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Palo Alto Networks, Inc. (PANW)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

Good day, everyone, and welcome to Palo Alto Networks Fiscal Third Quarter 2022 Earnings Conference Call. I am Clay Bilby, Head of Palo Alto Networks' Investor Relations. Please note that this call is being recorded today, Thursday, May 19, 2022, at 1:30 PM Pacific Time. With me on today's call are Nikesh Arora, our Chairman and Chief Executive Officer; and Dipak Golechha, our Chief Financial Officer. Our Chief Product Officer, Lee Klarich, will join us in the Q&A session following the prepared remarks. You can find the press release and information to supplement today's discussion on our website at investors.paloaltonetworks.com. While there, please click on the link for Events & Presentations, where you'll find the investor presentation and supplemental information.

In the course of today's conference call, we will make forward-looking statements and projections that involve risk and uncertainty that could cause actual results to differ materially from the forward-looking statements made in this presentation. These forward-looking statements are based on our current beliefs and information available to management as of today. Risks, uncertainties and other factors that could cause actual results to differ are identified in the Safe Harbor statements provided in our earnings release and presentation and in our SEC filings. Palo Alto Networks assumes no obligation to update the information provided as part of today's presentation.

We will also discuss non-GAAP financial measures. These non-GAAP financial measures are not prepared in accordance with GAAP and should not be considered as a substitute for or superior to measures of financial performance prepared in accordance with GAAP. We have included tables which provide reconciliations between the non-GAAP and GAAP financial measures in the appendix to the presentation and in our earnings release which we have filed with the SEC and can also be found in the Investors section of our website. Please note that all comparisons are on a year-over-year basis, unless specifically noted otherwise. We would also like to note management is scheduled to participate in the upcoming JPMorgan, Jefferies and Bank of America investor conferences in the next several weeks.

I will now turn the call over to Nikesh.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

Thank you, Clay. Good afternoon, everyone, and thank you for joining us today for our earnings call. In this time of increased macroeconomic volatility and geopolitical uncertainty, we saw a combination of strong cybersecurity market demand and our team's execution in line with our strategy drive our Q3 financial results. We reported strong top line metrics with both billings and RPO growing 40% year-over-year. This is the highest billings growth we have reported looking back over the past four years and was driven both by strong demand for our Next-Generation Security offerings and strong customer commitments to our network security business.

In network security, we saw product again grow over 20% as we continue the transition to software. Customers continue to consolidate their network security to Palo Alto Networks as a result of the significant expansion in our subscription capabilities over the last several years. Our Next-Generation Security ARR ended Q3 at \$1.61 billion, up 65% year-over-year. Our top line performance translated into non-GAAP operating income that grew ahead of revenue [ph] and enabled (00:03:24) strong cash flow conversion. We're pleased that we were able to achieve these bottom line results despite challenges in the supply chain.

Speaking of the global backdrop, whether it is supply chain, geopolitical conflict or rising interest rates and inflation, this environment is creating challenges for our customers and testing our execution. I'm pleased our teams have risen to the occasion and shown strong execution across sales, operations and all areas that support the business. The trend that started with the pandemic and the widespread cyberattacks, the trend of network transformation, cloud transformation and [ph] fortifying one's (00:03:59) infrastructure continue to be strong.

Coupled with consolidation in cybersecurity, we expect this to continue to drive strength and growth both for the industry and us in particular given our unique three-platform approach. Of course, the events of Ukraine are on everyone's mind. We stand with the people of Ukraine against Russian aggression and have been working to provide direct cybersecurity support the Ukrainian organizations. This geography has not been significant for us in terms of revenue or our overall growth expectations. For this quarter and our most recent quarters, our combined Russia and Ukraine revenue was well below 1%. We've halted new sales in Russia and we're also complying with all government sanctions.

Since December, we have deployed protection for over 3,400 new indicators of attack that defend organizations from disruptive and destructive Russian cyberattacks. As you might expect, we're seeing heightened interest from commercial and government customers in Europe around mitigating this nation-state activity. This ever-challenging threat landscape is driving broader and more strategic customer conversations. We continue to see our customers look for an elevated level of partnership, and this is expanding our market opportunity.

We continue to see success in consolidating share within the enterprise market, and this has become a core tenet of our growth strategy. We see evidence of this in our multi-platform sales with 48% of our Global 2000 customers having transacted now with us on all three of our major platforms of Strata, Prisma and Cortex. The number of million-dollar deal transactions we signed was up 65% in Q3 and the average size of our million-dollar deals increased in the quarter. We also saw the number of \$5 million deals increase by 73% year-over-year. Large deals are an important selling motion for us as we further penetrate Global 2000 customers with our second and third platforms.

Innovation is the engine that underpins our growth in the market, which Gartner estimates will total over \$250 billion in end-user spending by 2026. With a trend towards vendor consolidation in the market, customers appreciate our best-of-breed capabilities within each of our three platforms. This quarter, we added four additional categories to the recognition we received for our best-of-breed capabilities. Remember, they're all integrated into our three platforms. So, the customers get the benefit of our platforms, as well as the individual best-of-breed capabilities which compete effectively against independent vendors in our industry.

Forrester recognized our position in cloud workload security with a Leader designation in the inaugural Wave in this market, the only company to have that recognition. Early recognition of the importance of attack surface management, which we entered through the acquisition of Expanse in 2020, was validated as we were recognized as an Outperforming Leader by GigaOm. We received Strong Performer designations from Forrester in two categories, incident response and EDR.

I'll next provide you an update on our platforms and what progress we made in the last quarter, starting with Prisma Cloud. We continue to see strong momentum driven by both new customers, and notable for this quarter, large upsell and expansion commitments, which drove 25 deals north of \$1 million. This growth in customers and existing customer expansion is evidenced in our credit consumption, which grew 50% year-over-year in Q3.

We continue to drive cloud security leadership across the industry. And as I've said before, all Prisma Cloud customers are inherently customers of hyperscalers. Yet, they choose us. Customers are looking for a scaled, integrated cloud security platform that Prisma Cloud provides, enabling us to deliver high double-digit growth. Our customers are increasingly recognizing that operating securely in the cloud means ensuring the software that is written for the cloud is secure. This starts with the developer. Our early observation of this trend led us to acquire Bridgecrew in early 2021.

We have been focused on building out a portfolio of offerings targeted at developers. This is our fifth pillar of Prisma Cloud. Cloud Code leverages all the existing capabilities of Prisma Cloud, including its approach to credit consumption, deployment and reporting. One quarter from release, we've seen success in six-figure commitments to Prisma Cloud driven by Cloud Code, and also this is amongst the fastest modules adopted in Prisma Cloud in terms of credit consumption. Critical to our developer strategy, we continue to see strong downloads of our Checkov open source offering, which reached over 7 million in Q3.

Moving on to Cortex, we're helping customers reimagine how they operate their security operation centers with automation and AI/ML at the core. Cortex customers grew over 60% in Q3, supported by multi-product Cortex transactions in EMEA and the Americas. We achieved an important milestone in Q3 with approximately \$500 million in Cortex ARR. In Q3, we saw strength in each of our established Cortex product areas with a record number of transactions for XDR and Xpanse and nearly that level of business with XSOAR.

XDR continues to shine with industry awards and benchmarks. This quarter, XDR was recognized for 100% threat prevention and detection in the recent MITRE Evaluation. Forrester also recognized the significant progress we have made with XDR in our series of releases over the last nine months, recognizing XDR as a Strong Performer in its EDR Wave. Our Xpanse performance with transactions up well over 100% in the last 12 months shows that attack surface management is now seeing an inflection in mainstream demand.

After our recent limited release of XSIAM, we are making progress in our goal to initiate co-designed work with 10 partners and expect to be on track at the end of this quarter with our plans. XSIAM will ultimately enable us to achieve our Cortex vision around SOC automation, delivering what we expect to be a very unique value to our customers and disrupting the multibillion-dollar SIEM category by offering a modern alternative that leverages AI and ML.

Moving on to SASE, last week, we made a call to the industry to adopt ZTNA 2.0, which ushers in a new era of hybrid workforce security based on key zero trust principles like least privilege access, continuous trust verification and continuous security inspection across all apps. Our mantra for Prisma Access is to provide zero trust with zero exceptions. The pandemic has accelerated the adoption of SASE.

In addition to significant traction from our installed base, we continue to see strong momentum from net new customers for whom Prisma SASE is their first significant purchase from us. These customers then become opportunities for incremental engagements across our other platforms. SASE saw particular success with large transactions in Europe, as we signed 11 large transactions in EMEA, further endorsing the global nature of SASE demand. SASE is in the early innings and we're making significant investments to ensure we continue our momentum in this category.

Moving on to Strata, our hardware and subscription services platform. For the third consecutive quarter, we delivered north of 20% product revenue growth. We saw strength across our portfolio of both hardware appliances and software form factors. As you're all aware, the industry is dealing with unprecedented supply chain

issues, which are likely to persist for yet another year. Our team is adeptly managing these with our partners, allowing us to maintain better lead times than some in the industry.

We have seen instances where we are advantaged in having supply where competitors cannot timely deliver, and we believe this has helped contribute to market share gains. We saw our momentum validated by third-party recognition of market share gains in both hardware and VM form factors. In hardware, Omdia recognized Palo Alto Networks as being number one in market share for the appliance market with over 27% share, up more than 5 points year-over-year. In the VM market, according to Dell'Oro, we added 6 points of market share year-over-year and command nearly 34% of the market.

We continue to execute on our Generation 3 to Generation 4 transition. We have now released nearly all Gen-4 appliance models. Although customers are very early in their evaluation and adoption of Gen-4, we expect this Gen-4 adoption will help drive our appliance growth rates ahead of the market growth rate. We're seeing strong uptake of Advanced URL subscriptions and strong early demand for our new Advanced Threat Prevention subscription. We released next-generation CASB last quarter and saw a solid Q3 performance here.

Lastly, we announced our second partnership with a hyperscaler to embed our network security into the fabric of their cloud. This is differentiated innovation that leverages our engineering scale, our market leadership position and relationships with the hyperscalers. Cloud Next-Generation Firewall on AWS brings a combination of Palo Alto Networks' industry-leading network security in a cloud-native form factor and marries it with the ease-of-use of Amazon Web Services. This relationship with AWS follows the launch of Cloud IDS on Google Cloud platform last July. We expect Cloud Next-Generation Firewall will drive further growth of our Firewall as a Platform and specifically our software form factor.

It also gives customers another reason to standardize on our network security platform. Innovations like Cloud Next-Generation Firewall on AWS, Cloud IDS on Google Cloud and our licensing of security subscriptions to SaaS providers to protect their cloud applications are differentiators for us versus competitors that are primarily focused on the appliance form factor. Bringing it all together, we were very pleased with our Q3 results, where we saw exceptional top line growth. At the same time, even while growing faster, we are prioritizing investments and delivering on the profitability targets we committed during our September 2021 Analyst Day. We believe this is an important discipline and we intend to maintain this focus on profitability targets while maximizing growth.

We continue to see broadening demand for cybersecurity, which is enabling us to grow and invest from a position of strength. As we focus on our mission to be our customers' cybersecurity partner of choice for today and tomorrow, we also aspire to deliver to our shareholders outstanding returns as a proxy for growth of the cybersecurity opportunity as well as world-class execution. We're very pleased with the first three quarters we have delivered so far in fiscal year 2022. We look forward to updating you in three months on our plans to continue accelerated growth, balanced profitability and look at how we intend to target GAAP profitability in the near future.

With that, I will pass the call over to Dipak to talk about our results in more detail.

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

Thank you, Nikesh, and good afternoon, everyone. Our strong results continue to be driven by solid demand across the breadth of our offerings with results again ahead of our guidance across all metrics. In the midst of top line strength, we balanced profitability well. With the strength of this momentum and our favorable outlook, we are

again raising our full-year guidance. For Q3, revenue of \$1.39 billion grew 29% and was above the high-end of our guidance range. Product grew 22% and total services grew by 32%.

By geography, growth was balanced across all theaters, with the Americas growing 30%, EMEA up 28% and JAPAC growing by 29%. NGS ARR grew 65% to \$1.61 billion, supported by balanced strength across this portfolio. As noted in our Q2 earnings, going forward, we're focused on NGS ARR as one of our core metrics, as we believe it's indicative of the return we're seeing on our growth investments and also helps investors track the growing mix of this business within our revenue.

We saw strong double-digit growth across all of our major NGS offerings with Prisma Cloud, Prisma SASE and Cortex, as well as growing contributions from recently introduced NGS offerings. We are pleased with this diversified portfolio-driven growth. Overall, this performance as well as the continued maturity of our go-to-market organization in selling our NGS capabilities gives us confidence to raise our annual guidance for NGS ARR again in Q3.

In the third quarter of 2022, we delivered total billings of \$1.8 billion, up 40% and also above the high-end of our guidance range. Total deferred revenue in Q3 was \$5.9 billion, an increase of 34%. Remaining performance obligation or RPO was \$6.9 billion, increasing 40%, with current RPO representing a similar percentage of the total as in recent quarters. Our teams executed very well again in Q3, and you see the result of the strength in these top line metrics which lead revenue. There were a few factors to call out that drove the strength that we saw this quarter. In addition to the significant strength in our NGS business, we saw strength in our attached subscriptions.

We've seen customers use their budget to make incremental commitments to our attached subscriptions as they anticipate firewall upgrades and overall network security capacity increases. As well, they're seeing the value in newer subscriptions we have brought to the market over the last 12 to 18 months. This gives us further conviction around sustained demand for appliances, as well as our software-based FWaaS form factors, as customers look to benefit from our consistent architecture, including these subscription capabilities.

Product revenue again was strong, growing 22% in Q3 with demand exceeding our ability to ship due to supply chain challenges. We estimate customers refresh their products every four to seven years, with many now evaluating our Gen-4 hardware. We're in the early days of this refresh cycle with only a small proportion having updated their products. As I noted earlier, we're seeing signs of customers making commitments to our hardware platform both based on strong subscription demand and also the beginning of our installed base refresh activity.

Our Firewall as a Platform billings grew 25% on top of the accelerated Q3 growth in the year-ago period. We continue to see this performance well-balanced across our FWaaS form factors. Within our FWaaS offerings, the strength of our product business held our Q3 software mix at approximately 39%, in line with Q2 and the year-ago quarter.

Turning to the details of our results, product revenue was \$352 million, growing 22%; subscription revenue was \$640 million, increasing by 35%; support revenue of \$395 million increased 27%. In total, subscription and support revenue of \$1.04 billion increased 32% and accounted for 75% of total revenue. Non-GAAP gross margin of 72.9% was down 170 basis points. The driver continues to be supply chain-related costs as we incurred additional expense for components and shipping.

Despite the pressure on our gross margins, non-GAAP operating margin of 18.2% was up 120 basis points year-over-year. We were able to offset higher supply chain costs with lower operating expenses, as we drove

efficiencies across the business. Non-GAAP net income for the third quarter grew 38% to \$193 million or \$1.79 per diluted share. Our non-GAAP effective tax rate was 22%. GAAP net losses were \$73 million or \$0.74 per basic and diluted share.

Turning now to the balance sheet and cash flow statement, we finished April with cash, equivalents and investments of \$4.6 billion. Product and associated subscription shipments shifted [ph] toward three (00:19:52), resulting in days sales outstanding of 71 days. Cash flow from operations was \$390 million. We generated adjusted free cash flow of \$351 million, a margin of 25.3%.

With regard to capital allocation priorities, we did not repurchase stock during Q3. However, we do expect share repurchase to be a major use of cash flow as previously stated. We currently have approximately \$450 million remaining on our authorization for future share repurchases. This current authorization expires on December 31, 2022. On the M&A front, we did not close any acquisitions in Q3.

Managing stock-based compensation remains a management focus. This quarter, we reduced SBC as a percentage of revenue by approximately 4 points year-over-year and 2 points quarter-over-quarter. We will continue to apply discipline to this process while balancing reductions against the market dynamics for cybersecurity talent. Key to our ongoing success is maintaining balanced top and bottom line growth while continuing to acquire and retain top talent.

Lastly, moving to guidance and modeling points, as Nikesh highlighted, we continue to see very balanced demand from customers across our portfolio. This includes demand for our appliance form factors that outstrips our ability to fulfill in the near-term, as well as strength in our Next-Generation Security portfolio. Our Q4 guidance takes into account the strong demand picture, the best information we have today on supply chain and other factors. Recall that a year ago in the second half of fiscal year 2022 (sic) [2021] (00:21:32), we were hiring aggressively. As we move beyond that comparison, investors should be considering the comments we provided around medium-term margin expansion goals.

Turning to our guidance for the fourth quarter of 2022, we expect billings to be in the range of \$2.32 billion to \$2.35 billion, an increase of 24% to 26%. We expect revenue to be in the range of \$1.53 billion to \$1.55 billion, an increase of 25% to 27%. We expect non-GAAP EPS to be in the range of \$2.26 to \$2.29 based on a weighted average diluted count of approximately 106 million to 108 million shares.

For fiscal year 2022, we expect billings to be in the range of \$7.106 billion to \$7.136 billion, an increase of 30% to 31%. We expect revenue to be in the range of \$5.48 billion to \$5.50 billion, an increase of approximately 29%.

We expect Next-Generation Security ARR to be \$1.775 billion to \$1.825 billion, an increase of 50% to 55% versus a very strong performance in the fourth quarter of fiscal year 2021. We expect strength in product revenue to continue in Q4 with full-year growth of 20%. We expect non-GAAP operating margin to be 18.5% to 19%. We expect non-GAAP EPS to be in the range of \$7.43 to \$7.46 based on weighted average diluted count of approximately 106 million to 107 million shares. We continue to expect an adjusted free cash flow margin for the year of 32% to 33%.

