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## ELASTIC FISCAL Q2 2024 EARNINGS

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NOVEMBER 30, 2023

### CONTEXT

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Elastic showcased an impressive performance in its latest earnings report, handily beating consensus estimates for revenue and EPS, and even surprised Wall Street with its forecast. The earnings showed Elastic making significant strides across every segment of its business.

While much of Elastic's growth is boosted by the current happenings in generative AI, the company is also taking a strategic approach to growing its business across segments. For example, the company is increasingly playing in observability and has announced the completion of its acquisition of Opster.

### FINANCIAL PERFORMANCE

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Elastic's financial performance during the quarter can be summarized as follows:

- **Revenue Growth:** The company reported a 17% year-over-year increase in total revenue.
- **Elastic Cloud Growth:** Elastic Cloud, a significant segment of the company's business, grew by 31% compared to the same period in the previous year.
- **Non-GAAP Operating Margin:** Elastic achieved a non-GAAP operating margin of 13%. This reflects the company's profitability and effective operational management.
- **Subscription Revenue:** The bulk of the revenue, amounting to 93%, was driven by subscription services. Subscription revenue experienced a 19% year-over-year increase.
- **Professional Services Revenue:** This segment saw a slight downturn, with a 1% decline year-over-year.
- **Overall Financial Health:** The company maintained a solid financial position, ending the quarter with cash, cash equivalents, and marketable securities totaling \$966 million.

## Revenue Highlights

\$ millions	Q2 FY24	Y/Y	Y/Y CC
Total Revenue	\$311	17%	16%
Total Subscription Revenue	\$288	19%	18%
Elastic Cloud Revenue	\$135	31%	30%
Subscription % of Total Revenue	93%		
Professional Services Revenue	\$23	(1)%	(3)%

Source: Elastic

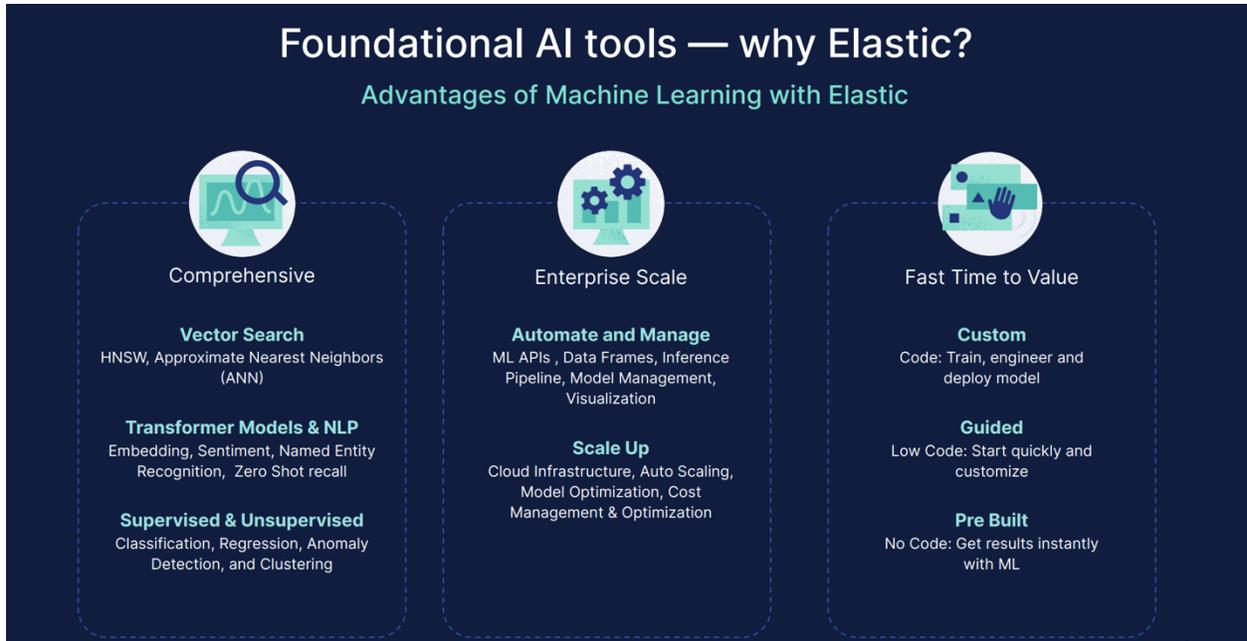
These results indicate a robust growth trajectory for Elastic, particularly in its cloud services, and an ability to maintain profitability amidst ongoing growth and expansion efforts.

## SPECIAL IMPACT OF AI

Artificial Intelligence (AI), particularly generative AI, had a significant impact on Elastic's business in several critical ways:

- Revenue Growth:** Incorporating generative AI into Elastic's offerings contributed to the company's revenue growth. This was evidenced by the increased adoption of Elastic Cloud and the 17% year-over-year revenue increase.
- Product Development and Innovation:** Elastic's focus on generative AI led to developing and enhancing products like the Elasticsearch Relevance Engine (ESRE). This advancement in AI technology improved existing products and enabled the creation of new AI-driven applications.
- Customer Engagement and Market Demand:** The success in generative AI drove customer excitement and engagement. Elastic observed a strong customer interest in using their platform, particularly the ESRE, for developing generative AI applications. This surge in interest likely contributed to the company's revenue growth and market presence.
- Long-Term Business Opportunities:** Elastic acknowledged that while generative AI's contribution to revenue was not significant now, it presented a substantial long-term opportunity. The company was optimistic about the future impact of AI on its revenue streams.

