



## Palo Alto Networks Reports Fiscal Third Quarter 2018 Financial Results

June 4, 2018

- Fiscal third quarter revenue grows 31 percent year over year to **\$567.1 million**
- Fiscal third quarter billings grow 33 percent year over year to **\$721.0 million**
- Deferred revenue grows 34 percent year over year to **\$2.2 billion**
- **Announced appointment of Nikesh Arora as chief executive officer and chairman and Mark McLaughlin as vice chairman on June 1, 2018**

SANTA CLARA, Calif., June 4, 2018 /PRNewswire/ -- Palo Alto Networks® (NYSE: PANW), the global cybersecurity leader, announced today financial results for its fiscal third quarter 2018, ended April 30, 2018.

Total revenue for the fiscal third quarter 2018 grew 31 percent year over year to \$567.1 million, compared with total revenue of \$431.8 million for the fiscal third quarter 2017. GAAP net loss for the fiscal third quarter 2018 was \$46.7 million, or \$0.51 per diluted share, compared with GAAP net loss of \$60.9 million, or \$0.67 per diluted share, for the fiscal third quarter 2017.

Non-GAAP net income for the fiscal third quarter 2018 was \$95.1 million, or \$0.99 per diluted share, compared with non-GAAP net income of \$57.1 million, or \$0.61 per diluted share, for the fiscal third quarter 2017. A reconciliation between GAAP and non-GAAP information is contained in the tables below.

In a separate [news release](#) issued on June 1, 2018, the Company announced the appointment of Nikesh Arora as chief executive officer and chairman and Mark McLaughlin as vice chairman effective June 6, 2018.

"We delivered strong fiscal third quarter results with record revenue, deferred revenue and billings, while continuing to capture market share at rates that far outpace the competition," said Mark McLaughlin, chief executive officer of Palo Alto Networks. "Our Security Operating Platform utilizes software, the cloud and analytics to deliver increasingly better prevention through automation and ecosystem leverage, while dramatically reducing the complexity of the consumption model for customers."

"We drove market-leading top-line results through robust new customer acquisition and lifetime value expansion in the third quarter," said Kathy Bonanno, chief financial officer of Palo Alto Networks. "We also delivered continued leverage in our operating model and generated strong cash flow, ending the quarter with cash, cash equivalents and investments of \$2.2 billion."

### Recent Highlights

- **Platform leadership:** More than 50 companies are now actively engaged with us on the Application Framework. At our Ignite USA user conference in May, many third-party applications were demonstrated, and we announced that the Application Framework will be production-ready for third party applications in August 2018.
- **Cloud capabilities:** We have established ourselves as the leader in cloud security through the unique combination of our VM-Series virtualized next-generation firewalls for inline cloud security, API-based security for public cloud services infrastructure, and Traps for host-based protections. The acquisition of Evident.io extends our API-based security capabilities to help cloud practitioners ensure their deployments are secure and achieve a constant state of compliance through a single approach to continuous monitoring, storage security, and compliance validation and reporting.
- **Endpoint capabilities:** We introduced Traps™ 5.0 to the market, offering a cloud-delivered management service, Linux support and many other features. These capabilities allow our customers to more easily deploy and manage Traps, enabling them to stop threats on the endpoint and coordinate enforcement with cloud and network security to prevent successful cyberattacks. We also announced the acquisition of Secdo, which brings sophisticated endpoint detection and response, or EDR, capabilities - including unique data collection and visualization - to Traps and the Application Framework. Additionally, we received a "Recommended" rating for Traps from NSS Labs Inc., the world's leading information security testing, research, and advisory company.

### Financial Outlook

Palo Alto Networks provides guidance based on current market conditions and expectations.

For the fiscal fourth quarter 2018, we expect:

- Total revenue in the range of \$625 to \$635 million, representing year-over-year growth between 23 percent and 25 percent. Product revenue in the range of \$246 to \$249 million, representing year-over-year growth between 16 percent and 17 percent.
- Total billings in the range of \$815 to \$830 million, representing year-over-year growth between 22 percent and 24 percent.
- Diluted non-GAAP net income per share in the range of \$1.15 to \$1.17 using 97 to 99 million shares.

For the fiscal year 2018, we expect:

- Total revenue in the range of \$2.240 to \$2.250 billion, representing year-over-year growth between 27 percent and 28 percent. Product revenue in the range of \$850 to \$853 million, representing year-over-year growth of approximately 20 percent.
- Total billings in the range of \$2.807 to \$2.822 billion, representing year-over-year growth between 22 percent and 23 percent.
- Diluted non-GAAP net income per share in the range of \$3.86 to \$3.89 using 95 to 96 million shares.

Guidance for non-GAAP financial measures excludes share-based compensation related charges including share-based payroll tax expense, acquisition related costs, amortization expense of acquired intangible assets, litigation-related charges including legal settlements, facility exit costs, non-cash interest expense related to our convertible senior notes, foreign currency gains (losses) and income and other tax effects associated with these items, and certain non-recurring expenses. We have not reconciled diluted non-GAAP net income per share guidance to GAAP net income (loss) per diluted share because we do not provide guidance on GAAP net income (loss) and would not be able to present the various reconciling cash and non-cash items between GAAP net income (loss) and non-GAAP net income, including share-based compensation expense, without unreasonable effort. Share-based compensation expense is impacted by the company's future hiring and retention needs and, to a lesser extent, the future fair market value of the company's common stock, all of which is difficult to predict and subject to constant change. The actual amounts of such reconciling items will have a significant impact on the company's GAAP net income (loss) per diluted share.

#### **Conference Call Information**

Palo Alto Networks will host a conference call for analysts and investors to discuss its fiscal third quarter 2018 results and outlook for its fiscal fourth quarter and full fiscal year 2018 today at 8:00 a.m. Eastern time/5:00 a.m. Pacific time. Open to the public, investors may access the call by dialing 1-888-394-8218 or 1-323-701-0225 and using conference ID 1424255. A live audio webcast of the conference call, along with supplemental financial information, will also be accessible from the "Investors" section of our website at [investors.paloaltonetworks.com](http://investors.paloaltonetworks.com). Following the webcast, an archived version will be available on our website for one year. A telephonic replay of the call will be available three hours after the call, will run for ten days, and may be accessed by dialing 1-888-203-1112 or 1-719-457-0820 and entering the passcode 1424255.

#### **Forward-Looking Statements**

This press release contains forward-looking statements that involve risks and uncertainties, including statements regarding our future financial and operating performance, including our financial outlook for the fiscal fourth quarter and full fiscal year 2018, regarding the company's transition to a new chief executive officer and Mark McLaughlin's transition to vice chairman of the Board, and our expectations regarding the benefits to our customers of our newly acquired offerings and capabilities and the effectiveness of these offerings and capabilities to perform as intended. There are a significant number of factors that could cause actual results to differ materially from statements made in this press release, including: our limited operating history; our ability as an organization to acquire and integrate other companies, products or technologies in a successful manner; risks associated with managing our rapid growth; the risks associated with new products and subscription and support offerings, including the discovery of software bugs; organizational changes and the timing of these changes; our ability to attract and retain new customers; delays in the development or release of new subscription offerings, or the failure to timely develop and achieve market acceptance of new products and subscriptions as well as existing products and subscription and support offerings; rapidly evolving technological developments in the market for network security products and subscription and support offerings; length of sales cycles; and general market, political, economic and business conditions.

Additional risks and uncertainties that could affect our financial results are included under the captions "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Quarterly Report on Form 10-Q filed with the SEC on February 27, 2018, which is available on our website at [investors.paloaltonetworks.com](http://investors.paloaltonetworks.com) and on the SEC's website at [www.sec.gov](http://www.sec.gov). Additional information will also be set forth in other filings that we make with the SEC from time to time. All forward-looking statements in this press release are based on information available to us as of the date hereof, and we do not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.

#### **Non-GAAP Financial Measures and Other Key Metrics**

Palo Alto Networks has provided in this press release financial information that has not been prepared in accordance with generally accepted accounting principles in the United States (GAAP). The company uses these non-GAAP financial measures and key metrics internally in analyzing its financial results and believes that the use of these non-GAAP financial measures and key metrics is useful to investors as an additional tool to evaluate ongoing operating results and trends, and in comparing the company's financial results with other companies in its industry, many of which present similar non-GAAP financial measures or key metrics.

The presentation of these non-GAAP financial measures and key metrics are not meant to be considered in isolation or as a substitute for comparable GAAP financial measures, and should be read only in conjunction with the company's consolidated financial statements prepared in accordance with GAAP. A reconciliation of the company's historical non-GAAP financial measures and key metrics to their most directly comparable GAAP measures has been provided in the financial statement tables included in this press release, and investors are encouraged to review these reconciliations.

*Non-GAAP net income and net income per share, diluted.* Palo Alto Networks defines non-GAAP net income as net income (loss) plus share-based compensation related charges including share-based payroll tax expense, acquisition related costs, amortization expense of acquired intangible assets, litigation related charges including legal settlements, facility exit costs, non-cash interest expense related to the company's convertible senior notes, and intellectual property restructuring related charges. The company also excludes from non-GAAP net income the foreign currency gains (losses) and tax effects associated with these items in order to provide a complete picture of the company's recurring core business operating results. The company defines non-GAAP net income per share, diluted, as non-GAAP net income divided by the weighted average diluted shares outstanding, which includes the potentially dilutive effect of the company's employee equity incentive plan awards and the company's convertible senior notes outstanding, after giving effect to the anti-dilutive impact of the company's note hedge agreements, which reduces the potential economic dilution that otherwise would occur upon conversion of the company's convertible senior notes. Under GAAP, the anti-dilutive impact of the note hedge is not reflected in diluted shares outstanding. The company believes that excluding these items from non-GAAP net income and non-GAAP net income per share, diluted, provides management and investors with greater visibility into the underlying performance of the company's core business operating results, meaning its operating performance excluding these items and, from time to time, other discrete charges that are infrequent in nature, over multiple periods.

*Billings.* Palo Alto Networks defines billings as total revenue plus the change in total deferred revenue, net of acquired deferred revenue, during the

period. The company considers billings to be a key metric used by management to manage the company's business given the company's hybrid-SaaS revenue model, and believes billings provides investors with an important indicator of the health and visibility of the company's business because it includes subscription and support revenue, which is recognized ratably over the contractual service period, and product revenue, which is recognized at the time of shipment, provided that all other revenue recognition criteria have been met. The company considers billings to be a useful metric for management and investors, particularly if sales of subscriptions continue to increase and the company experiences strong renewal rates for subscriptions and support.

*Free cash flow.* Palo Alto Networks defines free cash flow as cash provided by operating activities less purchases of property, equipment, and other assets. The company considers free cash flow to be a profitability and liquidity measure that provides useful information to management and investors about the amount of cash generated by the business after necessary capital expenditures.

Investors are cautioned that there are a number of limitations associated with the use of non-GAAP financial measures and key metrics as analytical tools. In particular, the billings metric reported by the company includes amounts that have not yet been recognized as revenue, and free cash flow does not represent the total increase or decrease in our cash balance for the period. In addition, many of the adjustments to the company's GAAP financial measures reflect the exclusion of items that are recurring and will be reflected in the company's financial results for the foreseeable future, such as share-based compensation, which is an important part of Palo Alto Networks employees' compensation and impacts their performance. Furthermore, these non-GAAP financial measures are not based on any standardized methodology prescribed by GAAP, and the components that Palo Alto Networks excludes in its calculation of non-GAAP financial measures may differ from the components that its peer companies exclude when they report their non-GAAP results of operations. Palo Alto Networks compensates for these limitations by providing specific information regarding the GAAP amounts excluded from these non-GAAP financial measures. In the future, the company may also exclude non-recurring expenses and other expenses that do not reflect the company's core business operating results.

#### About Palo Alto Networks

We are the global cybersecurity leader, known for always challenging the security status quo. Our mission is to protect our way of life in the digital age by preventing successful cyberattacks. This has given us the privilege of safely enabling tens of thousands of organizations and their customers. Our pioneering Security Operating Platform emboldens their digital transformation with continuous innovation that seizes the latest breakthroughs in security, automation, and analytics. By delivering a true platform and empowering a growing ecosystem of change-makers like us, we provide highly effective and innovative cybersecurity across clouds, networks, and mobile devices.

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**Palo Alto Networks, Inc.**  
**Preliminary Condensed Consolidated Statements of Operations**  
(In millions, except per share data)  
(Unaudited)

	<u>Three Months Ended April 30,</u>		<u>Nine Months Ended April 30,</u>	
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
Revenue:				
Product	\$ 215.2	\$ 164.2	\$ 603.9	\$ 496.8
Subscription and support	351.9	267.6	1,011.1	755.7
Total revenue	<u>567.1</u>	<u>431.8</u>	<u>1,615.0</u>	<u>1,252.5</u>
Cost of revenue:				
Product	68.9	49.7	190.4	137.7
Subscription and support	91.0	74.0	270.2	200.4
Total cost of revenue	<u>159.9</u>	<u>123.7</u>	<u>460.6</u>	<u>338.1</u>
Total gross profit	<u>407.2</u>	<u>308.1</u>	<u>1,154.4</u>	<u>914.4</u>
Operating expenses:				
Research and development	99.6	86.0	290.4	260.1
Sales and marketing	277.1	226.9	800.6	673.7
General and administrative	82.1	44.3	201.1	133.1
Total operating expenses	<u>458.8</u>	<u>357.2</u>	<u>1,292.1</u>	<u>1,066.9</u>
Operating loss	(51.6)	(49.1)	(137.7)	(152.5)
Interest expense	(6.5)	(6.2)	(19.2)	(18.3)
Other income, net	8.6	2.1	18.3	7.3
Loss before income taxes	(49.5)	(53.2)	(138.6)	(163.5)
Provision for (benefit from) income taxes	(2.8)	7.7	7.0	14.9
Net loss	<u>\$ (46.7)</u>	<u>\$ (60.9)</u>	<u>\$ (145.6)</u>	<u>\$ (178.4)</u>
Net loss per share, basic and diluted	<u>\$ (0.51)</u>	<u>\$ (0.67)</u>	<u>\$ (1.59)</u>	<u>\$ (1.97)</u>
Weighted-average shares used to compute net loss per share, basic and diluted	<u>91.9</u>	<u>91.0</u>	<u>91.3</u>	<u>90.5</u>

**Palo Alto Networks, Inc.**  
**Reconciliation of GAAP to Non-GAAP Financial Measures**  
(In millions, except per share amounts)  
(Unaudited)

<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
<u>April 30,</u>		<u>April 30,</u>	
<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>

