

Palo Alto Networks Q4 FY2024 Earnings

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CONTEXT

Palo Alto Networks recently [announced its earnings](#) for the fourth quarter of the fiscal year 2024. Delivering an estimate-beating \$2.19 billion quarter, the company demonstrated robust financial performance, driven by strategic platformization efforts and significant advancements in its next-generation security offerings.

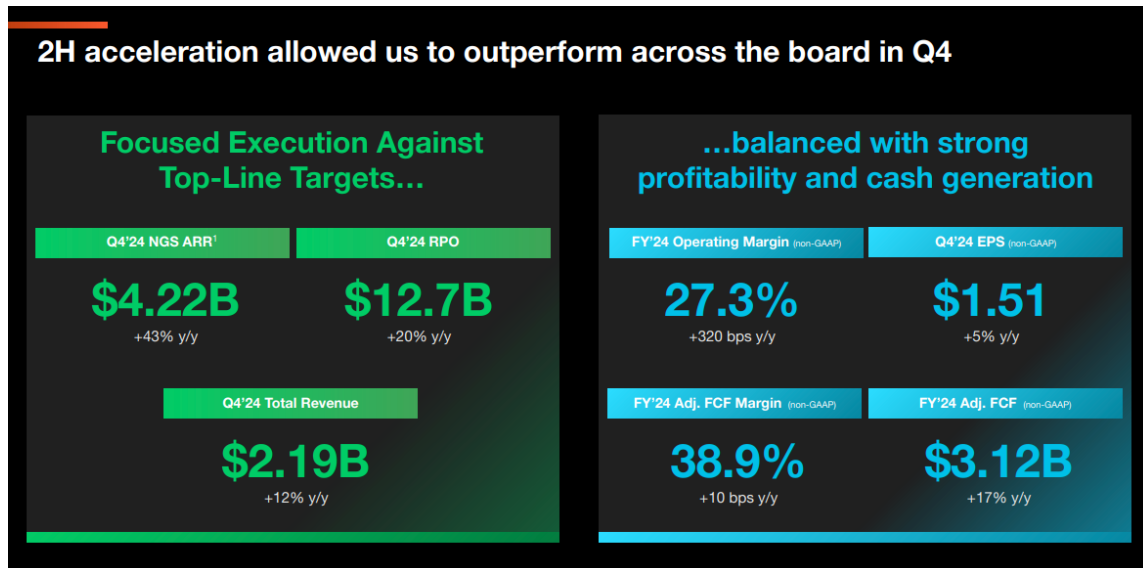


FIGURE 1 (SOURCE: PALO ALTO NETWORKS)

This Research Note provides an overview of the key financial and non-financial highlights from the earnings report and the company's guidance and outlook for the upcoming fiscal year.

FINANCIAL PERFORMANCE

Palo Alto Networks exceeded expectations in several key financial metrics, reflecting strong execution of its strategy.

| Q4'24 Metrics | Q4'24 Guidance (as of 5/20/24) | Q4'24 Actual |
|----------------------------------|---|---------------------------------|
| Total Billings | \$3.43B-\$3.48B 9%-10% <i>yr/yr</i> | \$3.50B 11% <i>yr/yr</i> ✓ |
| Total Revenue | \$2.15B-\$2.17B 10%-11% <i>yr/yr</i> | \$2.19B 12% <i>yr/yr</i> ✓ |
| Product Revenue | | \$481M (5)% <i>yr/yr</i> |
| Remaining Performance Obligation | | \$12.7B 20% <i>yr/yr</i> |
| Next-Gen Security ARR | | \$4.22B 43% <i>yr/yr</i> |
| Gross Margin (Non-GAAP) | | 76.8% (50) <i>bps yr/yr</i> |
| Operating Income (Non-GAAP) | | \$588M 6% <i>yr/yr</i> |
| Operating Margin (Non-GAAP) | | 26.9% (150) <i>bps yr/yr</i> |
| EPS (Non-GAAP) | \$1.40-\$1.42 (3)% - (1)% <i>yr/yr</i> | \$1.51 ✓ |
| EPS (GAAP) | | \$1.01 |
| Adj. Free Cash Flow (Non-GAAP) | | \$485M |

