

Proofpoint, Inc. (PFPT)

\$106.65 (As of 02/28/20)

Price Target (6-12 Months): **\$91.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 01/30/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:C

Value: F

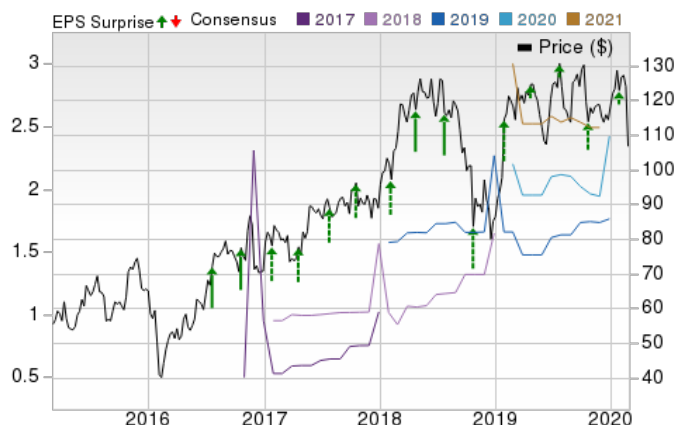
Growth: A

Momentum: A

Summary

Proofpoint's near-term bottom-line results are expected to remain under pressure due to continued investments in sales and marketing initiatives. Higher depreciation expense is also expected to drag down profitability. Moreover, declining hardware and services revenues are likely to keep straining the company's near-term top-line performances. Notably, shares of Proofpoint have underperformed the industry in the past year. Nonetheless, the company is benefiting from strong customer wins and solid progress in emerging products. Solid demand for its next-generation cloud security and compliance platform, ongoing migration to the cloud, solid international growth and high renewal rates are other tailwinds. Robust demand for Email Fraud Defense, Threat Response and PSAT are positives as well.

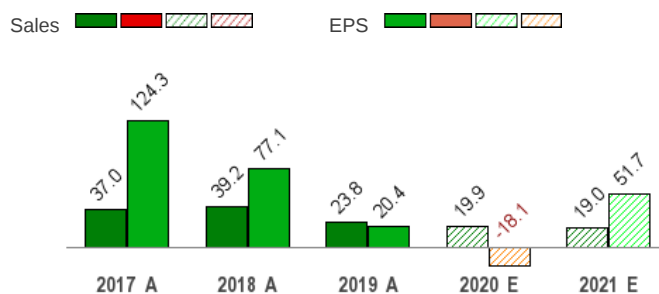
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$133.58 - \$102.25
20 Day Average Volume (sh)	615,492
Market Cap	\$6.1 B
YTD Price Change	-7.1%
Beta	1.64
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Security
Zacks Industry Rank	Bottom 36% (163 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	10.6%
Last Sales Surprise	1.6%
EPS F1 Est- 4 week change	-80.0%
Expected Report Date	04/23/2020
Earnings ESP	0.0%
P/E TTM	58.6
P/E F1	73.6
PEG F1	2.6
P/S TTM	6.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	297 E	308 E	326 E	346 E	1,267 E
2020	247 E	257 E	271 E	290 E	1,065 E
2019	203 A	214 A	227 A	243 A	888 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.41 E	\$0.47 E	\$0.54 E	\$0.62 E	\$2.20 E
2020	\$0.27 E	\$0.33 E	\$0.39 E	\$0.45 E	\$1.45 E
2019	\$0.40 A	\$0.41 A	\$0.49 A	\$0.52 A	\$1.77 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/28/2020. The reports text is as of 03/02/2020.

Overview

Headquartered in Sunnyvale, CA, Proofpoint is a leading security-as-a-service (SaaS) provider of on-demand data protection solutions to large and mid-sized organizations.

Proofpoint offers cloud-based solutions for threat protection, compliance, archiving and governance, and secure communications. Organizations around the world depend on its expertise, patented technologies, and on-demand delivery system to protect against phishing, malware and spam and to safeguard privacy, encrypt sensitive information, and archive and govern messages and critical enterprise information.

The company's products are sold to customers on a subscription basis and are delivered by a cloud infrastructure. Proofpoint markets and sells its solutions directly, through a network of distributors and resellers and through strategic partners.

Moreover, Proofpoint has customers across all major verticals including Aerospace and defense, education, financial services, government, healthcare, manufacturing and retail, and has maintained a renewal rate of more than 90%.

Proofpoint's revenues rallied 24% year over year to \$888.2 million in 2019. The company has two reportable segments — Subscription (which contributed 98.5% to 2019 total revenues) as well as Hardware and Services (that contributed 1.5% to total revenues).

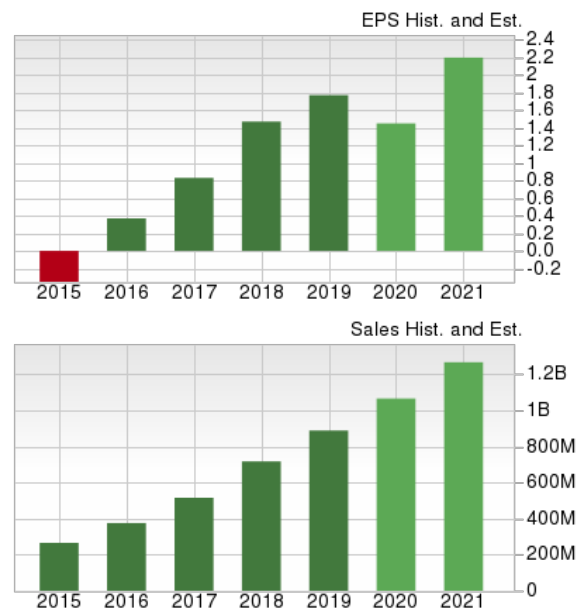
The company is in the process of transitioning to a subscription-based business model.

Subscription revenues increased 24.2% year over year in 2019, while Hardware and Services revenues increased 4.7%.

In the email and advanced threat protection area, Proofpoint faces significant competition from Cisco Systems, Inc., Microsoft Corporation, FireEye, Inc., Symantec Corporation, Mimecast Ltd, Barracuda Networks, Inc. and Google, Inc.

This apart, Micro Focus International and Veritas Technologies present sizeable competition to the company in the field of archiving.

Fortinet and Palo Alto's growing dominance in the cybersecurity market poses significant threat to Proofpoint's offerings.



Reasons To Sell:

- ▼ To survive in the highly competitive cyber security market, each player must continually invest in broadening its capabilities. Over the past few years, Proofpoint has invested heavily to enhance its sales and marketing capabilities, particularly by increasing the sales force. This remains a drag on the company's bottom line. Furthermore, though the company foresees these investments to garner benefit over the long run, we note that there is uncertainty about the payback period.
- ▼ Near-term prospects for Proofpoint are not promising as changing customer spending behavior recently hit several other players in this space. For the past few months, various competitors in the cyber security space noticed that the companies have been breaking their cybersecurity investment plans into phases and implementing the same over longer periods of time, instead of making a single large investment. Therefore, we are slightly cautious about the company's near-term prospects.
- ▼ Proofpoint faces competition from numerous big and small companies in the security application market. As Internet threats and attacks increase, stiff competition will follow suit. Competing firms must deliver prompt and advanced technologies to suit customer requirements and expedite product introduction in order to survive. Moreover, we believe that Proofpoint's dominance could be challenged by new entrants. This could lead the company to resort to competitive pricing to maintain and capture market share.
- ▼ Proofpoint expects inorganic revenue contributions in 2019 to lead to a challenging year-over-year comparison in 2020. The company anticipates additional headwinds in 2020 due to adoption of ASC 606 as it would require Proofpoint to make adjustments to reflect unbilled accounts receivable activity.

Since Proofpoint continues to invest in sales and marketing, we anticipate this to remain a drag on the company's bottom line in the near term.

Risks

- Cyber security is becoming a mission-critical, high-profile requirement. The long list of data breaches has brought to light the fact that a company's financial well-being, brands and reputation are today increasingly exposed to sophisticated cyber threats. The advent of cloud computing and the idea of sharing resources to lower cost have further increased demand for adequate security policies, protocols and products. As a result, companies are allotting increasing portions of their IT budgets for security solutions. Per Gartner's report, worldwide spending on IT security will grow 8.7% to \$124 billion in 2019. Going by MarketsandMarkets, the global cybersecurity market size was valued at \$137.63 billion in 2017 and is projected to reach \$248.26 billion by 2023, witnessing a CAGR of 10.2% during the period. These predictions bode well for Proofpoint, which has a diversified product portfolio for large and mid-sized organizations to protect their sensitive data. Furthermore, Proofpoint has partnered with Palo Alto Networks, CyberArk, IBM, Imperva and Intel to provide best-in-class cyber security solutions to customers. Its rich experience in the security space and continued delivery of mission-critical solutions will help it to grow market share.
 - Proofpoint has made strategic acquisitions to expedite growth. With the buyout of Cloudmark, the company earned the opportunity to continue growing its footprint within the carrier community. As a result of its Weblife acquisition, the company brought to market a new personal email defense, which is its new browser isolation solution. The acquisition of FireLayers has helped Proofpoint in extending its Targeted Attack Protection (TAP) solution to SaaS applications and protects these from advanced malware. Same year, it acquired the Email Fraud Protection (EFP) business unit from Return Path, which helped it further enhance its Business Email Compromise (BEC) capabilities. Apart from these, the company made various other acquisitions that have not only expanded its product portfolio but also its customer and revenue base.
 - Proofpoint mainly focuses on selling subscription-based services. This business model generates recurring revenues and higher margins for the company (approximately 70%) than the hardware-centric model. Notably, the company garners nearly 98% of total revenues (FY19) from these services, which has helped it to maintain gross margin above 70% over the last few quarters. We believe that the strategy will continue to boost its top and the bottom lines. Proofpoint has been witnessing tremendous customer growth for its subscription-based services. We believe that continued focus on subscription-based products and services and product upgrades will enhance its top line.
 - Proofpoint had a debt free balance sheet with cash and cash equivalents and short-term investments of approximately \$890.1 million as of Dec 31, 2019. This enhances liquidity and can be used for funding product development and to pursue growth strategies like acquisitions.
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Last Earnings Report

Proofpoint Q4 Earnings & Revenues Beat Estimates

Proofpoint Inc. reported fourth-quarter 2019 non-GAAP earnings of 52 cents per share, which beat the Zacks Consensus Estimate by 10.6% and increased 1.9% year over year.

Revenues came in at \$243.4 million, which beat the consensus mark by 1.6% and increased 23% year over year.

The top-line growth can be attributed to strong customer wins and solid progress in the company's emerging products. Strong demand for its next-generation cloud security and compliance platform, ongoing migration to the cloud, solid international growth and high renewal rates were the other tailwinds.

Quarter Ending **12/2019**

Report Date	Jan 30, 2020
Sales Surprise	1.63%
EPS Surprise	10.64%
Quarterly EPS	0.52
Annual EPS (TTM)	-1.01

Top-Line Details

Total billings during the quarter jumped 29% year over year to \$347.2 million. Also, renewal rates again soared above 90%.

Subscription revenues (98.7% of total revenues) came in at \$240.4 million, up 23.2% from the year-ago quarter. Hardware and services revenues (1.3%) declined 9.7% year over year to \$3 million.

The company stopped reporting for its advanced threat and compliance-oriented products as it believes that the data is not informative in terms of measuring business performance.

Emerging products, which contributed to more than 33% of total new and add-on businesses closed during the quarter, steadily surpassed the company's remaining product portfolio. This upside was led by robust demand for Email Fraud Defense, Proofpoint Security Awareness Training (PSAT) and Threat Response.

Notably, PSAT Management remains optimistic about the prospects of PSAT, which is expected to drive growth and boost its capabilities in the new segment of the cybersecurity market.

Proofpoint continues to expand abroad. Its international business grew 30% year over year and accounted for 20% of its total revenues in the fourth quarter.

The company won many international deals during the quarter. These include a Global 2000 pharmaceutical firm that purchased Protection TAP Isolation and threat response for 140,000 users, a Global 2000 financial services firm that purchased a P1 bundle with isolation for 70,000 users and a Global 2000 retailer that purchased Protection TAP and EFD for 60,000 users.

Moreover, Proofpoint's partnerships with Okta (OKTA) and CrowdStrike (CRWD) resulted in several client wins, leading to implementation of the companies' joint solutions.

