

Palo Alto Networks Inc.

NASDGS: PANW

Analyst: David Itoafa

Sector: Networking

Buy

Price Target: 179.61\$

Key Statistics as of 11/12/2016

Market Price: 156.01

Market Cap: 14.5 B

52-Week Range: 111.0901-194.728

Beta: 1.103

Catalysts:

- Q3 Earning Call on November 21st
- Policy changes during Trump Presidency

Company Description:

Palo Alto Networks is a company offering network security solutions to clients. The initial public offering was in July of 2012 and has since then taken off to become one of the leaders in cybersecurity. The network security functions offered by PANW include firewall, threat protection, intrusion detection system, intrusion preventive system and uniform resource locator filtering's. This company was founded by Nir Zuk, Rajiv Bartra, and Yuming Mao, but Mr. Zuk is the only member still active in the board of directors. Palo Alto Networks has it's headquarter in Santa Clara California, but offers its services to various countries all over the world.



Thesis

- Palo Alto Networks is positioned very well to withstand a shift from traditional to robust solutions.
- Revenue growth and a booming cybersecurity market will enable PANW to continue moving in the right direction.
- The upcoming earnings call on the 21st will provide clarity and confidence to investors.

Valuation

As of right now Palo Alto Networks is fairly priced due to three main concerns, which can be fixed in the long run. Many analysts are turned off by an overstatement that could have occurred in the growth of free cash flows. In the most recent earnings call CEO Mark D McLaughlin explained that FCF rose to 95%. For the time being analysts or looking at the fact that there has been a significant increase in the amount of paid stock compensations. The reason that Palo Alto Networks is giving out these compensations is to attract and keep highly talented individuals to and within the corporation. I believe that the fact that these compensations have not been added to FCF has already been adjusted in the price of PANW. Therefore, once the company expands and starts offering less stock based compensations in the future the price and the company will be positively affected. Moreover, PANW's operating margin is becoming a major problem.

In Millions of USD except Per Share	FY 2014	FY 2015	FY 2016	Last 12M
12 Months Ending	07/31/2014	07/31/2015	07/31/2016	07/31/2016
+ Sales & Services Revenue	598.2	928.1	1,378.5	1,378.5
- Cost of Revenue	159.6	239.2	357.7	363.8
+ Cost of Goods & Services	159.6	239.2	357.7	363.8
Gross Profit	438.6	688.8	1,020.8	1,014.7
+ Other Operating Income	0.0	0.0	0.0	0.0
- Operating Expenses	485.7	809.3	1,198.6	1,192.5
+ Selling, General & Admin	383.5	623.5	914.4	914.4
+ Selling & Marketing	334.8	522.7	776.0	776.0
+ General & Administrative	48.7	100.8	138.4	138.4
+ Research & Development	104.8	185.8	284.2	284.2
+ Other Operating Expense	-2.6	0.0	0.0	-6.1
Operating Income (Loss)	-47.2	-120.5	-177.8	-177.8

Each fiscal year there has been a drastic increase in selling general & Administration expenses because the company is trying to keep up with

revenue growth. I believe that this is factored into the price and once PANW is able to reduce its operating expenses there will be a very bright future. These two dilemmas of compensations and operating expenses are interconnected because as explained in their last earnings call compensations will help motivate employees and decrease labor costs. Eventually these two short term fixes will subside and Palo Alto Networks will attract more investors. Advertising expenses could also be on the chopping block for PANW leaving more room for a more impressive bottom line. The final concern that is making investors hesitant is an increase in deferred revenue, which some analysts believe means they are unable to convert unearned revenue into revenue.

Deferred revenue	\$1.2Bn	\$713.7Mn	73.9%
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Palo Alto Networks Earning's call Slides

However, this could also mean that there is just far too much demand for their robust security solutions and that they have potential to tap into deferred revenue in the long run as they continue to expand. These are the main reasons why Palo Alto Networks has had such a turbulent past year and all have the potential to be fixed in the long run because they have business model and product that none of their competitors can match.

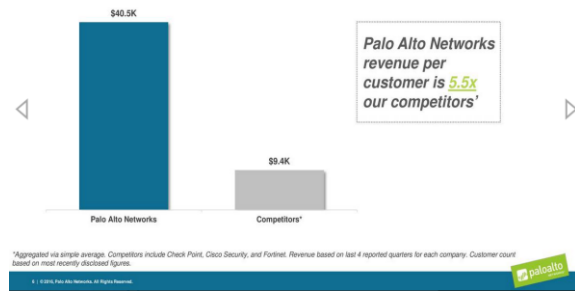
Business Model

Although certain financials explained seem negative there are far more positives associated with PANW. The main driver of stock price for this company is revenue growth and is why the company has prospered since its IPO in 2012. The company opened publicly with a price trading at roughly \$62 and is trading today at around 150 dollars. Before understanding the business model and strategies they have imposed to be successful one must understand the experience Palo Alto Networks offers.



This simple triangle demonstrating how their platform works is the reason for PANW ability to attract new customers. Since basic firewall is no longer enough to protect from hackers companies have invested in comprehensive platforms that offer ongoing support and various means of protection. Therefore, as companies continue to invest more money into cybersecurity PANW stands ready to prosper.