GAAP net loss	\$ (46.7)	\$ (60.9)	\$ (145.6)	\$ (178.4)
Share-based compensation related charges	123.1	120.6	388.3	368.0
Acquisition related costs <sup>(1)</sup>	13.3	2.4	13.3	3.1
Amortization expense of acquired intangible assets	3.6	2.3	8.6	6.4
Litigation related charges <sup>(2)</sup>	3.1	3.1	9.2	9.2
Facility exit costs <sup>(3)</sup>	23.8	—	40.8	—
Non-cash interest expense related to convertible notes	6.5	6.2	19.2	18.3
Foreign currency (gain) loss associated with non-GAAP adjustments	(2.0)	1.4	(0.5)	1.8
Income tax and other tax adjustments related to the above <sup>(4)</sup>	(29.6)	(18.0)	(76.9)	(60.5)
Non-GAAP net income	<u>\$ 95.1</u>	<u>\$ 57.1</u>	<u>\$ 256.4</u>	<u>\$ 167.9</u>
GAAP net loss per share, diluted	\$ (0.51)	\$ (0.67)	\$ (1.59)	\$ (1.97)
Share-based compensation related charges	1.30	1.30	4.15	4.01
Acquisition related costs <sup>(1)</sup>	0.14	0.03	0.15	0.03
Amortization expense of acquired intangible assets	0.04	0.03	0.09	0.07
Litigation related charges <sup>(2)</sup>	0.03	0.03	0.10	0.10
Facility exit costs <sup>(3)</sup>	0.26	0.00	0.45	0.00
Non-cash interest expense related to convertible notes	0.07	0.07	0.21	0.20
Foreign currency (gain) loss associated with non-GAAP adjustments	(0.02)	0.02	(0.01)	0.02
Income tax and other tax adjustments related to the above <sup>(4)</sup>	(0.32)	(0.20)	(0.84)	(0.67)
Non-GAAP net income per share, diluted	<u>\$ 0.99</u>	<u>\$ 0.61</u>	<u>\$ 2.71</u>	<u>\$ 1.79</u>
GAAP weighted-average shares used to compute net loss per share, diluted	91.9	91.0	91.3	90.5
Weighted-average effect of potentially dilutive securities <sup>(5)</sup>	4.3	2.3	3.3	3.2
Non-GAAP weighted-average shares used to compute net income per share, diluted	<u>96.2</u>	<u>93.3</u>	<u>94.6</u>	<u>93.7</u>
Net cash provided by operating activities	\$ 241.3	\$ 211.2	\$ 759.1	\$ 629.0
Less: purchases of property, equipment, and other assets	28.8	48.6	86.6	114.2
Free cash flow (non-GAAP)	<u>\$ 212.5</u>	<u>\$ 162.6</u>	<u>\$ 672.5</u>	<u>\$ 514.8</u>
Net cash used in investing activities	<u>\$ (225.1)</u>	<u>\$ (166.8)</u>	<u>\$ (313.6)</u>	<u>\$ (411.1)</u>
Net cash provided by (used in) financing activities	<u>\$ 17.8</u>	<u>\$ (113.8)</u>	<u>\$ (240.8)</u>	<u>\$ (260.3)</u>

(1) Consists of acquisition transaction costs, share-based compensation related to the cash settlement of certain equity awards, and costs to terminate certain employment and operating lease contracts of the acquired companies.

(2) Consists of the amortization of intellectual property licenses.

(3) Consists of charges related to the relocation of the company's corporate headquarters, including a cease-use loss of \$15.4 million and accelerated depreciation during the three months ended October 31, 2017, and an additional cease-use loss of \$23.8 million during the three months ended April 30, 2018, and charges related to the relocation of the company's research and development center in Israel, including a cease-use loss of \$1.3 million and accelerated depreciation during the three months ended January 31, 2018.

(4) The company changed its non-GAAP effective tax rate from 31% to 22% in its second quarter of fiscal 2018 due to the reduction of the U.S. federal corporate income tax rate under the U.S. Tax Cuts and Jobs Act, which was enacted into law on December 22, 2017.

(5) Non-GAAP net income per share, diluted, includes the potentially dilutive effect of employee equity incentive plan awards and convertible senior notes outstanding. In addition, non-GAAP net income per share, diluted, includes the anti-dilutive impact of the company's note hedge agreements, which reduced the potentially dilutive effect of the convertible notes by 2.2 million shares and 1.6 million shares for the three and nine months ended April 30, 2018, respectively, and 0.1 million shares and 0.8 million shares for the three and nine months ended April 30, 2017, respectively.

**Palo Alto Networks, Inc.**  
**Calculation of Billings**  
(In millions)  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	April 30,		April 30,	
	2018	2017	2018	2017
Total revenue	\$ 567.1	\$ 431.8	\$ 1,615.0	\$ 1,252.5
Add: change in total deferred revenue, net of acquired deferred revenue	153.9	112.3	377.1	370.1
Billings	<u>\$ 721.0</u>	<u>\$ 544.1</u>	<u>\$ 1,992.1</u>	<u>\$ 1,622.6</u>