Proofpoint's archiving pipeline continued to strengthen due to the completion of several deals during the quarter. These include a Fortune 500 financial services firm that added additional compliance services for their 80,000 users, a Fortune 100 retailer that added archiving for 11,000 users, a large asset management firm that purchased archiving and PSAT for 4,500 users and the U.S. government's health services department that purchased archiving for 13,000 users.

Operating Details

Non-GAAP gross profit advanced 23.9% from the year-ago quarter to \$194.1 million. Non-GAAP gross margin improved 100 basis points (bps) to 80%, driven by strong revenue performance.

Proofpoint's non-GAAP operating income surged 26.3% to \$37 million. Non-GAAP operating margin expanded 40 bps to 15.2%.

Balance Sheet & Cash Flow

As of Dec 31, 2019, cash, cash equivalents and short-term investments of \$890.9 million compared with \$1.05 billion as of Sep 30, 2019.

The company generated operating cash flow of \$76.4 million compared with \$68.6 million in the previous quarter. Free cash flow was \$65.1 million compared with \$58.6 million reported in the third quarter of 2019.

Guidance

Proofpoint raised its full-year 2020 revenue guidance. The company now expects revenues of \$1.060-\$1.067 billion, up from the previous projection of \$1.050-\$1.062 billion.

Non-GAAP gross margin is projected to be 80%.

Non-GAAP earnings per share are anticipated in the band of \$1.42-\$1.48, which includes an estimated \$40 million expense from the acquisition of ObserveIT, offset by \$3.7 million of deferred revenues from the acquisition.

Free cash flow is envisioned in the range of \$178-\$182 million, down from \$225 million expected previously, due to an estimated expense of \$25 million to be used for the construction of the new company headquarters.

It also includes an estimated \$20 million cash tax payment for the transfer of intellectual property from Israel to the United States, and approximately \$40 million of cash spending pertaining to the acquisition of ObserveIT.

Capital expenditures are expected to be approximately \$93.5 million for full-year 2020.

For the first quarter of 2020, Proofpoint anticipates revenues of \$246-\$248 million.

Non-GAAP gross margin is estimated to be 79%. Non-GAAP earnings per share are anticipated in the band of 25-29 cents.

Free cash flow is estimated in the range of \$52-\$54 million.

Capital expenditures are expected to be approximately \$11 million for first quarter 2020.

Recent News

On Jan 22, 2020, Proofpoint announced that it has secured Federal Risk and Authorization Management Program (FedRAMP) certification for its products including Proofpoint Email and Information Protection Service and Proofpoint Targeted Attack Protection (TAP).

On Jan 15, 2020, Proofpoint's Email Protection won the CRN 2019 Product of the Year Awards in the web and email security category.

On Nov 26, 2019, Proofpoint completed the acquisition of ObserveIT for \$225 million.

Valuation

Proofpoint's shares have fallen 8.9% in the past six months and 7.1% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Technology sector are up 2.7% and up 9.6% in the past six months, respectively. Over the past year, the Zacks sub-industry has plunged 8.7% while the technology sector has gained 12.5%.

The S&P 500 Index has jumped 2.1% in the past six months, and 4.9% in the past year.

The stock is currently trading at 5.53X forward 12-month sales, which compares to 6.74X for the Zacks sub-industry, 3.34X for the Zacks sector and 3.12X for the S&P 500 index.

Over the past five years, the stock has traded as high as 9.42X and as low as 4.18X, with a 5-year median of 6.87X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$91 price target reflects 4.7X forward 12-month sales.

The table below shows summary valuation data for PFPT

Valuation Multiples - PFPT					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	5.53	6.74	3.34	3.12
	5-Year High	9.42	8.96	3.58	3.43
	5-Year Low	4.18	5.32	2.30	2.54
	5-Year Median	6.87	6.73	3.05	3.01
P/B TTM	Current	10.09	7.73	4.53	3.96
	5-Year High	130.45	10.01	5.34	4.54
	5-Year Low	8.66	4.25	3.13	2.85
	5-Year Median	27.63	6.38	4.25	3.62
EV/Sales TTM	Current	5.77	6.54	3.88	2.96
	5-Year High	11.61	10.68	4.19	3.42
	5-Year Low	4.10	5.26	2.53	2.10
	5-Year Median	8.14	6.88	3.48	2.80