FIGURE 2: (SOURCE: PALO ALTO NETWORKS)

- **Revenue:** Total revenue for Q4 reached \$2.19 billion, marking a 12% year-over-year increase and surpassing the high end of the company's guidance.
- **Product Revenue:** Declined by 5%, reflecting a shift in the company's focus towards services and software-based solutions.
- **Services Revenue:** Increased by 18%, with subscription revenue growing by 23% and support revenue by 10%.
- **Operating Margins:** Expanded by 320 basis points, contributing to a nearly 39% free cash flow margin.
- **Next-Generation Security (NGS) ARR:** Achieved a significant milestone by surpassing \$4.2 billion, growing 43% year-over-year.
- **RPO (Remaining Performance Obligation):** Grew by 20%, reaching \$12.7 billion, indicating strong future revenue visibility.

NON-FISCAL PERFORMANCE

Beyond its financial performance, Palo Alto Networks made significant strides in several strategic areas during the quarter.

- **Platformization Success:** The company added over 90 new platformization deals in Q4, bringing the total to over 1,000 among its top 5,000 customers.
- **Product Innovation:** Launched AI-driven security products, including AI Access, AI Firewall, and AI Security Posture Management, positioning the company as a leader in securing AI technologies.
- **Customer Engagement:** Senior-level customer meetings increased by 70% year-over-year, reflecting growing interest in the company's comprehensive platform solutions.
- **Strategic Acquisitions:** Announced the acquisition of IBM's QRadar SaaS assets, expected to close by the end of September 2024, further strengthening its security operations capabilities.

GOING DEEPER: IMPACT OF PLATFORMIZATION

Palo Alto Networks' shift towards platformization, which began in 2023, had a significant positive impact on its Q4 performance, acting as a key driver of growth and operational success. This strategic move allowed the company to offer its customers a more integrated and comprehensive security solution, which resonated strongly in the market.

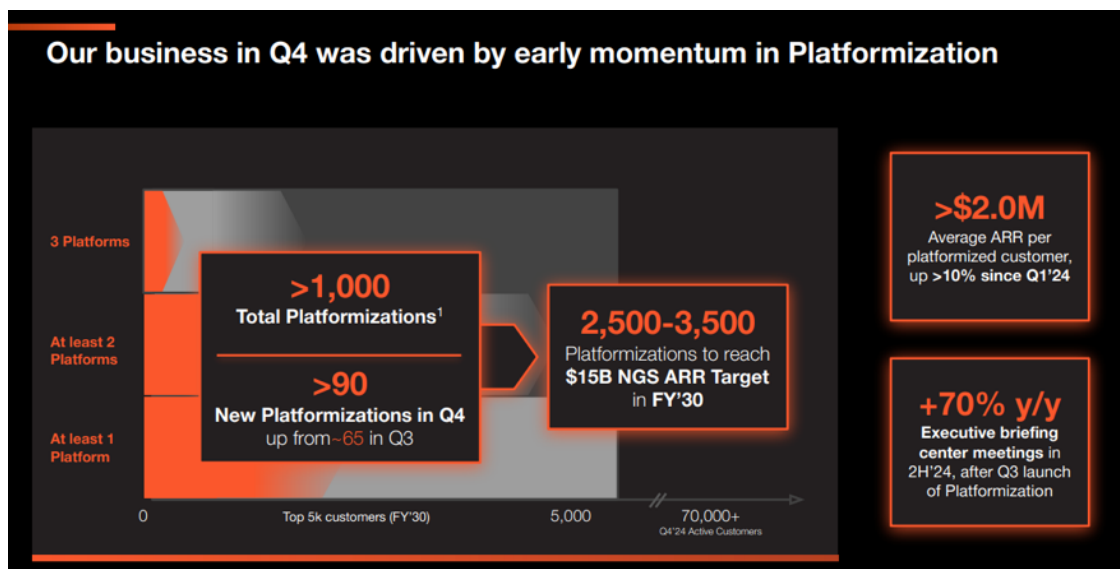


FIGURE 3: (SOURCE: PALO ALTO NETWORKS)

The impact of its platformization strategy was evident in several critical areas:

