

Edgar Filing: Palo Alto Networks Inc - Form 10-Q

Palo Alto Networks Inc
Form 10-Q
March 03, 2015
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 31, 2015

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number 001-35594

Palo Alto Networks, Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

4401 Great America Parkway

Santa Clara, California 95054

(Address of principal executive office, including zip code)

(408) 753-4000

(Registrant's telephone number, including area code)

20-2530195

(I.R.S. Employer

Identification No.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's common stock as of February 18, 2015 was 82,272,834.

Table of Contents

TABLE OF CONTENTS

	Page
PART I - FINANCIAL INFORMATION	
Item 1. <u>Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Loss</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>17</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>30</u>
Item 4. <u>Controls and Procedures</u>	<u>30</u>
PART II - OTHER INFORMATION	
Item 1. <u>Legal Proceedings</u>	<u>31</u>
Item 1A. <u>Risk Factors</u>	<u>31</u>
Item 6. <u>Exhibits</u>	<u>53</u>

Table of Contents

PART I

ITEM 1. FINANCIAL STATEMENTS

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share data)

	January 31, 2015	July 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$342,983	\$653,812
Short-term investments	332,074	118,690
Accounts receivable, net of allowance for doubtful accounts of \$855 and \$471 at January 31, 2015 and July 31, 2014, respectively	135,251	135,518
Prepaid expenses and other current assets	51,196	50,306
Total current assets	861,504	958,326
Property and equipment, net	52,639	48,744
Long-term investments	463,908	201,880
Goodwill	155,402	155,033
Intangible assets, net	45,856	47,955
Other assets	93,475	66,528
Total assets	\$1,672,784	\$1,478,466
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$14,001	\$14,526
Accrued compensation	53,158	48,727
Accrued and other liabilities	23,436	25,000
Deferred revenue	324,479	259,918
Total current liabilities	415,074	348,171
Convertible senior notes, net	476,872	466,875
Long-term deferred revenue	211,364	162,660
Other long-term liabilities	53,413	32,177
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock; \$0.0001 par value; 100,000 shares authorized; none issued and outstanding at January 31, 2015 and July 31, 2014	—	—
Common stock; \$0.0001 par value; 1,000,000 shares authorized; 82,265 and 79,519 shares issued and outstanding at January 31, 2015 and July 31, 2014, respectively	8	8
Additional paid-in capital	924,634	804,406
Accumulated other comprehensive income (loss)	221	(105)
Accumulated deficit	(408,802)	(335,726)
Total stockholders' equity	516,061	468,583
Total liabilities and stockholders' equity	\$1,672,784	\$1,478,466

See notes to condensed consolidated financial statements.

Table of Contents

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three Months Ended January 31,		Six Months Ended January 31,	
	2015	2014	2015	2014
Revenue:				
Product	\$ 115,621	\$ 80,823	\$ 217,097	\$ 156,308
Services	102,034	60,245	192,904	112,940
Total revenue	217,655	141,068	410,001	269,248
Cost of revenue:				
Product	30,640	20,221	59,781	38,175
Services	28,685	17,283	53,005	33,136
Total cost of revenue	59,325	37,504	112,786	71,311
Total gross profit	158,330	103,564	297,215	197,937
Operating expenses:				
Research and development	46,948	24,253	84,253	44,146
Sales and marketing	122,875	76,734	229,241	144,100
General and administrative	27,023	19,733	46,000	33,858
Legal settlement	—	20,000	—	20,000
Total operating expenses	196,846	140,720	359,494	242,104
Operating loss	(38,516)	(37,156)	(62,279)	(44,167)
Interest expense	(5,539)	(14)	(11,028)	(22)
Other income (expense), net	344	(170)	685	235
Loss before income taxes	(43,711)	(37,340)	(72,622)	(43,954)
Provision for (benefit from) income taxes	(703)	2,606	454	3,853
Net loss	\$(43,008)	\$(39,946)	\$(73,076)	\$(47,807)
Net loss per share, basic and diluted	\$(0.53)	\$(0.55)	\$(0.91)	\$(0.66)
Weighted-average shares used to compute net loss per share, basic and diluted	80,824	72,854	80,105	72,260

See notes to condensed consolidated financial statements.

Table of Contents

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited, in thousands)

	Three Months Ended		Six Months Ended	
	January 31,		January 31,	
	2015	2014	2015	2014
Net loss	\$(43,008)	\$(39,946)	\$(73,076)	\$(47,807)
Other comprehensive gain, net of tax:				
Change in unrealized gains (losses) on investments	234	48	326	69
Reclassification adjustment for realized net gains on investments included in net loss	—	(10)	—	(10)
Net change	234	38	326	59
Comprehensive loss	\$(42,774)	\$(39,908)	\$(72,750)	\$(47,748)

See notes to condensed consolidated financial statements.

