Palo Alto Networks, Inc. (PANW)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

Price ($) (5/26/20): 231.17
52WK H-L ($) : 251 - 125
Market Cap (mil): 22,608
Shares Out (mil): 97.8
Float (mil): 96.7
Avg. Daily Vol (mil): 1.74
Dividend ($) : 0.00
Yield (%): 0.0

Rating: Outperform
Suitability: Average Risk
Price Target ($) : 265
L-Term Rev. Gr Rate Est: 20%
L-Term EPS Gr Rate Est: 30%
Debt/Cap: 70.0%
ROE: NM
Price Target ($) : 265
L-Term Rev. Gr Rate Est: 20%
L-Term EPS Gr Rate Est: 30%
Debt/Cap: 70.0%
ROE: NM

Headquartered IPO/Founded
Santa Clara, CA 2012/2005

Management
Nikesh Arora CEO/Chairman
Kathy Bonanno CFO

Company Description
Palo Alto Networks, founded by industry veterans and headquartered in Santa Clara, California, has emerged as one of the most high-profile and disruptive companies within the IT security market over the last several years. Founded in 2005 and first shipping products in 2007, the company pioneered the concept of the “Next-Generation Firewall” (NGFW). NGFWs are firewalls that provide granular application visibility and control at the user level, in addition to providing traditional network security functionality (firewall, IPS, VPN, AV, URL filtering). PANW has since expanded its portfolio with its Prisma and Cortex product families, addressing security in areas like in the cloud and on the endpoint. The company boasts 70,000+ customers in 150 countries spanning all enterprise verticals, the Service Provider and MSSP (Managed Security Service Provider) customer base, and the global Public Sector vertical. Palo Alto Networks sells its appliance, the PA-Series, primarily through its network of channel partners.

Investment Thesis
Network Security thought leader. Founded in 2005 by industry veterans, Palo Alto created and termed the Next-Generation Firewall (NGFW) market. The company takes a Layer 7 platform-based approach that traditional firewalls struggle to handle in today's world of thousands of new applications and sophisticated threats.

Expanding portfolio addressing a variety of use cases. PANW has built out, including through acquisitions, a security portfolio addressing use cases beyond its core network security market. The company’s Prisma product family addresses a variety of cloud security needs from remote access to container security. Cortex products include endpoint protection and the company's data lake. Assuming PANW is able to successfully integrate acquisitions it has made, we see potential for a security platform addressing a wide variety of enterprise needs to resonate with customers and lead to continued growth.

Positive channel feedback around product. Overall, our channel feedback remains quite positive around PANW’s product capabilities, with partners continuing to call out product quality as a positive for PANW relative to other firewall peers.

Strong channel/marketing presence. One of PANW’s advantages is the company’s broad network of channel partners as well as its powerful marketing capabilities. We believe PANW can leverage this base of channel partners to effectively compete with some of its still emerging products.

Valuation. Our price target of $265 represents a multiple of ~20.2x CY21E EV/FCF. We believe our valuation is reasonable for a market leader positioning the business to capitalize on emerging market trends and when compared to peers such as FYNT (~24x) and PFPT (~29x) which exhibit similar growth profiles.

Risks & Caveats
Competition. Palo Alto Networks competes against a variety of companies, both in the core firewall market (with competitors including Cisco, Check Point, and Fortinet) and increasingly with next-gen security vendors such as Zscaler.

Firewall market risk. We see potential for pressure on the firewall market as companies reevaluate their security architectures and/ or push to adopt a zero-trust security approach. While PANW has expanded into relevant, emerging security markets, a slowdown in core firewall would likely negatively impact the business.

Jonathan B. Ruykhaver, CFA
Sr. Research Analyst
jruykhaver@rwbaird.com
617.451.4568

Joe Orecchio
Research Analyst
jorecchio@rwbaird.com
414.765.3757
**Purchasing drivers.** While we view network security as a strategic and relatively resilient category in a tough macro, network security purchases tend to be a proactive and near-term discretionary spend area. Palo Alto Networks will need to continue educating its channel partners and devoting marketing dollars to the sector to ensure it retains mind share of the IT decision-makers in the enterprise.