1. **Acceleration in Bookings:** The platformization strategy contributed to a notable acceleration in bookings during the second half of the fiscal year. Customers increasingly opted for bundled solutions rather than piecemeal, standalone products, leading to larger and more strategic deals. This not only boosted the company's overall revenue but also enhanced the predictability and stability of its earnings through increased recurring revenue streams.
2. **Growth in Next-Generation Security ARR:** The success of platformization directly fueled the growth of Palo Alto Networks' next-generation security ARR, which surged by 43% year-over-year, surpassing the \$4.2 billion mark. This strong performance well demonstrates the effectiveness of the platform approach in driving customer adoption of the company's newer, more advanced security offerings.
3. **Increased Customer Engagement:** Palo Alto's platformization strategy led to a significant increase in senior-level customer engagements, which grew by 70% year-over-year. The company said that the deeper level of engagement with key decision-makers in client organizations enabled by its approach helped to secure large, long-term deals, further solidifying customer loyalty and reducing churn.
4. **Higher ARR per Customer:** The average ARR per platformized customer saw a sequential increase in Q4, indicating that as customers transitioned to the platform model, they were likely to expand their usage and investment in Palo Alto Networks' offerings. This uplift in ARR per customer is a clear sign of the strategy's success in driving deeper customer penetration and maximizing revenue potential.

Overall, the move to platformization has positioned Palo Alto Networks as a more integral part of its customers' security infrastructure, leading to stronger financial performance, enhanced customer relationships, and a more resilient business model. This strategy not only boosted the company's quarterly results but also set a strong foundation for sustained growth in the future.

GOING DEEPER: IMPACT OF SUBSCRIPTIONS

Subscriptions had a significant positive impact on Palo Alto Networks' performance in the quarter, driving growth and contributing to the company's overall financial health.

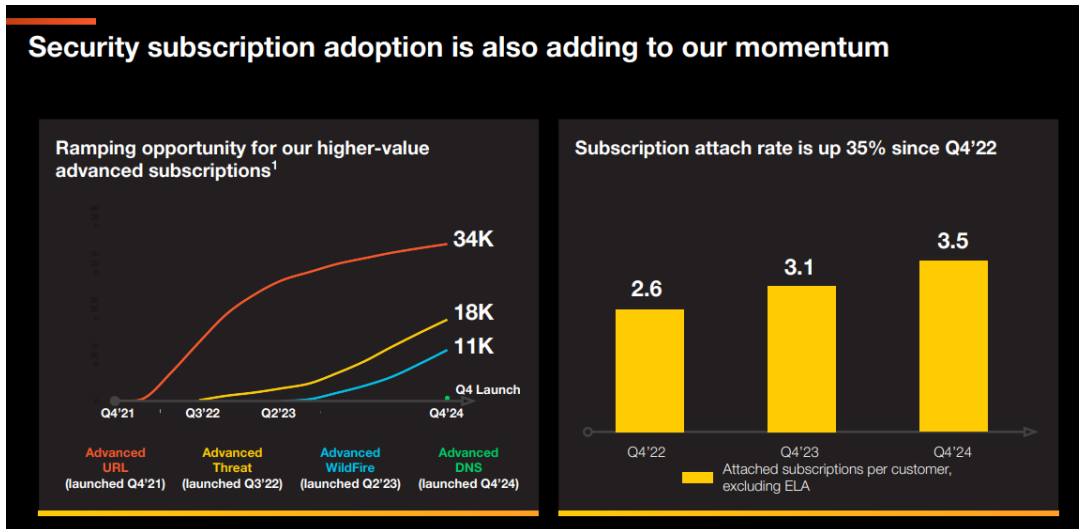


FIGURE 4: (SOURCE: PALO ALTO NETWORKS)

The impact of subscriptions on Palo Alto's quarter can be summarized as follows:

