

PALO ALTO NETWORKS FQ2 2024 EARNINGS

STEVE McDOWELL, CHIEF ANALYST
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CONTEXT

Palo Alto Networks [announced](#) its fiscal Q2 2024 earnings with impressive figures that beat consensus for both revenue and EPS, showcasing its continued growth and market resilience. The company reported a 19% year-over-year increase in revenue, reaching \$1.98 billion, along with a 16% rise in billings.



QUARTER PERFORMANCE

Key highlights of their financial performance include:

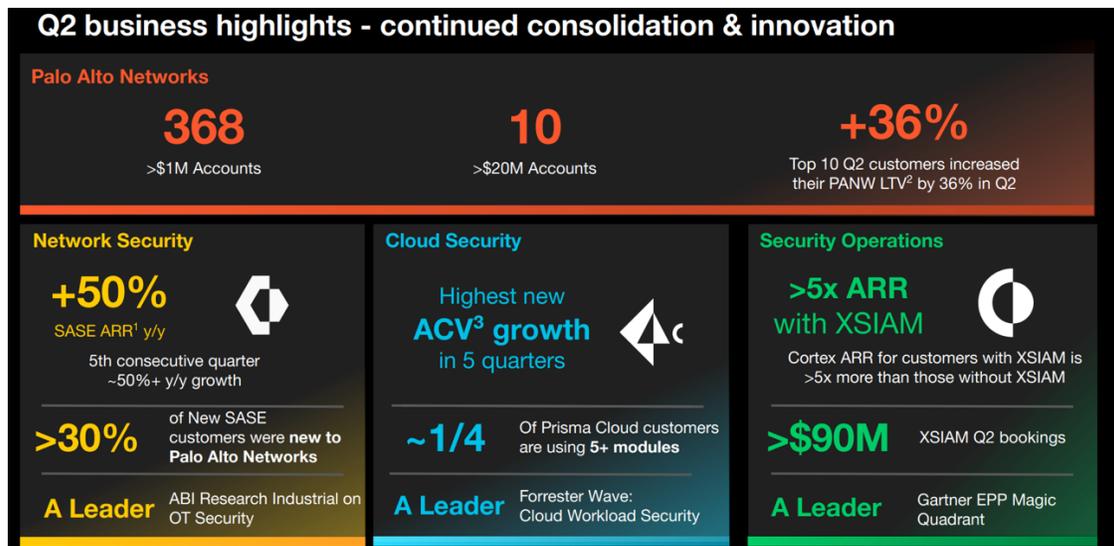
- Revenue Growth:** The company reported a 19% year-over-year increase in revenue, amounting to \$1.98 billion. This growth was consistent across different geographies, with Americas, EMEA, and APAC growing by 19%.
- Billings and Remaining Performance Obligation (RPO):** Billings grew by 16% year-over-year. The Remaining Performance Obligation (RPO) stood at \$10.8 billion, while the current RPO was reported at \$5.2 billion.

3. **Product and Service Revenue:** Product revenue grew by 11%, while total service revenue increased by 22%. Subscription revenue saw a 26% growth, and support revenue grew by 14%.
4. **Non-GAAP Operating Margins:** The company achieved a significant expansion in non-GAAP operating margins, which rose to 28.6%, an increase of nearly 600 basis points compared to the previous year.
5. **Free Cash Flow:** Palo Alto Networks generated \$2.9 billion in adjusted free cash flow on a trailing 12-month basis.
6. **Earnings Per Share (EPS):** Non-GAAP EPS was \$1.46, up 39% year-over-year. The GAAP EPS was notably higher at \$4.89, primarily due to a one-time tax-related benefit.
7. **Net Income:** GAAP net income was reported at \$1.75 billion, benefiting from a one-time release of a tax-related valuation allowance of \$1.5 billion.
8. **Contract Duration:** The average duration for new contracts remained approximately three years, indicating stability in customer commitments.

Palo Alto Networks shows that the company is successful executing its growth strategy, marked by a balanced focus on revenue growth, margin expansion, and strong cash flow generation.

QUARTER HIGHLIGHTS

CEO Nimesh Arora highlighted a significant number of achievements for the company that occurred during the quarter.



1. **Deal Sizes and Customer Growth:** The company successfully secured larger deals, including a steady stream of \$1 million-plus transactions. Notably, there

were ten deals over \$20 million in the quarter. The top 10 spending customers increased their expenditure by 36% during the period.

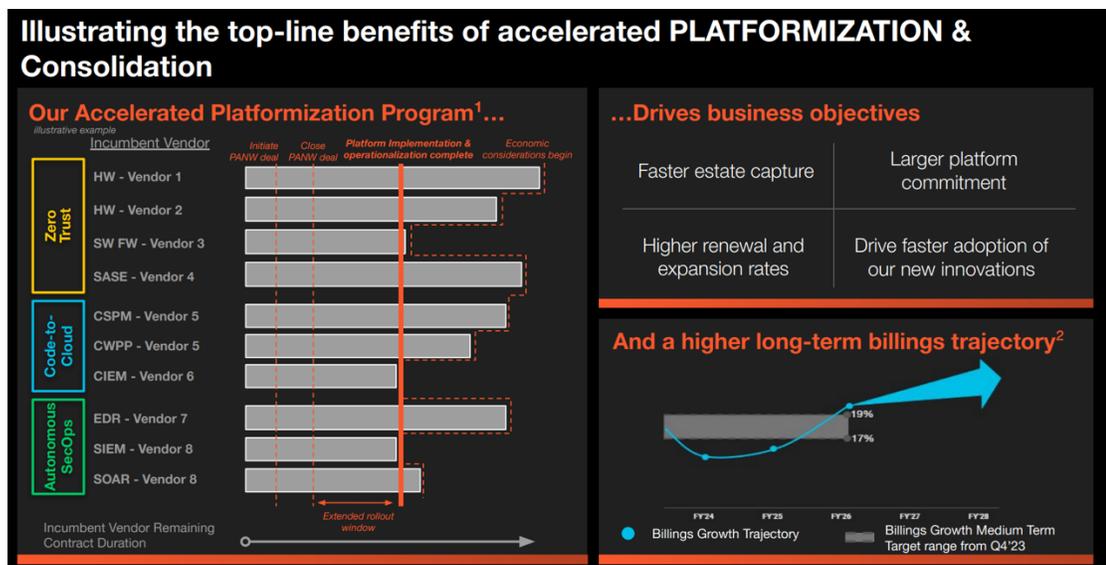
2. **Network Security Business:** In the Network Security segment, Palo Alto Networks saw continued growth in ARR (Annual Recurring Revenue), particularly in their SASE (Secure Access Service Edge) business, marking the fifth consecutive quarter of 50% ARR growth. Over 30% of new SASE customers in Q2 were new to Palo Alto Networks, indicating successful market penetration.
3. **Prisma Cloud:** Significant investments in Prisma Cloud in the first half of the year paid off with the highest new ACV (Annual Contract Value) growth in 5 quarters. The company observed strong trends in multi-module adoption, with approximately 30% growth in customers using two or more modules and about 60% growth in those using three or more.
4. **Cortex and XSIAM Performance:** The Cortex platform, particularly with XSIAM (Extended Security Information and Event Management), continued to be a significant growth driver. ARR for XSIAM customers was more than five times higher than that of Cortex customers who had not adopted XSIAM.
5. **Market Recognition and Leadership Positions:** Palo Alto Networks achieved notable market recognitions, including being positioned as a leader in the Cloud Workload Security Wave report by Forrester Research. It was also added as a leader in the Gartner Endpoint Protection Magic Quadrant, marking its leadership in 21 different categories across its three platforms.
6. **Global 2000 Market Penetration:** As of Q2, 79% of the Global 2000 had transacted with Palo Alto Networks on at least two of its platforms and 57% on all three platforms. This is up from 73% and 47% two years ago, indicating significant market penetration and customer trust.
7. **Product Innovations and Updates:** The company continued to drive innovation, especially in network security, with the refreshment of its high-end platform and new investments in OT (Operational Technology) security capabilities.
8. **Zero Trust Platform Expansion:** Palo Alto Networks has successfully consolidated network security capabilities through its Zero Trust platform, which large enterprises increasingly adopt.
9. **AI Integration and Initiatives:** The company has accelerated its efforts in AI, recognizing it as a significant inflection point in technology. Their AI-driven products crossed \$100 million in ARR, showcasing early success in this domain.
10. **Customer Engagement and Support Programs:** Palo Alto Networks offered pre-support during breaches to 1,500 top customers, with 400 signing up in 90

days, reflecting the high level of customer engagement and trust in their cybersecurity expertise.

OUTLOOK

The outlook and forecast for Palo Alto Networks, as presented by Nikesh Arora, Chairman & CEO, and Dipak Golechha, Executive VP & CFO, reflect a strategic focus on platformization and consolidation, with significant investment in AI and cybersecurity. The key elements of their outlook and forecast include:

1. **Continued Revenue Growth:** Despite short-term impacts, the company aims for sustained top-line growth. Revenue is expected to grow by 13% to 15% in Q3 2024, with fiscal year revenue projected to increase by 15% to 16%.
2. **Platformization and Consolidation Strategy:** Palo Alto Networks increases its focus on accelerating platform adoption and vendor consolidation among its customers. This strategy is expected to drive larger customer commitments, higher renewal rates, and faster adoption of innovations.