**Macroeconomic volatility.** Palo Alto has exposure to EMEA (~20%), Financial Services (10%+), Government (10%+) and many other verticals and regions that can be difficult to predict on a quarterly basis.
Appendix - Important Disclosures and Analyst Certification

Approved on 27 May 2020 07:52EDT/ Published on 27 May 2020 07:57EDT.

1 Robert W. Baird & Co. Incorporated makes a market in the securities of PANW.

Appendix – Important Disclosures and Analyst Certification

Robert W. Baird & Co. Incorporated (“Baird”) and/or its affiliates expect to receive or intend to seek investment-banking related compensation from the company or companies mentioned in this report within the next three months. Baird may not be licensed to execute transactions in all foreign listed securities directly. Transactions in foreign listed securities may be prohibited for residents of the United States. Please contact a Baird representative for more information.

Investment Ratings: Outperform (O) - Expected to outperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months. Neutral (N) - Expected to perform in line with the broader U.S. equity market over the next 12 months. Underperform (U) - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

Risk Ratings: L - Lower Risk – Higher-quality companies for investors seeking capital appreciation or income with an emphasis on safety. Company characteristics may include: stable earnings, conservative balance sheets, and an established history of revenue and earnings. A - Average Risk – Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings. H - Higher Risk – Higher-growth situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include: higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility. S - Speculative Risk – High growth situations appropriate only for investors willing to accept a high degree of volatility and risk. Company characteristics may include: unpredictable earnings, small capitalization, aggressive growth strategies, rapidly changing market dynamics, high leverage, extreme price volatility and unknown competitive challenges.

Valuation, Ratings and Risks. The recommendation and price target contained within this report are based on a time horizon of 12 months but there is no guarantee the objective will be achieved within the specified time horizon. Price targets are determined by a subjective review of fundamental and/or quantitative factors of the issuer, its industry, and the security type. A variety of methods may be used to determine the value of a security including, but not limited to, discounted cash flow, earnings multiples, peer group comparisons, and sum of the parts. Overall market risk, interest rate risk, and general economic risks impact all securities. Specific information regarding the price target and recommendation is provided in the text of our most recent research report.

Distribution of Investment Ratings. As of April 30, 2020, Baird U.S. Equity Research covered 724 companies, with 59% rated Outperform/Buy, 40% rated Neutral/Hold and 1% rated Underperform/Sell. Within these rating categories, 12% of Outperform/Buy-rated and 4% of Neutral/Hold-rated companies have compensated Baird for investment banking services in the past 12 months and/or Baird managed or co-managed a public offering of securities for these companies in the past 12 months.

Analyst Compensation. Research analyst compensation is based on: (1) the correlation between the research analyst's recommendations and stock price performance; (2) ratings and direct feedback from our investing clients, our institutional and retail sales force (as applicable) and from independent rating services; (3) the research analyst's productivity, including the quality of such analyst's research and such analyst's contribution to the growth and development of our overall research effort; and (4) compliance with all of Baird’s internal policies and procedures. This compensation criteria and actual compensation is reviewed and approved on an annual basis by Baird's Research Oversight Committee. Research analyst compensation is derived from all revenue sources of the firm, including revenues from investment banking. Baird does not compensate research analysts based on specific investment banking transactions.

A complete listing of all companies covered by Baird U.S. Equity Research and applicable research disclosures can be accessed at http://www.rwbaird.com/research-insights/research/coverage/third-party-research-disclosures.aspx. You can also call 800-792-2473 or write: Robert W. Baird & Co., Equity Research, 777 E. Wisconsin Avenue, Milwaukee, WI 53202.
Analyst Certification
The senior research analyst(s) certifies that the views expressed in this research report and/or financial model accurately reflect such senior analyst's personal views about the subject securities or issuers and that no part of his or her compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.