Achieving the Rule of 60 was an aspiration we called out in our September 21st (sic) [2021] (00:23:20) Analyst Day. The rule combines revenue growth and adjusted free cash flow margin. Based on our Q4 guidance, we're pleased to project that the combination will exceed 60% in fiscal year 2022, which is ahead of our prior stated plan. We've seen strong growth in fiscal year 2022. On a revenue basis, our guidance for the year is 3.6% higher at the midpoint than where we started and 7.5% higher at the midpoint for NGS ARR.

Along with this top line, we've absorbed incremental supply chain costs and are happy to be able to continue to project the same operating profitability range as at the beginning of the year. Additionally, please consider the following additional modeling points. We expect non-GAAP tax rate to remain at 22% for Q4 and fiscal year 2022, subject to the outcome of future tax legislation. For Q4 2022, we expect net interest and other expenses of \$1 million to \$2 million. We expect capital expenditures in Q4 of \$36 million to \$41 million, and we expect capital expenditures for the full fiscal year of \$190 million to \$195 million, which includes \$39 million outlaid in Q2 2022 related to our Santa Clara headquarters.

Stepping back, we're focused on balancing our drivers of total shareholder return, recognizing not only the importance of top line growth as we focus on executing strong market demand, but also profitability, cash conversion and our capital structure. Balancing profitability is a commitment we made at our Analyst Day, and we've been able to deliver on this in fiscal year 2022 despite increased costs related to our supply chain.

We will continue to make progress on our commitment of 50 to 100 basis points operating margin expansion and 100 to 150 basis points of adjusted cash flow margin expansion beyond fiscal year 2022 through 2024 whilst balancing top line growth opportunity. We're on track to achieving our fiscal year 2024 targets we outlined in our September 2021 Analyst Day, including \$10 billion in billings and \$8 billion in revenue. We believe we can continue to deliver shareholders outstanding returns as a proxy for the growth of the cybersecurity opportunity as well as world-class execution.

With that, I will turn the call back over to Clay for the Q&A portion of the call.

QUESTION AND ANSWER SECTION

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Great. Thank you, Dipak. To allow for broad participation, I would ask that each person ask only one question. The first question will be from Phil Winslow of Credit Suisse, with Hamza Fodderwala to follow. Phil, you may ask your question.

Philip Winslow

Analyst, Credit Suisse Securities (USA) LLC

Q

Great. Thanks, guys, for taking my question and congrats on just another great quarter of execution. Now, in a quarter where a lot of numbers really jumped out, the one – 73% growth in \$5 million-plus deals and the fact that nearly half the Global 2000 have purchased all three platforms from you all really jumped out to us. Now, if you put these numbers in the context of the upside of the Strata product revenues as well as the strong Prisma SASE customer count, Nikesh, what are customers telling you about why they're selecting Palo Alto Networks sort of just at an accelerating rate versus the traditional on-prem firewall vendors or they call it the cloud-native zero trust competitors? Is it just increasingly understanding the value of the hybrid nature of the portfolio, the value of all three together, et cetera? And how are you just seeing these competitive dynamics playing out?

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Phil, I'm accused of speaking fast. Dude, you're beating me at it. So, thank you...

Philip Winslow

Analyst, Credit Suisse Securities (USA) LLC

[indiscernible] (00:26:45).

Q

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

I know. Thank you for the question, Phil. Look, it's kind of everything you said. And we've been saying this for a while that cybersecurity is consolidating, and the evidence we've been shown by people like yourself is, look, it's never happened before. And I still submit that the reason it never happened before, because you didn't have a cybersecurity company, which would show you 20 best-of-breed products in its portfolio. Because customers are not suggesting they will buy something you have because it's in your platform, they are still demanding best-of-breed. And we're able to demonstrate to them the best-of-breed.

A

But not only that, I think in the last 3.5 years, we've been able to demonstrate our track record saying, if something is important, we will make sure we deliver it to you with best-in-class capability. So, we're seeing that. This allows us to go back into customers. As you can imagine, if all you got is EDR or XDR to sell, if the customer has just bought it, you got to move on. If all you got is SASE, you got to move on if the customer has bought SASE. In our case, our sales teams have a very large bag of tricks. If you don't want SASE, you've got cloud security going on, let me talk to you about cloud security. If you don't have cloud security going on yet, do you want to talk about buying more firewalls or replacing somebody? If you don't have that, do you want me to help you automate your SOC?

So, just the ability for us to demonstrate that we can help them with a multitude of their cybersecurity challenges and also show them that we're not trying to get them to make a very large commitment across all three of our platforms, they can walk and then they can run. They actually start by taking one of our platforms, allowing us to demonstrate our credibility and our security capabilities, thereby giving us the opportunity to then bid for the next business that they have. And I think the \$1 million deals and \$5 million deals are just a way look at it, because \$1 million deals are typically single-platform deals, and as you get into the 5s and the 10s, you suddenly see that there is more of a portfolio approach. So, it's what we said.

Philip Winslow

Analyst, Credit Suisse Securities (USA) LLC

Awesome. Thanks, guys. Keep up the good work.

Q

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

Thanks, Phil.

A

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

Next from Hamza Fodderwala of Morgan Stanley, followed by Fatima Boolani. Hamza, please proceed.

A

Hamza Fodderwala

Analyst, Morgan Stanley & Co. LLC

Hey, guys. Thanks for taking my question. I'll try to speak a little more slowly. Maybe just on the consolidation theme, sticking to that, one, just from a macro standpoint, I'm wondering if you're hearing anything different from

Q

customers around how they're thinking about the spending environment. And in relation to that, given the macro pressures on IT budgets more broadly, are you seeing more of a willingness to want to consolidate to pure vendors as opposed to multiple different point products?

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Yeah. Hamza, it's a great question. Look, interestingly, if you compare and contrast what we're seeing today with what we saw about 2.5 years ago or 2 years ago when the pandemic hit, believe it or not, there were more industries impacted by the pandemic than are impacted right now by inflation concerns. The oil industry is not stressing about IT budgets. The commodity industry is not stressing about IT budgets. The CPG industry is not stressing about IT budgets. The tech industry is not worried about IT budgets. So, it's funny. If you think about it, the impact is yet to be felt in the companies. And even when it is felt, you'll see it in some constrained industries, because there's a services boom right now. [ph] People can't because there's more jobs and people being hired (00:30:11).