- Strategic Partnerships:** Elastic's advancements in AI also opened doors for strategic partnerships and deals, like the multiyear agreement with DocuSign. These partnerships validated the company's AI capabilities and expanded its market reach.



Source: Elastic

AI was crucial in Elastic business growth during the quarter. It was a key driver in product innovation, customer engagement, revenue growth, and shaping long-term business strategies. It will continue to grow in importance moving forward.

## BUSINESS HIGHLIGHTS

Elastic noted several key achievements occurring during the quarter:

- Advancements in Generative AI:** Elastic focused on generative AI, enhancing customer engagement and business growth. The Elasticsearch Relevance Engine (ESRE) was crucial in this advancement.
- Strategic Partnerships and Deals:** The company secured significant partnerships and deals, notably a multiyear agreement with DocuSign and a contract with a leading video-sharing platform, showcasing the utility and demand for Elastic's search capabilities.
- Product Innovations:** Elastic introduced new features and improvements, such as the ES|QL (Elasticsearch Query Language) and its machine learning inference API enhancements, improving the developer experience and platform capabilities.

- **Global Outreach:** The organization of ElasticON User Conferences across major cities worldwide highlighted Elastic's commitment to international expansion and community engagement.
- **Acquisition of Opster:** The acquisition of Opster, specializing in Elasticsearch and OpenSearch optimization, marked a strategic move to enhance Elastic's product offerings and customer support.

These achievements collectively demonstrate Elastic's commitment to growth, innovation, and customer engagement, reinforcing its position in the market.

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## FORECAST

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During its earnings call, Elastic offered several forecasts and outlooks for its future performance:

- **Revenue Growth:** Elastic projected continued revenue growth, expecting to maintain its strong performance.
- **Cloud Revenue Trends:** The company forecasted growth in self-managed and cloud subscription revenue, indicating optimism in the expanding cloud segment.
- **Guidance for Upcoming Quarters:** For the third quarter of fiscal '24, Elastic expected total revenue from \$319 million to \$321 million, representing a year-over-year growth of 17% at the midpoint. They also projected a non-GAAP operating margin between 11.5% and 12% for the third quarter.
- **Full Fiscal Year Outlook:** For the full fiscal year '24, Elastic raised its outlook to total revenue from \$1.247 billion to \$1.253 billion, indicating a 17% year-over-year growth. The non-GAAP operating margin for the full year is expected to be between 10.25% and 10.75%.
- **Long-term Growth:** Elastic anticipated continuing to grow revenue faster than overall expenses in fiscal '25, aiming for an expanded non-GAAP operating margin.
- **Free Cash Flow Expectations:** The company expected its free cash flow margin on an adjusted basis for fiscal '24 to be slightly above the non-GAAP operating margin for the same period.



*Source: Elastic*

These forecasts reflect Elastic's confidence in its business strategy and growth trajectory, particularly in cloud services and overall revenue. However, the company also remained prudent, acknowledging potential fluctuations in the market and the need for disciplined investment.

## POTENTIAL CHALLENGES

Like any technology company operating in a fast-moving environment, Elastic faces several potential challenges as it moves forward:

- **Sustaining Rapid Growth:** Maintaining an impressive growth rate, especially in the Elastic Cloud segment, may be challenging. As the market matures and competition intensifies, sustaining such high growth rates requires continuous innovation and expansion.
- **Scaling in a Competitive Market:** Elastic operates in a highly competitive sector with several established players, especially as it moves further into new segments such as observability. As the company scales, it must continuously innovate and differentiate its offerings to stay ahead.
- **Managing Profitability Amid Expansion:** While Elastic has shown good profitability metrics, balancing investment in growth and innovation with maintaining profitability is a complex challenge, especially as it scales and expands into new markets.

- **Integration of Acquisitions:** The successful integration of acquisitions, like Opster, is crucial. Elastic needs to ensure these integrations align with its broader strategy and add value without disrupting existing operations.
- **Dependency on Strategic Partnerships:** Strategic partnerships and deals partly drive Elastic's performance. The future challenge lies in maintaining and growing these partnerships while navigating any dependencies that arise.
- **Global Market Penetration:** While Elastic has a growing global presence, entering new markets involves challenges such as localization, compliance with regional regulations, and understanding local market dynamics.

Overall, while Elastic is positioned well currently, with leadership showing steady and prudent execution, addressing these potential challenges will be critical to its sustained success and growth in the future.

## ANALYSIS

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Elastic's performance shows a company adeptly navigating the complexities of a hyper-competitive and challenging market. The year-over-year revenue increase, notably its surge in Elastic Cloud, underscores the growing market appetite for cloud-based solutions.

The company's operating margin growth is particularly noteworthy, suggesting that Elastic isn't just growing its top line; it's doing so efficiently, maintaining profitability even as it scales. This balance is crucial in Elastic's current growth phase, where rapid expansion often impacts the bottom line.

However, as with any company in a rapidly evolving segment, challenges loom. Maintaining the growth momentum in a fiercely competitive market, continually innovating in the fast-paced AI landscape, and successfully integrating its just-closed Opster acquisition will be key areas to watch. So far, Mr. Kulkarni and his leadership team are demonstrating exemplary execution.

Elastic's stellar earnings paint a picture of a company that's growing, profitable, and strategically positioned for the future. Its success is more than just being in the right place at the right time as AI explodes; Elastic is delivering the right set of enabling technologies and solutions to help a rapidly evolving industry find success. What a great position to be in.



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