1. **Growth in Services Revenue:** Subscriptions were a key driver of the 18% increase in total services revenue for the quarter. Specifically, subscription revenue grew by 23%, indicating strong customer adoption of Palo Alto Networks' recurring service offerings.
2. **Next-Generation Security (NGS) ARR:** The strong performance in subscriptions was closely tied to the growth of the company's NGS ARR, which surged by 43% to surpass \$4.2 billion. The increasing demand for subscription-based services, particularly in next-generation security offerings, was a major contributor to this milestone.
3. **Increased Subscription Attach Rates:** The quarter saw an increase in the average number of subscriptions per customer, rising from 2.6 at the end of fiscal year 2022 to 3.5 by the end of the current fiscal year. This higher attach rate indicates that customers are increasingly opting for multiple subscriptions, further enhancing the company's ability to generate consistent and growing revenue.
4. **Higher Margins and Cash Flow:** The growth in subscription revenue also contributed to the expansion of operating margins and strong free cash flow generation. Subscriptions typically offer higher margins than traditional product sales, which helped Palo Alto Networks improve its profitability during the quarter.

The continued growth in subscription revenue, combined with higher attach rates and contributions to NGS ARR, underscores the strategic importance of subscriptions in the company’s business model. The shift towards subscription-based offerings not only supports revenue growth but also enhances the company’s financial stability and long-term profitability.

GUIDANCE & OUTLOOK

Palo Alto Networks provided a positive outlook for the upcoming fiscal year, underpinned by its strong pipeline and ongoing strategic initiatives.

| Q1 & Fiscal Year 2025 Guidance | | |
|---------------------------------------|--|--|
| | Q1 FY'25 <small>Guidance (as of 8/19/24)</small> | FY 2025 <small>Guidance (as of 8/19/24)</small> |
| Next-Gen Security ARR | \$4.33B - \$4.38B <small>34% - 36% yrllyr</small> | \$5.42B - \$5.47B <small>28% - 30% yrllyr</small> |
| Remaining Performance Obligation | \$12.4B - \$12.5B <small>19% - 20% yrllyr</small> | \$15.2B - \$15.3B <small>19% - 20% yrllyr</small> |
| Total Revenue | \$2.10B - \$2.13B <small>12% - 13% yrllyr</small> | \$9.10B - \$9.15B <small>13% - 14% yrllyr</small> |
| Operating Margin (Non-GAAP) | | 27.5% - 28.0% <small>+20 bps - +70 bps yrllyr</small> |
| EPS (Non-GAAP) | \$1.47 - \$1.49 <small>7% - 8% yrllyr</small> | \$6.18 - \$6.31 <small>9% - 11% yrllyr</small> |
| Adj. Free Cash Flow Margin (Non-GAAP) | | 37.0% - 38.0% |

Our RPO guidance, with no change in mix between PAN-FS and billing programs vs. FY24 would drive 12% Y/Y billings growth in FY25

FIGURE 5: (SOURCE: PALO ALTO NETWORKS)

- **NGS ARR Guidance:** Expected to grow between 28% and 30%, reaching \$5.42 billion to \$5.47 billion by the end of FY 2025.
- **RPO Guidance:** Anticipated to increase by 19% to 20%, indicating sustained long-term growth.
- **Revenue Guidance:** Forecasted to be in the range of \$9.10 billion to \$9.15 billion, representing a 13% to 14% year-over-year growth.
- **Operating Margins:** Projected to be between 27.5% and 28%, with non-GAAP EPS expected to rise by 9% to 11%.

ANALYSIS

Palo Alto Networks is executing well in an increasingly complex cybersecurity landscape. The company exceeded expectations on key financial metrics and

demonstrated the effectiveness of its strategic pivot towards platformization and AI-driven security solutions.

One of the standout aspects of this quarter's performance is the impressive growth in next-generation security (NGS) ARR, which surged by 43% to surpass the \$4.2 billion mark. This growth shows Palo Alto Networks' success in transitioning its business model towards a recurring revenue stream, anchored by its comprehensive security platform offerings.

The significant traction in platformization, with over 90 new deals added in Q4 alone, demonstrates the demand for integrated cybersecurity solutions among large enterprises.

Overall, Palo Alto Networks continues solidifying its cybersecurity leadership through strategic innovation and a focus on integrated, AI-driven solutions. As the threat landscape evolves and organizations increasingly demand comprehensive security platforms, Palo Alto Networks remains well-positioned to capitalize on these trends, making it one of the most compelling cybersecurity players in the industry.



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