So, we're not seeing the pressure from an inflation or a reduced economic activity perspective. I will tell you, when the pandemic hit, we were getting letters from CIOs saying, listen, our revenue has gone away, we're not sure when it's going to come back and how it's going to come back. All the prices were at zero for a few days. So, at that point in time, they were all in that scenario you described. We haven't seen that scenario. And I don't want to be way too optimistic. But the fact that we were able to tide over that pandemic moment as an industry, to be fair, as cybersecurity, I'm less worried about it right now given what's going on in the environment. Because I think on the flip side, as I've said, you're seeing way more security awareness and concern more than I've ever seen, and we don't hear about it until there's a big ransomware discussion publicly. But trust me, they're going on right now as we speak.

Hamza Fodderwala

Analyst, Morgan Stanley & Co. LLC

Q

Thank you.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Clay?

Hamza Fodderwala

Analyst, Morgan Stanley & Co. LLC

Q

Oh, thank you. I don't know if you heard me. Sorry.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

[indiscernible] (00:31:20). Next is Fatima Boolani from Citigroup. Fatima, please proceed.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Thank you for taking my questions. I have a bean-counting question that I'd like to ask of Dipak. Dipak, on your billings performance, just to unpack the strength there a little bit, can you contextualize any changes to contract duration, specifically reconciling some of the commentary on the mega deal volumes that you realized this quarter

and also giving us maybe some flavors on the Palo Alto Financial Services vehicle, the financing arm that you introduced two years ago? And then thirdly, just around any discounts that we're peeling off from the COVID era. So, just to get some of those dynamics, how we should think about the really outsized billings performance. Thank you.

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Okay. A couple of different questions there, Fatima. Thanks for the question. So, overall, I would say – let me just start off with the billings growth was really quite widespread. Our contract durations have remained roughly at around three years. They've been around that time. At any one given quarter, they can change a little bit like a month or two, not significant. So, it's possible that we get a little bit of – which was the last year's fluctuation versus this year. But overall, it was very broad-based and we're not seeing really many issues related to that.

With respect to the PAN FS, I think we've had that in place for a while. We're roughly at the same level of exposure that we've had before. It's not massively growing. Nothing's really changing significantly on that. So, I don't think that's an unpack like reconciling item. It really is like strength of the overall business. And sorry, just remind me of the third part of your question.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Just in the COVID era, I think you had been generous or flexible with your customers with respect to payment terms. So, there was maybe a point or two of impact of discounts that are probably rolling off.

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Yeah.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

So, I'm just curious if those have completely been flushed out of the model in terms of discounts.

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Yeah. No. So, we track our discounts obviously very closely. We haven't really seen anything particularly significant in our discount changes either. So, I would say that as you unpack the model, it really becomes pretty clear that it's broad-based growth.

Fatima Boolani

Analyst, Citigroup Global Markets, Inc.

Q

Perfect. Thank you.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Okay. Next question from Brian Essex of Goldman Sachs, followed by Gray Powell. Brian, please proceed.

Brian Essex

Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you, Clay, and congrats on some nice results from me as well. I have a bit of a bean-counting question as well. Maybe for Dipak, could you help us understand a little bit what's going on on the cost side of the equation? Really great job in this environment delivering on the operating margin side. So, I guess from a gross margin perspective, impact of pricing increases, and then from an OpEx perspective, where is it that you're getting better cost control measures and how sustainable are they? Thanks.

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Sure. So, let me just start off with the – the cost pressures are really all within the supply chain area. We did take pricing. We took 7.5% pricing in September of last year, followed later internationally. We monitor that all the time and we try to capture the impacts we'll have of future inflation. We recently did realization of that pricing, which has been good. But obviously, the supply chain environment remains fluid. I think when it comes to where we've been able to focus on operating expenses to offset that, it really is just a laser-focus – there's no magic silver bullet. It's just a laser-focus on the execution, making sure that we're watching every single dollar, [ph] acting like an owner (00:35:09), incredible intense scrutiny on travel because that was a concern of – would that come back with a vengeance. We focused a lot there. Looking at leveraging scale when it comes to all the areas frankly. We've had good scale in R&D, good scale in sales, marketing good scale and G&A. But it's really just making sure that we're purposefully looking at every single head count and justifying it.

Brian Essex

Analyst, Goldman Sachs & Co. LLC

Q

All right. And is a lot of that sustainable? T&E, I would imagine, would be relatively flexible, but how much are you going back for sustainable cost measures?

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

I think we're very comfortable with the sustainability like as reflected in our guidance. Going forward, we just need to continue to act with that kind of diligence going forward.

Brian Essex

Analyst, Goldman Sachs & Co. LLC

Q

Very helpful. Thank you.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Great. Thanks. And next is Gray Powell from BTIG, followed by Saket Kalia. Gray, please proceed.

Gray Powell

Analyst, BTIG LLC

Q

Okay. Thank you very much and congratulations on the great results. So, yeah, a question on the product side. 12 to 18 months ago, we're all thinking that product revenue should be growing in like the low single-digit range. And it's consistently been much better, closer to 20% the last few quarters. So, how should we think about the sustainability of product revenue growth going forward? And then, beyond the price increases that you called out

earlier this year, is there anything helping product revenue growth in fiscal 2022 that creates a tougher comp in fiscal 2023?

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Well, Gray, as first of all we said this last quarter, we have been positively surprised by the growth in product obviously, and Lee has a very interesting explanation on why people need more firewalls as their internet traffic grows and I'll let him speak to it because otherwise he won't come to these calls. He told me that. But before he does that, look, we are seeing the Gen-2, Gen-4 evals causing people to go through a refresh cycle, which typically lasts 12 to 18 months when it's in full flow, and it's not yet in full flow.

As we highlighted the market share changes, look, there are people in our industry who are not able to keep up to 12 to 18 weeks of supply chain and sort of deliver firewalls. We have seen certain isolated incidences where customers have [ph] torn up deals for (00:37:32) some of our competitors and chosen Palo Alto Networks because we have product and others are not able to do that, which – the best way to measure that is through market share gains. And these market share gains [indiscernible] (00:37:43) but they're not going to go way, because you're buying something which has a six to seven-year life and you're basically making a technology decision to switch to Palo Alto Networks. So, I think the combination of market share gains, the refresh cycle, the increased volume. And Lee, do you want to give your explanation?

