

Proofpoint, Inc. (PFPT)

\$122.23 (As of 01/07/20)

Price Target (6-12 Months): **\$128.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 02/19/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:D

Value: F

Growth: A

Momentum: F

Summary

Proofpoint is benefiting from a firm international footing and solid uptick in emerging suite of products. Robust demand for Email Fraud Defense, Threat Response and PSAT are tailwinds. Its new offerings have expanded the total addressable market, and are proving to be a key growth catalyst. Strong demand for its next-generation cloud security and compliance platform, ongoing migration to the cloud, and high renewal rates are other tailwinds. Shares have outperformed the industry year to date. However, Proofpoint expects no contribution from the Cloudmark's OEM business to negatively impact its top line. Moreover, continuous investment in sales and marketing is expected to weigh on the company's bottom line in the near term. Capital expenditures and depreciation are expected to keep margins under pressure in the near term.

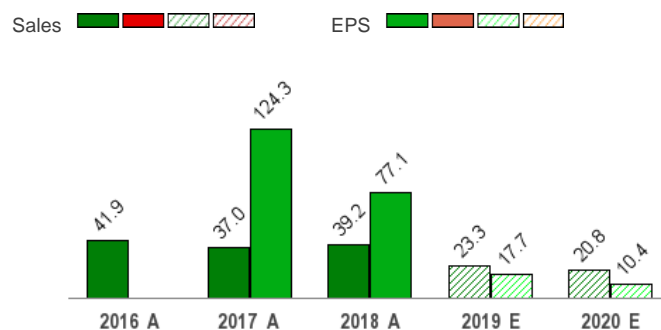
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$133.58 - \$88.82
20 Day Average Volume (sh)	449,744
Market Cap	\$6.9 B
YTD Price Change	6.5%
Beta	1.60
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Security
Zacks Industry Rank	Top 36% (91 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	22.5%
Last Sales Surprise	1.2%
EPS F1 Est- 4 week change	-25.0%
Expected Report Date	01/30/2020
Earnings ESP	-0.4%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	245 E	258 E	273 E	289 E	1,068 E
2019	203 A	214 A	227 A	240 E	884 E
2018	162 A	172 A	184 A	198 A	717 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.39 E	\$0.44 E	\$0.49 E	\$0.55 E	\$1.91 E
2019	\$0.40 A	\$0.41 A	\$0.49 A	\$0.48 E	\$1.73 E
2018	\$0.30 A	\$0.26 A	\$0.40 A	\$0.51 A	\$1.47 A

*Quarterly figures may not add up to annual.

P/E TTM	67.5
P/E F1	64.0
PEG F1	2.2
P/S TTM	8.1

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/07/2020. The reports text is as of 01/08/2020.

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 climbed 38% year over year to \$717 million in 2018. The company has two reportable segments: Subscription, which contributed 98% to 2018 total revenues and Hardware and Services that contributed 2% to total revenues.

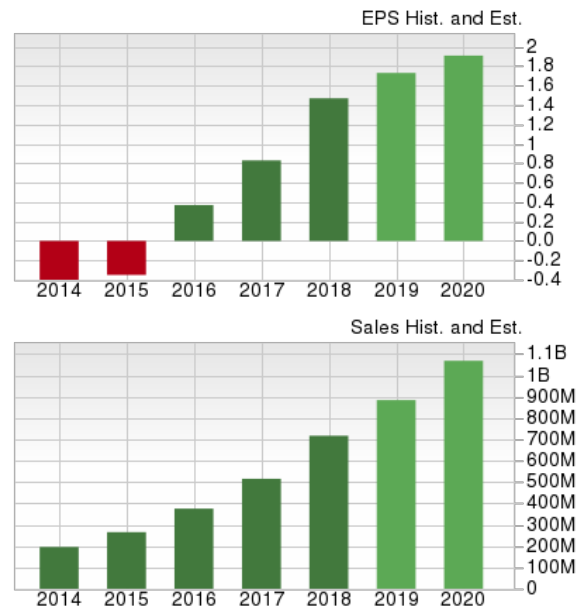
The company is in the process of transitioning to a subscription-based business model.

Subscription revenues increased 39% year over year in 2018 whereas Hardware and Services revenues dropped 5%.

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 Buy:

- ▲ 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. Likewise, management remains optimistic about its most recent acquisition of Wombat Security Technologies (February 2019).
- ▲ 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 (FY18) 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 \$1.05 billion as of Sep 30, 2019. This enhances liquidity and can be used for funding product development and to pursue growth strategies like acquisitions.

Proofpoint's sustained focus on launching new products, acquisitions and partnerships will continue to drive its top-line over the long run.

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 the inorganic revenue contributions in 2018 to lead to challenging year-over-year comparison in 2019. The company anticipates additional headwinds in 2019 due to adoption of ASC 606 and no contribution from Cloudmark business.

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.

Last Earnings Report

Proofpoint Q3 Earnings & Revenues Beat Estimates

Proofpoint reported third-quarter 2019 non-GAAP earnings of 49 cents per share, which outpaced the Zacks Consensus Estimate of 40 cents. The bottom line also came ahead of the year-ago quarter figure of 40 cents.

Proofpoint generated total revenues of \$227.4 million, up 23% year over year. The top line also surpassed the consensus estimate of \$225 million.

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

Top-Line Details

Total billings during the quarter jumped 26% year over year to \$277.8 million. Also, renewal rates again soared above 90%.

Subscription revenues (98.6% of total revenues) came in at \$224.3 million, up 23.6%. Hardware and services revenues (1.4%) grew 14.8% to \$3.1 million.

On the basis of solutions, revenues from Advanced Threat (72.2%), which includes Targeted Attack Protection or TAP offering, rose 19% from the year-earlier quarter to \$164.2 million. Compliance revenues (27.8%) of \$63.2 million surged 36.8%.

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.

The company added new video-based awareness content to PSAT in the third quarter. 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 by the dint of its international business, which grew 28% year over year and accounted for 20% of its total revenues in the third quarter.

The company won many international deals during the quarter. These are a Global 2000 financial services firm that purchased Protection for 160,000 users, a Global 2000 financial services firm that added Protection and TAP for 18,000 users, a transportation services company that bought P3 bundle for 5,000 users, and a electrical products distributor that purchased Protection, TAP, Threat Response and internal e-mail defense for 16,000 users.

Ecosystem partnerships included a technology partnership with CrowdStrike, aimed at protecting customers from advanced threats across e-mail and endpoints through cloud-to-cloud APIs established between TAP and CrowdStrike Falcon.

Proofpoint also expanded its technology partnership with identity access management provider Okta to enhance the capability of customers to protect their users from sophisticated cyber-attacks.

The pipeline in Proofpoint's digital risk products area remained strong. