Sorenson

William Sorenson

Chief Financial Officer

(Principal Financial Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Yancey Spruill, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of DigitalOcean Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. [Reserved];
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2022

By: /s/ Yancey Spruill

Name: Yancey Spruill

Title: Chief Executive Officer

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, William Sorenson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of DigitalOcean Holdings, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. [Reserved];
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2022

	By:	<u>/s/ William Sorenson</u>
	Name:	William Sorenson
	Title:	Chief Financial Officer

**CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Yancey Spruill, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of DigitalOcean Holdings, Inc. for the fiscal quarter ended September 30, 2022 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of DigitalOcean Holdings, Inc.

Date: November 7, 2022 By: /s/ Yancey Spruill
Name: Yancey Spruill
Title: Chief Executive Officer

I, William Sorenson, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of DigitalOcean Holdings, Inc. for the fiscal quarter ended September 30, 2022 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of DigitalOcean Holdings, Inc.

Date: November 7, 2022 By: /s/ William Sorenson
Name: William Sorenson
Title: Chief Financial Officer