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

A

Yeah. I think one of the sort of misunderstandings with the move to the cloud is that everyone thought that that would be the death of hardware. But the reality is you have all of these users that need to now reach applications running in the cloud, and these applications generally are higher bandwidth-type applications. And so, that triggers a need to upgrade the firewall infrastructure to be able to secure higher bandwidth connectivity. And so, that actually is a positive trend toward hardware sales and hardware requirements, especially as we come out of the pandemic and more and more companies are moving back toward a hybrid workforce, where more and more employees are showing up to the office as well.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

[indiscernible] (00:38:41) example, we're primarily in the cloud with our capabilities but...

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

A

Yeah. A few years ago, we had a pair of 1 gig links to the internet at our main headquarters. We now have a pair of 10 gig links, just to kind of give you an order of magnitude. And I don't think that's an unusual situation for companies to be in.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

So, despite us moving to the cloud, we've had to upgrade our firewalls in our headquarters.

Gray Powell

Analyst, BTIG LLC

Q

Makes a lot of sense. All right, super helpful. Thank you very much.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Thanks. And next question from Saket Kalia of Barclays, followed by Michael Turits. Saket, please proceed.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

Okay, great. Okay, guys. Thanks for taking my question here. Nikesh, maybe for you, again, going back to the billings, great to see the acceleration. Maybe just to look at it from a different angle, you've talked about some new attached subscriptions that – some of them might be higher value. Of course, you've got the NGS billings in there as well. Can you just talk to how much each of those is sort of driving that billings acceleration, some of those newer attached subscriptions to the core firewall, as well as that NGS billings line?

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Well, as you know – Saket, thanks for your question. You've seen we share our NGS ARR with you. So, it's quite transparent. And you see that number at that scale continues to grow in the 50%, 60% range, which is clearly a big contributor to our billings. Our product being at 20% also contributes to the billings. We've highlighted that Cortex hit \$500 million ARR in that number. So, clearly, it's reached a milestone for us in that entire mix. And as you rightfully identified, we have now 10 subscriptions that we run. When I came three years ago, we used to have four. So, clearly, you should expect that there is a significant attach that is going on, which will persist as we continue to sell hardware in the current growth rates that we are. So, higher growth rate of hardware drives more subscriptions and services which, with a higher attach, ends up giving us a nice lift on our billings.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

Got it. Very helpful. Thanks.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Super. Next, we've got Michael Turits of KeyBanc, followed by Roger Boyd. Michael, please go on.

Michael Turits

Analyst, KeyBanc Capital Markets, Inc.

Q

Great. Thanks very much, everybody. So, I think, Dipak, I'll ask you on the labor and wage front. We've seen – given the shortages out there on that side, we've seen some large corporations have hiring freezes. Some are raising wages for their existing customers. So, A, how are you doing in terms of hiring as many people that you need? And then, B, what exactly are you doing in order to maintain cost in that increasing wage environment around skilled labor?

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Yeah. [indiscernible] (00:41:30).

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

[ph] So, Michael (00:41:31), we haven't hired as many people as we were expecting to in this market. It's a very tight labor market at this current point, as you see. Having said that, my personal view is the labor market is going to become easier in the next 6 to 12 months. And anecdotally, as you've seen, we're seeing hiring freezes anecdotally. If you think about it, six months ago, we were losing people to start-ups. We were losing people to competitors whose stocks prices were going up and to the right. The market rationalization is causing people to take stock and say, wait, do I really want to go make this move?

I've already seen anecdotally start-ups start to stop hiring because they're trying to hold on to their cash because they don't expect to be able to raise money in the market for the next 12 to 18 months. So, I think from that perspective, the labor market actually, in our opinion, is going to ease up a little bit. We expect some degree of wage inflation, which is being caused because of the fact that we're in Silicon Valley and we live around some very large tech companies who are trying to get people to come work there. So, we have factored into our planning some degree of inflation on our wages. But I personally don't think it's going to be off the charts.

Michael Turits

Analyst, KeyBanc Capital Markets, Inc.

Q

Thanks for answering, Nikesh. I usually hit you on product, but Gray got you first. So, I thought I'd hit Dipak. But thanks for answering.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

That's all right. No problem. Great.

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

I'll just add one comment maybe to the overall, it's like wages is one factor that people look at when they choose a company. We've recently had a Welcome Home program. I think a couple quarters ago, we actually showed you guys a video of it. And that's been remarkably successful. We find a lot of people that will leave realize that the culture of the company is equally as important as what was potentially short-term gains when they leave...

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

[ph] More important (00:43:24).

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Yeah. Well, a lot more important ultimately than the gains. And then, the grass is not always greener. We've had remarkable success bringing them back, and we'll continue to do that.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Next is Roger Boyd of UBS, followed by Andy Nowinski. Roger, please go.

Roger Boyd

Analyst, UBS Securities LLC

Q

Great. Thanks for taking my questions and congrats on the quarter. Just going back to the macro conversation, I think you noted a couple of larger deals in EMEA. Just curious if you have any commentary on what you're seeing around sales cycles and any sense of whether maybe you're pulling forward some demand given the threat environment. Thanks.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Yeah. Look, in every quarter, we've seen some deals get pulled forward. Sometimes it's our salespeople because they're trying to hit quotas. Sometimes, a customer because they're in a compromised situation, they're trying to get something sorted quickly as possible. Sometimes, it has to do with budgets expiring. In different parts of the world, December becomes one of those moments. August becomes that for the federal government. So, I think perhaps the best answer is that we have not seen any unusual activity around that topic.

Having said that, as we said, we are seeing heightened activity from nation-states, especially with the proximity to where the war is, where they're trying to fortify their defenses and make sure they understand their attack surfaces as a nation better, which they've not had to worry about in the past. They should have worried about it, but they haven't focused on it. But now, as people are trying to petition to go become members of NATO, they've got to make sure that their defenses are robust in case they see retaliation.