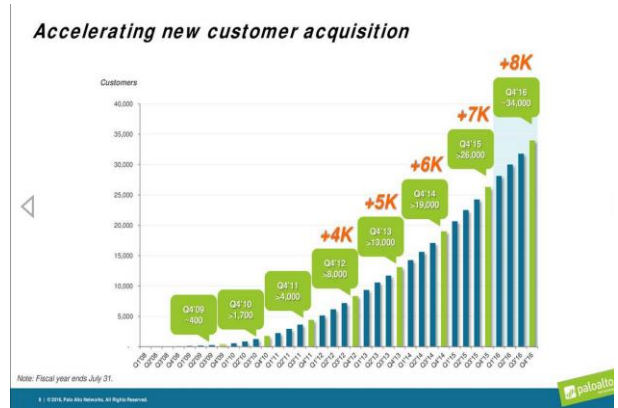
Platforms win... revenue per customer



Since the company makes up to 5.5 times more revenue per customer and the cybersecurity industry is booming their no reason for Palo Alto Networks not to be able to maintain or improve their revenue growth In the short and long term. Their business model of switching 1 time subscriptions into longer and more meaningful relationships with clients has enabled them to cash in on this which brings me to the earnings call.

Important Dates and Catalysts

The upcoming earning call on November 21st will have a major impact on this company’s future. If PANW is able to demonstrate to investors that operating expenses can decrease in the long run there is great potential in this company. Additionally, there must be some sort of limit on stock compensations because shares are becoming more and more diluted. I believe that the company’s \$500 million share repurchase program is one way that they are combating this and is the main reason for its approval by the board of directors last earning’s call. In the upcoming earning’s call PANW will have less stock compensation leaving investors more satisfied then last quarter in terms of the share buyback program. Revenue growth will also impress investors as seen in the chart more customers means more revenue



Guidance from the previous earnings call had revenue growth for the next two quarters at 12%, which is shockingly low for PANW. The fact that the number of customers they acquired last quarter was an all-time high and the fact that PALO Alto Networks make much more revenue per client and the fact that during the 2 previous fiscal years revenue has been underestimated leads me to believe that revenue growth for this quarter will edge closer to 15%-20%. Another very important event will be in the near future when Donald Trump announces his plans for cybersecurity and technology. He has states previously that he intends to bring cybersecurity to the next level. Although, no specifics were discussed his new policies could also bolster Palo Alto Networks stock price.

Summary

There are risks associated to Palo Alto Networks, but my stance remains bullish due its main driver of the stock price revenue growth. The valuation at this time remains fair at this moment in time, but once PANW is able to reduce operating expenses and fix their stock compensation dilemma this company will not look back. There will continue to be a high demand for products that follow a similar business model to PANW because it offers their customers not only a deeper sense of security, but also results. The company has a 95% retention ratio In terms of clients along with constant acquisition of new customers. Therefore, the positives outweigh the negatives for this company because a few minor changes that must be addressed in the next earnings call will calm investors. A solid business model along with a booming industry means good times ahead for Palo Alto Networks.

Palo Alto Networks, Inc.
(PANW)

CENTER FOR GLOBAL FINANCIAL STUDIES

NEUTRAL

Analysed by David Iltis
11/12/2016

Current Price:
Dividend Yield:

\$152.93
0.9%

Intrinsic Value:
Target Price:

\$153.39
\$179.61

Target 1 year Return: 17.44%
Probability of Price Increase: 93.2%



Description
Palo Alto Networks, Inc. provides security platform solutions to enterprises, service providers, and governmental entities worldwide.

General Information
Sector: Information Technology
Industry: Communications Equipment
Last Guidance: November 3, 2015
Next earnings date: November 21, 2016
Estimated Costing Risk Premium: 7.30X
Effective Tax rate: 34X
Effective Operating Tax rate: 34X

Market Data

Market Capitalization	\$13,348.74
Daily volume (mil)	1.18
Shares outstanding (mil)	87.24
Diluted shares outstanding (mil)	87.18
X shares held by institutional	82X
X shares held by investment managers	67X
X shares held by hedge funds	7X
X shares held by insiders	3.33X
Short interest	0.25X
Days to cover short interest	4.37
52-week high	\$134.73
52-week low	\$111.83
Levered Beta	1.16
Volatility	0.88X

Quarter ending

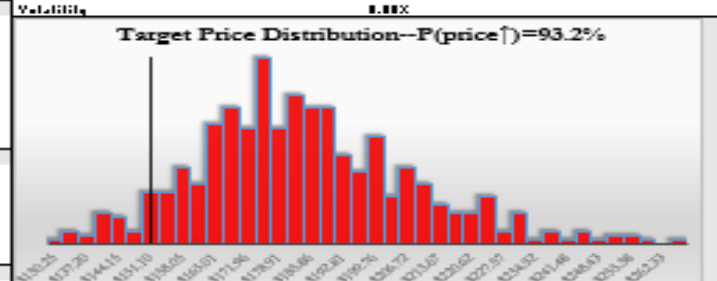
7/31/2015	2.35X
10/31/2015	2.47X
1/31/2016	2.67X
4/30/2016	2.84X
7/31/2016	2.55X
Mean	2.78X
Standard error	1.6X

EBITDA

Revenue	-151.88X
	-137.72X
	-164.25X
	-145.14X
	-132.28X
	-147.34X
	5.8X

Peers

Helixcor, Inc.	2.35X per annum over 4q
Parclon, Inc.	27.23X per annum over 2q
FiveEye, Inc.	N/A
PS Networks, Inc.	2.35X per annum over 4q
NetScout Systems, Inc.	N/A
Check Point Software Technologies Ltd.	N/A
Finisar Corp.	N/A

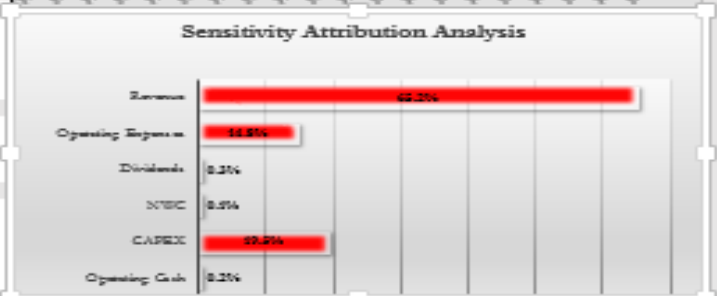


Management

McLaughlin, Mark	Chairman and Chief Executive
Anderson, Mark	President
Zak, Nir	Co-President, Chief Technology
Tamir, Steven	Chief Financial Officer and
Deussen, Ross	Chief Marketing Officer and
Hsu, Yeming	Co-President and Chief People

Total compensation to CEO

2015	\$18.52X per annum over 4q
2014	\$18.0X per annum over 2q
2013	\$23.24X per annum over 2q
2012	\$2.35X per annum over 4q
2011	\$4.67X per annum over 2q
2010	N/A

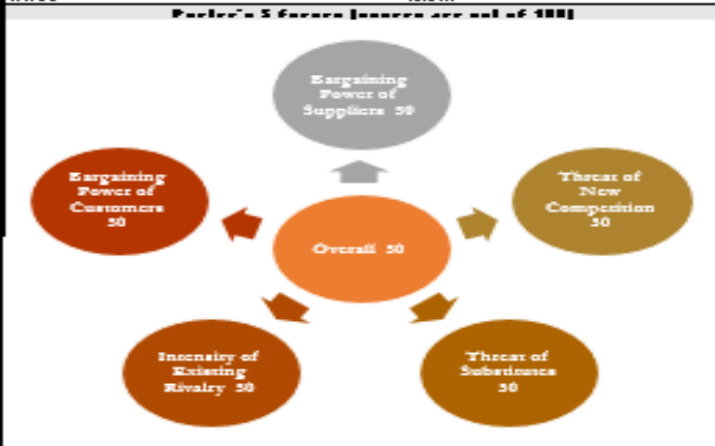


Financial Ratios

ROIC	23.7X
HOPAT Margin	17X
Revenue/Invested Capital	1.37
ROE	11.8X
Adjusted net margin	16X
Revenue/Adjusted Book Value	8.74
Invested Funds	
Total Cash/Total Capital	44.3X
Estimated Operating Cash/Total Capital	14.2X
Mean working Capital/Total Capital	-14.2X
Invested Capital/Total Capital	47.4X

PE Ratios

PE [5 years historical]	53.88X
Industry [LTM]	15.54X
PE [5 years historical]	26.38X
Industry [LTM]	15.3X
PE [5 years historical]	135.23X
Industry [LTM]	1.82
PE [5 years historical]	25.38X
Industry [LTM]	18.48X
PE [5 years historical]	5.22
Industry [LTM]	1.32



Revenue Growth

Year	Revenue
2017	48.5X
2018	4.8X
2019	38.2X
2020	58.8X
2021	48.8X
2022	38.8X
2023	28.8X
2024	18.8X
2025	13.6X
2026	18.4X
2027	7.3X
Coexisting Period	4.1X

Valuation

HOPAT margin	17.3X
ROIC/WACC	1.33
	2.17
	3.25
	5.16
	4.71
	4.84
	3.23
	2.78
	2.41
	2.18
	1.82
	1.58

Invested Capital

Year	Invested Capital
2017	\$77.77
2018	\$155.67
2019	\$262.86
2020	\$425.61
2021	\$1,084.15
2022	\$1,375.64
2023	\$1,643.47
2024	\$2,865.84
2025	\$3,888.47
2026	\$4,385.77
2027	\$6,123.53
Coexisting Period	

Net Claims

Year	Net Claims
2017	-\$188.15
2018	-\$1,844.48
2019	-\$1,855.76
2020	-\$3,338.88
2021	-\$4,336.72
2022	-\$5,384.76
2023	-\$5,162.73
2024	-\$11,288.68
2025	-\$13,485.43
2026	-\$15,732.41
2027	-\$17,336.63