As of 02/28/2020

Industry Analysis Zacks Industry Rank: Bottom 36% (163 out of 254)



Top Peers

Check Point Software Technologies Ltd. (CHKP)	Neutral
CyberArk Software Ltd. (CYBR)	Neutral
FireEye, Inc. (FEYE)	Neutral
Fortinet, Inc. (FTNT)	Neutral
Palo Alto Networks, Inc. (PANW)	Neutral
Qualys, Inc. (QLYS)	Neutral
Radware Ltd. (RDWR)	Neutral
VMware, Inc. (VMW)	Neutral

Industry Comparison Industry: Security				Industry Peers		
	PFPT Underperform	X Industry	S&P 500	CYBR Neutral	FEYE Neutral	QLYS Neutral
VGM Score	C	-	-	D	C	C
Market Cap	6.08 B	3.13 B	21.48 B	3.95 B	2.95 B	3.13 B
# of Analysts	13	11.5	13	11	13	8
Dividend Yield	0.00%	0.00%	2.07%	0.00%	0.00%	0.00%
Value Score	F	-	-	F	F	F
Cash/Price	0.13	0.12	0.04	0.23	0.30	0.08
EV/EBITDA	87.89	36.11	12.57	58.77	-30.77	25.85
PEG Ratio	2.62	2.45	1.84	3.00	5.77	NA
Price/Book (P/B)	10.26	8.96	2.88	6.33	4.20	8.10
Price/Cash Flow (P/CF)	44.63	31.58	11.58	48.75	NA	31.58
P/E (F1)	75.75	37.57	16.87	44.92	63.49	30.82
Price/Sales (P/S)	6.84	6.84	2.34	9.11	3.31	9.75
Earnings Yield	1.36%	2.58%	5.91%	2.23%	1.59%	3.24%
Debt/Equity	1.33	0.61	0.70	0.78	1.37	0.00
Cash Flow (\$/share)	2.39	2.15	6.94	2.15	-0.18	2.54
Growth Score	A	-	-	B	A	B
Hist. EPS Growth (3-5 yrs)	NA%	15.24%	10.85%	20.06%	NA	47.06%
Proj. EPS Growth (F1/F0)	-18.12%	2.50%	6.79%	-15.85%	316.92%	11.64%
Curr. Cash Flow Growth	127.88%	45.71%	5.92%	28.60%	-24.85%	27.15%
Hist. Cash Flow Growth (3-5 yrs)	55.69%	34.15%	8.38%	40.13%	10.10%	34.15%
Current Ratio	1.59	1.59	1.23	5.95	1.55	1.77
Debt/Capital	57.01%	40.81%	42.53%	43.73%	57.87%	0.00%
Net Margin	-14.67%	8.95%	11.57%	14.53%	-28.95%	21.56%
Return on Equity	-8.73%	7.14%	16.80%	11.59%	-19.35%	18.38%
Sales/Assets	0.50	0.46	0.54	0.46	0.32	0.50
Proj. Sales Growth (F1/F0)	19.94%	14.30%	4.07%	18.92%	5.79%	14.28%
Momentum Score	A	-	-	C	B	B
Daily Price Chg	-4.00%	-0.87%	-1.44%	-0.87%	-1.27%	3.22%
1 Week Price Chg	-2.56%	-0.87%	-0.94%	1.64%	-4.91%	-0.87%
4 Week Price Chg	-15.28%	-11.32%	-10.98%	-25.77%	-19.30%	-7.64%
12 Week Price Chg	-9.92%	-6.52%	-7.84%	-12.69%	-19.15%	-6.52%
52 Week Price Chg	-9.69%	-9.52%	1.20%	-4.62%	-21.03%	-4.13%
20 Day Average Volume	615,492	652,353	2,169,477	1,084,511	4,542,468	344,272
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-80.00%	-6.93%	-0.09%	-37.39%	19.77%	2.73%
(F1) EPS Est 12 week change	-153.13%	-8.59%	-0.24%	-37.68%	19.16%	6.16%
(Q1) EPS Est Mthly Chg	-80.93%	-32.28%	-0.72%	-55.94%	-28.45%	9.47%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	A
Momentum Score	A
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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