Roger Boyd

Analyst, UBS Securities LLC

Q

Got it. Thanks, Nikesh.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Great. And next, we've got Andy Nowinski from Wells Fargo, followed by Rob Owens. Andy, please proceed.

Andrew James Nowinski

Analyst, Wells Fargo Securities LLC

Q

All right. Thank you. Congrats on a great quarter. So, I had a question with regard to the Next-Gen ARR. Obviously, very strong quarter but your – and your net new ARR was also up about 32%. Yet, your guidance suggests that net new ARR will decline about 7% in Q4. Other than conservatism, are there any other factors that we should consider that might cause net new ARR growth to significantly decelerate in your fiscal year-end?

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Andy, I look at it from the other side of the lens. The other side of the lens says we had a great quarter. We're upping guidance across the board for Q4. We're upping guidance across the board for the full fiscal year way ahead of what we promised the markets in our Analyst Day not too long ago. And that seems to be a wonderful story and a happy place to be.

Andrew James Nowinski

Analyst, Wells Fargo Securities LLC

Q

Got it. Thank you. Understood.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

All right. Next, we've got Rob Owens of Piper Sandler, followed by Jonathan Ho. Rob, please proceed.

A

Rob D. Owens

Analyst, Piper Sandler & Co.

Great. Thanks, and thanks for taking my question. I was wondering if you could drill down a little bit into some of the supply chain advantages that you've alluded to both in the prepared script as well as Q&A here. Where do you see an advantage? How sustainable is it as well? Thanks.

Q

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

I think, Rob, the real opportunity here is Dipak has a team of experts who spend a lot of time trying to understand the puts and takes in terms of being able to deliver firewalls in terms of ordering forward. And I don't – I think that's worked out so far for us. We have been able to deliver 20% growth, which is basically shipping as you've heard across the board in the industry that most hardware businesses are building backlog. We're no different than most hardware businesses out there. During the year, we have more backlog than we started with. Or it moves back and forth depending on what we can ship in different categories.

A

So, the teams already have some of their marching orders in terms of what they need to go out and find. And I think the other way to think about it is that from a scale and scope perspective, if you're doing [ph] \$300 million plus (00:47:14) of product, the semiconductor cost on that is probably \$60 million, \$70 million. So, in here, we're looking for \$300 million semiconductors in a hundreds of billions of dollar industry. So, I joke that some of our – other players in the industry need the entire truck. I just need the box that falls off of the back of the truck. So, we're doing a good job chasing trucks to find the boxes.

Rob D. Owens

Analyst, Piper Sandler & Co.

All right. Thank you.

Q

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

So, if I can just add, like the only thing that I would add is like a lot of it just comes down to the people and the quality of the execution and discipline of the people. And that's really been like – I think across the board, the execution across pretty much every part of our portfolio is what we feel most proud of and what gives us the most confidence in our guidance going forward.

A

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

Next, we've got Jonathan Ho of William Blair, followed by Matt Hedberg. Jonathan, please proceed.

A

Jonathan Ho

Analyst, William Blair & Co. LLC

Thank you. One question for me to make sure he keeps coming on to these calls, how should we think about the pace of adoption for Prisma Cloud and are you seeing any specific drivers emerge there to drive some of this accelerated demand? Thank you.

Q

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

Yeah.

A

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

Thanks, Jonathan, for [indiscernible] (00:48:28).

A

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

Appreciate it. Thank you, Jonathan. Look, there's some obvious drivers. Cloud consumption continues to rise, and you have to secure that consumption of workloads that the companies are moving to the cloud. That's probably the most obvious one. But it goes hand-in-hand with that the recognition of all the different security capabilities that are actually needed to secure that cloud environment. If you look back even just three or four years ago, a lot of cloud security was just maybe one or two simple capabilities. And today, whole businesses are being run out of the cloud and the understanding of how important the security is and what it takes to do that.

A

And then, that then ends up leading to a choice for many customers. Do they try to patch together a whole bunch of different point products from different vendors and find a way to integrate them and get them to work and operate them? Or do they go with Prisma Cloud which is really unique in the industry as being a platform made up of best-of-breed capabilities that can secure their whole cloud environments? And that's really where we're seeing that – not only driving new customer adoption, but driving the expansion within our existing installed base as they adopt these new modules. And as Nikesh said in his prepared remarks, Cloud Code Security is the fastest growing new module that we've introduced, and that just shows the ability to deliver a high value new module to customers and then also the ease with which they can adopt those new capabilities into the platform they're already using.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

All right. Thanks folks for sticking with one question. Our next question from Matt Hedberg of RBC, followed by Ben Bollin.

A

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Hey. Thanks, Clay. Hey. Thanks, guys. So, I have another one for Lee actually. We'll keep Lee going here. Lee, obviously, there's a huge talent shortage out there for security experts. And obviously, the threat landscape is very challenging. Does that make your automation orchestration capabilities even more important today? And maybe how does that manifest itself in platform attach maybe even beyond SOAR?

Q

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

Yeah. Good question, Matt. I'll actually reverse what you said. The first key value that customers are realizing in that shortage is being able to adopt security on top of platforms as a significant benefit toward the ease with which it can be operationalized. And so, that actually is the starting point. Automation then becomes a layer on top of that, where the remaining manual workflows then start to go through cycles of where are the most repetitive tasks, how do we put those through an automation workflow engine like XSOAR and build that muscle of recognizing

A

manual workflows, automating and then finding the next manual workflows and automating those. I'll give you an example within our own IT organization. We track this. We actually quantify every quarter the number of hours that we've been able to automate. A typical quarter for us, we will automate an incremental 30,000 hours of manual repetitive tasks, and that's – it's not so much about the savings. It's about being able to then reallocate that focus toward new high-value tasks that people need to accomplish.

Matthew Hedberg

Analyst, RBC Capital Markets LLC

Super helpful. Thanks. Congrats, guys.

Q

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

Thanks.

A

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

Great. Next up, Ben Bollin of Cleveland Research, followed by Adam Tindle. Please go, Ben.