3. **Investment in AI and Cybersecurity:** The company is prioritizing AI to expand its total addressable market in cybersecurity. They foresee significant opportunities in AI security, expecting this to be a major growth area.
4. **Guidance for Fiscal Year 2024:**

Q3 & Fiscal Year 2024 Guidance - Maintaining EPS & Free Cash Flow

| | Q3 FY'24 Guidance (as of 2/20/24) | FY 2024 Guidance (as of 2/20/24) |
|---------------------------------------|---------------------------------------|--|
| Total Billings | \$2.30B - \$2.35B 2% - 4% yrllyr | \$10.10B - \$10.20B 10% - 11% yrllyr |
| Next-Gen Security ARR | | \$3.95B - \$4.00B 34% - 35% yrllyr |
| Total Revenue | \$1.95B - \$1.98B 13% - 15% yrllyr | \$7.95B - \$8.00B 15% - 16% yrllyr |
| Operating Margin (Non-GAAP) | | 26.5% - 27.0% +240 bps - 290 bps yrllyr |
| EPS (Non-GAAP) | \$1.24 - \$1.26 13% - 15% yrllyr | \$5.45 - \$5.55 23% - 25% yrllyr |
| Adj. Free Cash Flow Margin (Non-GAAP) | | 38.0% - 39.0% |

- Billings are projected to be in the range of \$10.10 billion to \$10.20 billion, an increase of 10% to 11%.
 - Non-GAAP EPS is estimated to be between \$5.45 and \$5.55, reflecting a 23% to 25% increase.
 - Adjusted free cash flow margin is anticipated to be 38% to 39%.
5. **Long-Term Aspirations:** The company has set a long-term target of achieving \$15 billion in next-generation security ARR (Annual Recurring Revenue) by 2030. This ambitious goal is underpinned by their platform strategy and investment in AI.
 6. **Challenges in the U.S. Federal Market:** The company has experienced some softness in the U.S. federal government market, which is expected to continue into Q3 and Q4. This has led to a shortfall in their U.S. federal government business.
 7. **Focus on ROI and Total Cost of Ownership:** There is a growing focus among customers on ROI and total cost of ownership, leading to a shift in spending priorities towards more efficient and effective cybersecurity solutions.
 8. **Operational Efficiency:** The company plans to continue improving operational efficiency across various areas, including cloud hosting and internal processes.
 9. **Medium-Term Financial Impact:** The platformization strategy might pressure top-line growth, particularly in billings, for about 12 to 18 months. However, the company views this as a strategic investment to drive long-term growth and profitability.

Overall, Palo Alto Networks' outlook is positive, strategically focusing on platformization, AI, and cybersecurity innovation. They anticipate short-term challenges but remain confident in their long-term growth prospects and market leadership.

ANALYSIS

Several key points from the earnings release and conference call stand out, reflecting the company's positioning and operational execution in the highly competitive cybersecurity market:

Strategic Focus on Platformization and AI: The focus on platformization and AI integration is a strategic move aligning with the current and future demands of the cybersecurity landscape. By consolidating its offerings across three platforms and emphasizing AI, Palo Alto Networks is positioning itself at the forefront of the next wave of cybersecurity innovation. Their ambitious target of achieving \$15 billion in next-generation security ARR by 2030 underlines their confidence in this strategy.

Operational Achievements and Market Recognition: The operational milestones achieved in this quarter, particularly the success in securing larger deals and the significant customer growth, are a testament to the company's strong market position. Recognition in reports like Forrester's Cloud Workload Security Wave and Gartner's Endpoint Protection Magic Quadrant further cements their industry leadership. Moreover, the increased penetration in the Global 2000 market segment indicates a growing trust and reliance on Palo Alto Networks' solutions among top-tier enterprises.

Challenges and Future Outlook: Despite the strong performance, challenges in the U.S. federal market and the necessity to navigate short-term impacts due to their platformization strategy should be closely monitored. However, the company's focus on AI and the ongoing shift towards a more consolidated cybersecurity approach presents significant opportunities for future growth and market share expansion.

Palo Alto Networks quarter demonstrates robust financial and operational health with a clear strategic vision for the future. Their emphasis on AI and platformization, combined with a strong market presence and recognition, positions them well for sustained growth and innovation in the cybersecurity domain.



RESEARCH NOTE

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