Disclaimers
Baird prohibits analysts from owning stock in companies they cover.
This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST
The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

Other Disclosures
The information and rating included in this report represent the research analyst's views based on a time horizon of 12 months, as described above, unless otherwise stated. In our standard company-specific research reports, the subject company may be designated as a “Fresh Pick”, representing that the research analyst believes the company to be a high-conviction investment idea based on a subjective review of one or more fundamental or quantitative factors until an expiration date specified by the analyst but not to exceed nine months. The Fresh Pick designation and specified expiration date will be displayed in standard company-specific research reports on the company until the occurrence of the expiration date or such time as the analyst removes the Fresh Pick designation from the company in a subsequent, standard company-specific research report. The research analyst(s) named in this report may, at times and at the request of clients or their Baird representatives, provide particular investment perspectives or trading strategies based primarily on the analyst's understanding of the individual client's objectives. These perspectives or trading strategies generally are responsive to client inquiries and based on criteria the research analyst considers relevant to the client. As such, these perspectives and strategies may differ from the research analyst's views contained in this report. Baird and/or its affiliates may provide to certain clients additional or research supplemental products or services, such as outlooks, commentaries and other detailed analyses, which focus on covered stocks, companies, industries or sectors. Not all clients who receive our standard company-specific research reports are eligible to receive these additional or supplemental products or services. Baird determines in its sole discretion the clients who will receive additional or supplemental products or services, in light of various factors including the size and scope of the client relationships. These additional or supplemental products or services may feature different analytical or research techniques and information than are contained in Baird’s standard research reports. Any ratings and recommendations contained in such additional or research supplemental products are consistent with the research analyst's ratings and recommendations contained in more broadly disseminated standard research reports. Baird disseminates its research reports to all clients simultaneously by posting such reports to Baird's password-protected client portal, https://bol.rwbaird.com/Login("BairdOnline"). All clients may access BairdOnline and at any time. All clients are advised to check BairdOnline for Baird’s most recent research reports. After research reports are posted to BairdOnline, such reports may be emailed to clients, based on, among other things, client interest, coverage, stock ownership and indicated email preferences, and electronically distributed to certain third-party research aggregators, who may make such reports available to entitled clients on password-protected, third-party websites. Not all research reports posted to BairdOnline will be emailed to clients or electronically distributed to such research aggregators. To request access to Baird Online, please visit https://bol.rwbaird.com/Login/RequestInstLogin or contact your Baird representative.

Dividend Yield. As used in this report, the term “dividend yield” refers, on a percentage basis, to the historical distributions made by the issuer relative to its current market price. Such distributions are not guaranteed, may be modified at the issuer’s discretion, may exceed operating cash flow, subsidized by borrowed funds or include a return of investment principal.

United Kingdom (“UK”) disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds a MiFID passport.
The contents of this report may contain an “investment recommendation”, as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). This report does not contain a “personal recommendation” or “investment advice”, as defined by the Market in Financial Instruments Directive 2014/65/EU ("MiFID"). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. The views contained in this report: (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated; and (ii) may differ from the views of another individual of Robert W. Baird Limited.
This material is distributed in the UK and the European Economic Area (“EEA”) by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority (“FCA”) in the UK.
For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being “Professional” investors under MiFID and to persons in the UK falling within Articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as “relevant persons”). Accordingly, this document is
intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated. There is no intention to update this report in future. Where, for any reason, an update is made, this will be made clear in writing on the research report. Such instances will be occasional only.

Please note that this report may provide views which differ from previous recommendations made by the same individual in respect of the same financial instrument or issuer in the last 12 months. Information and details regarding previous recommendations in relation to the financial instruments or issuer referred to in this report are available at https://baird.bluematrix.com/sellside/MAR.action.

Robert W. Baird Limited or one of its affiliates may at any time have a long or short position in the company or companies mentioned in this report. Where Robert W. Baird Limited or one of its affiliates holds a long or short position exceeding 0.5% of the total issued share capital of the issuer, this will be disclosed separately by your Robert W. Baird Limited representative upon request.

Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

This material is strictly confidential to the recipient and not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Robert W. Baird Limited is exempt from the requirement to hold an Australian financial services license and is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.

Copyright 2020 Robert W. Baird & Co. Incorporated

This information is prepared for the use of Baird clients and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without the express written consent of Baird. Any unauthorized use or disclosure is prohibited. Receipt and review of this information constitutes your agreement not to redistribute, retransmit, or disclose to others the contents, opinions, conclusion, or information contained in this information (including any investment ratings, estimates or price targets) without first obtaining expressed permission from an authorized officer of Baird.