

Global Innovation

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Twilio – delivering the message on profitability

Innovation cash kings of the next decade - In our new series we look at the standout companies that are 'pivoting to profit' and are at an inflection point of converting customer-driven innovation into shareholder value. This week we take a closer look at Twilio.

Whether you're receiving an SMS update about your food delivery status, being prompted that your Uber has arrived, getting a reminder for tomorrow's dental appointment, or being alerted to unusual banking activity, there's a good chance that **Twilio** – the global leader in cloud communications – is behind that text message. Its pervasive reach (over 144 billion messages delivered in 2022 alone) has redefined the way businesses communicate with customers, making Twilio the unsung hero in countless daily interactions.

You may well have engaged with Twilio's products in other ways: the company's range of real-time communication solutions span text, voice, video, chat, email, and more, all facilitated by Twilio's "Super Network" of more than 1,500 global carriers that businesses plug in to it via flexible and easy-to-use APIs. All of these interactions generate huge amounts of customer data, which Twilio helps companies utilise with a range of data management products including its industry-leading customer data platform *Segment*, facilitating deeper insights and more personalised customer interactions. The combination of both messaging and data products differentiates Twilio from peers and, importantly, is tangibly value-additive for its business customers: improved customer engagement (via enhanced data insights and targeted interactions) helps businesses expand and unlock addressable markets, all while reducing communication costs by up to 90%.

Twilio's scale and IP, in addition to the network effects of its "Super Network", has allowed it to capitalise on this value generation to expand its footprint. In the last five years alone, Twilio has grown active customers nearly seven-fold while revenues have amplified almost tenfold. Profitability, meanwhile, has taken a backseat in this pursuit of growth, with the group investing aggressively to build, enhance, and acquire technologies to cement its market leadership position. However, echoing a trend increasingly common among tech peers, Twilio made a pivot last year, placing renewed emphasis on balancing growth with bottom-line performance.

Starting with the “basics”, last autumn Twilio began cutting costs, and to date has significantly reduced headcount (down 28% over the past three quarters) and sizeably curtailed stock-based compensation. These actions have led to more than \$300 million in annualised cost savings – a good start, but Twilio’s management has been candid in acknowledging the need for further change. Acting with the type of agility we like to see in innovators, management opted for a broad-based operational shake-up, exiting some non-core businesses and splitting the group into two key divisions: *Communications* (encompassing its messaging solutions) and *Data & Applications* (including data-focused units such as *Segment*).

This operational split has enabled Twilio to take a two-pronged approach to pursue both profitability and growth. Much of its cost-reduction efforts are focused on its *Communications* business where, recognising its market leadership status, it is focused on more product-led growth and thus scaling back sales and marketing expenses. Meanwhile it is funnelling investment towards the *Data & Applications* business, where management recognises the best opportunities for growth so is aiming to speed up technological development and aggressively grow market share.

Twilio’s pivot has had an immediate impact. As of its latest Q2 2023 update, it had reduced GAAP operating losses by 50%, generated record free cash flow, and delivered its third consecutive quarter of positive (and expanding) adjusted operating income. Critically, this has not come at the expense of growth. While tough macro conditions have meant revenues have been somewhat muted in recent quarters (largely due to the usage-based model of its *Communications* business), Twilio is not seeing new competition nor ceding market share, active customer numbers are still growing, record-size contracts are being signed, and the customer funnel remains healthy.

Where to from here? The group is well positioned to grow in a more profitable way as its leaner *Communications* business recovers alongside macro sentiment. Meanwhile, focusing growth in the higher-margin *Data & Applications* business should enhance profitability and cash generation at the group level. Further, given that data is the lifeblood of AI, its timely operational re-focus and investment in the data business means Twilio is optimally positioned to benefit from the rise of generative AI. As outlined at its recent “Signal 2023” conference, Twilio has entered into an array of exciting partnerships with the likes of OpenAI, Google, Databricks, and AWS to support a suite of new products including *CustomerAI*, helping unlock further value for Twilio’s customers from its swathes of customer data. While the pace of adoption is hard to predict, it is clear Twilio remains an innovative leader that is well positioned to (profitably) capitalise on the myriad opportunities ahead.

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