**Palo Alto Networks, Inc.**  
**Preliminary Condensed Consolidated Balance Sheets**  
(In millions)  
(Unaudited)

**April 30, 2018 July 31, 2017****Assets**

## Current assets:

Cash and cash equivalents	\$ 949.0	\$ 744.3
Short-term investments	672.2	630.7
Accounts receivable, net	361.8	432.1
Prepaid expenses and other current assets	<u>222.5</u>	<u>169.2</u>
Total current assets	2,205.5	1,976.3
Property and equipment, net	264.2	211.1
Long-term investments	592.9	789.3
Goodwill	522.2	238.8
Intangible assets, net	147.7	53.7
Other assets	<u>175.8</u>	<u>169.1</u>
Total assets	<u>\$ 3,908.3</u>	<u>\$ 3,438.3</u>

**Liabilities, temporary equity, and stockholders' equity**

## Current liabilities:

Accounts payable	\$ 32.7	\$ 35.5
Accrued compensation	95.1	117.5
Accrued and other liabilities	106.0	79.9
Deferred revenue	1,165.5	968.4
Convertible senior notes, net	<u>543.8</u>	<u>—</u>
Total current liabilities	1,943.1	1,201.3
Convertible senior notes, net	—	524.7
Long-term deferred revenue	989.4	805.1
Other long-term liabilities	226.0	147.6
Temporary equity	27.7	—
Stockholders' equity:		
Preferred stock	—	—
Common stock and additional paid-in capital	1,717.6	1,599.7
Accumulated other comprehensive loss	(13.2)	(3.4)
Accumulated deficit	<u>(982.3)</u>	<u>(836.7)</u>
Total stockholders' equity	722.1	759.6
Total liabilities, temporary equity, and stockholders' equity	<u>\$ 3,908.3</u>	<u>\$ 3,438.3</u>

**Palo Alto Networks, Inc.**  
**Preliminary Condensed Consolidated Statements of Cash Flows**  
(In millions)  
(Unaudited)

	<b>Nine Months Ended April 30,</b>	
	<b>2018</b>	<b>2017</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (145.6)	\$ (178.4)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Share-based compensation for equity based awards	373.1	356.8
Depreciation and amortization	68.0	43.1
Cease-use loss related to facility exit	41.1	—
Amortization of debt discount and debt issuance costs	19.2	18.3
Amortization of investment premiums, net of accretion of purchase discounts	0.6	2.1
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	72.5	(14.9)
Prepaid expenses and other assets	(60.3)	(11.8)
Accounts payable	(4.6)	2.8
Accrued compensation	(24.4)	1.7
Accrued and other liabilities	42.4	39.2
Deferred revenue	<u>377.1</u>	<u>370.1</u>
Net cash provided by operating activities <sup>(1)</sup>	759.1	629.0
<b>Cash flows from investing activities</b>		
Purchases of investments	(387.9)	(726.9)
Proceeds from maturities of investments	531.0	520.7
Business acquisitions, net of cash acquired	(370.1)	(90.7)
Purchases of property, equipment, and other assets	<u>(86.6)</u>	<u>(114.2)</u>
Net cash used in investing activities	(313.6)	(411.1)
<b>Cash flows from financing activities</b>		
Repurchases of common stock	(259.1)	(295.1)
Proceeds from sales of shares through employee equity incentive plans	52.6	45.8
Payments for taxes related to net share settlement of equity awards	<u>(34.3)</u>	<u>(11.0)</u>
Net cash used in financing activities	(240.8)	(260.3)
Net increase (decrease) in cash and cash equivalents	204.7	(42.4)

Cash and cash equivalents - beginning of period	744.3	734.4
Cash and cash equivalents - end of period	<u>\$ 949.0</u>	<u>\$ 692.0</u>
<b>Non-cash investing and financing activities</b>		
Property and equipment acquired through lease incentives	\$ 37.8	\$ —

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(1) Cash provided by operating activities for the nine months ended April 30, 2018 includes the receipt of an upfront cash reimbursement of \$38.2 million from the company's landlords during the three months ended October 31, 2017, in connection with the exercise of their option to amend the lease payment schedules and eliminate the rent holiday periods under certain of the company's lease agreements. The upfront cash reimbursement will be applied against rental payments due in fiscal years 2018 through 2020 under the amended lease agreements.

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SOURCE Palo Alto Networks, Inc.

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