A

Ben Bollin

Analyst, Cleveland Research Co. LLC

Good afternoon. Thanks for taking the question. Dipak and Nikesh, I was hoping you could quantify the impact of supply chain you think was left on the table in the quarter and how you think about that in guidance, and any longer term thoughts you have on how your strategy around supply chain has evolved – or has changed because of what we've seen over the last several quarters. Thanks.

Q

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

Well, look, as you can imagine, the teams work hard every quarter with our suppliers and partners to see what the out of the possible is not just this quarter, but over the next four quarters and even longer, and depending on the lead times of the items. And again, despite that, as Dipak characterized it as a fluid environment, things keep moving around even in that timeframe. So, we have robust plans with our partners. We look at the inventory. We understand the inventory. Remember, the whole industry has gone from JIT to just-in-case, because you can have stuff lying around for three months because the required part doesn't show up for three months, so you got to go integrate it. So, there's a whole bunch of stuff that's moved. And as Dipak highlighted, there's a phenomenal team focused on executing that in a way that we can deliver our numbers.

A

In terms of the demand, the backlog and what we have been promising, we have reasonable line of sight if all things work in terms of what we're likely to get on a quarterly basis. Hence, our guidance is consistent with what our best guess on what will be available is, and that's why we keep telling you guys that this is not a demand problem, this is a supply challenge that we're trying to address as an industry. So, I think from that perspective, things are on track. Like at some point in time, this has to abate. At that point in time, we just want to make sure that we're not stuck with too much supply and we have the right stuff out there. So, there is a lot of work that goes into forecasting, predicting, understanding product roadmaps, understanding the refresh cycles of our customers, understanding which customer is more likely to order Gen-3 or Gen-4.

So, a lot of planning, a lot of math that's going into the stuff, because my sense is there is a big pendulum shift and a lot of people are ordering a lot of stuff, and there's – definitely, at some point in time, there will be more

supply and you just have to make sure that you don't get stuck with too much supply from a long-term perspective. So, we're trying to balance that. We've held a view that we're not going to do too many price increases, because stuck with a lot of supply in a higher price, it doesn't take a genius to figure what the consequences are. So, we have been very careful of our price increases. We're keeping them moderated. We watch our discounts and we're making sure that we don't order so much that we're going to have a hangover. I think that works like that. Does it? Yeah, okay. Okay. Does that help you better?

Ben Bollin

Analyst, Cleveland Research Co. LLC

Q

It does. Thank you.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

All right. Thanks.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Okay. Next, we've got Adam Tindle of Raymond James, followed by Brent Thill. Adam, please proceed.

Adam Tindle

Analyst, Raymond James & Associates, Inc.

Q

Okay. Thanks. Good afternoon. Nikesh, you alluded to GAAP profit in the near future in your prepared comments. And just wanted to challenge this, but admit it's double talk since it's part of my thesis. But as I question myself, why is now the time to show GAAP profit and leverage? The flip side is you're seeing momentum across almost all metrics. You could step on the gas even further and go to market given the portfolio is winning. You're having success in hiring, yet human capital is scarce. And your R&D engine has developed products that are clearly showing differentiation. And Dipak, if you wanted to add any comments to that, because there's some level of substituting this for increased cash margin in the future. So, what to do with the incremental cash that has a better ROI than a more aggressive internal investment strategy? Thank you.

Nikesh Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

A

Look, it's kind of interesting. If you look at – we've been sharing with you in the past, the amount of products we introduce into our field force, and we've actually asked them – asked Lee and his great team to slow down product introduction in the fourth quarter because I want to make sure that the teams out there are focused on delivering on Q4, which clearly is one of the larger quarters that we deliver. So, I don't think we need more fuel in the product pipeline. We need to make sure that the product pipeline gets to a lot of our customers. Having said that, as you see, as we traverse to larger and larger deal sizes, we keep driving efficiency from our go-to-market capabilities. And we think we have – and I think I was counting, Dipak probably said it four times [indiscernible] (00:56:33) script twice. So, he's clearly sending a message.

We are managing growth with the right aspiration for profitability. So, trust me, I am not shy if I feel there's an opportunity [ph] and I need to go over invest (00:56:47). We did that [indiscernible] (00:56:48) companies with \$3.5 billion when the time was right to be able to build the product portfolio. So, if we feel that we're leaving money on the table, we will go charge at it. But I think we're striking the right balance. And if we see better growth, we will make sure we go out and invest. But as of now, we feel we have ample resources in our plan in line with

our growth expectations, and our key is to sustain those growth expectations over time to generate most value for our shareholders. What are you going to do with all that free cash?

Dipak Golechha

Chief Financial Officer, Palo Alto Networks, Inc.

A

Look, I think it's a world-class problem to have. But I think I'm just going to echo what Nikesch said. I think everything in balance, and then we really let total shareholder return and the ROI determine what we do within the boundaries of what we've committed to.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

A

Okay, great. Last question for today from Brent Thill of Jefferies. Brent, please proceed.

Brent Thill

Analyst, Jefferies LLC

Q

Nikesch, on the G4 refresh cycle, you mentioned it's early days. Is there a percentage through this you put on it, 20%, 30%? Is there an easy ballpark you can give us on where you're at through that right now?

Lee Klarich

Chief Product Officer, Palo Alto Networks, Inc.

A

Yeah. It's a great question. It's a low number. Remember, the biggest chunk of the Gen-4 hardware was just introduced about three months ago toward the end of February. So, the first round was June of last year, but the broader set of platforms actually was just a few months ago. So, we're very much early innings on this. We've seen good – very good early adoption and interest from customers, and as Nikesch said, these refreshes are 12, 18, 24 months in nature.

Clayton Bilby

Head-Investor Relations, Palo Alto Networks, Inc.

All right, great. Well, that will conclude the Q&A portion of our call today. I will now turn it back over to Nikesch for his closing remarks.

Nikesch Arora

Chairman & Chief Executive Officer, Palo Alto Networks, Inc.

Look, I just want to say thank you to our employees, our partners, our customers for allowing us to be both their cybersecurity partners, and our employees for doing a phenomenal job all around the world. And I also want to thank you for taking the time. See you guys next quarter.

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