Table of Contents

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Six Months Ended	
	January 31,	
	2015	2014
Cash flows from operating activities		
Net loss	\$(73,076) \$(47,807
Adjustments to reconcile net loss to net cash provided by operating activities:		
Share-based compensation for equity based awards	95,291	38,729
Depreciation and amortization	12,917	7,082
Amortization of investment premiums, net of accretion of purchase discounts	1,510	747
Amortization of debt discount and debt issuance costs	10,999	—
Excess tax benefit from share-based compensation arrangements	(1,271) (674
Changes in operating assets and liabilities:		
Accounts receivable, net	267	1,371
Prepaid expenses and other assets	(32,435) (6,207
Accounts payable	(1,897) (4,387
Accrued compensation	4,431	7,709
Accrued and other liabilities	21,753	8,353
Deferred revenue	113,265	75,361
Net cash provided by operating activities	151,754	80,277
Cash flows from investing activities		
Purchases of investments	(587,273) (249,803
Proceeds from sales of investments	1,999	6,630
Proceeds from maturities of investments	109,921	129,096
Acquisition of business, net of cash acquired	—	(10,102
Purchases of property, equipment, and other assets	(12,035) (25,483
Net cash used in investing activities	(487,388) (149,662
Cash flows from financing activities		
Proceeds from exercise of stock options	15,743	14,085
Proceeds from employee stock purchase plan	7,791	5,988
Excess tax benefit from share-based compensation arrangements	1,271	674
Repurchases of restricted common stock from terminated employees	—	(109
Net cash provided by financing activities	24,805	20,638
Net decrease in cash and cash equivalents	(310,829) (48,747
Cash and cash equivalents—beginning of period	653,812	310,614
Cash and cash equivalents—end of period	\$342,983	\$261,867

See notes to condensed consolidated financial statements.

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(All dollar and share amounts rounded to the nearest thousand, except per share data)

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Palo Alto Networks, Inc. (the “Company,” “we,” “us,” or “our”), located in Santa Clara, California, was incorporated in March 2005 under the laws of the State of Delaware and commenced operations in April 2005. We offer a next-generation enterprise security platform that allows enterprises, service providers, and government entities to simultaneously empower and secure their organizations by safely enabling the increasingly complex and rapidly growing number of applications running on their networks and by preventing breaches stemming from targeted cyber attacks.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles, consistent in all material respects with those applied in our Annual Report on Form 10-K for the fiscal year ended July 31, 2014. The condensed consolidated financial statements include all adjustments necessary for a fair presentation of our quarterly results. All adjustments are of a normal recurring nature. We have made estimates and judgments affecting the amounts reported in our condensed consolidated financial statements and the accompanying notes. The actual results that we experience may differ materially from our estimates. Certain prior period amounts have been reclassified to conform with current period presentation.

Principles of Consolidation

The condensed consolidated financial statements include our accounts and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Summary of Significant Accounting Policies

There have been no material changes to our significant accounting policies as of and for the six months ended January 31, 2015, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended July 31, 2014.

Recent Accounting Pronouncements

In August 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-15, Presentation of Financial Statements-Going Concern (Subtopic 205-40)-Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The standard provides guidance about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern and to provide related footnote disclosures. The standard is effective for fiscal years ending after December 15, 2016, and for interim periods thereafter. Early adoption is permitted. We will adopt the new standard in our fiscal year ending 2017. The adoption of this standard is not expected to have a material impact on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 regarding Accounting Standards Codification (ASC) Topic 606-Revenue from Contracts with Customers. The standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also requires significantly expanded disclosures about revenue recognition. The guidance is effective for us in the first quarter of fiscal 2018 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the guidance; or (ii) retrospective with the cumulative effect of initially applying the guidance recognized at the date of initial application and providing certain additional disclosures as defined per the guidance. Early adoption is not permitted. We are currently evaluating adoption methods and whether this standard will have a material impact on our condensed consolidated financial statements.

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (Topic 740)-Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The standard requires us to present an unrecognized tax benefit as a reduction of a deferred tax asset for a net operating loss (NOL) carryforward or other tax credit carryforward when settlement in this manner is available under applicable

tax law. The guidance was effective for us in the first quarter of fiscal 2015. Our adoption of this guidance did not have an impact on our condensed consolidated financial statements.

- 7 -

Table of Contents

2. Fair Value Measurements

We categorize assets and liabilities recorded at fair value on our condensed consolidated balance sheets based upon the level of judgment associated with inputs used to measure their fair value. The categories are as follows:

Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

Level 3—Inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

The following table presents the fair value of our financial assets and liabilities using the above input categories as of January 31, 2015 and July 31, 2014 (in thousands):

	January 31, 2015				July 31, 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Short-term investments:								
Certificates of deposit	\$—	\$1,001	\$—	\$1,001	\$—	\$—	\$—	\$—
Corporate debt securities	—	51,352	—	51,352	—	22,239	—	22,239
U.S. government and agency securities	—	279,721	—	279,721	—	96,451	—	96,451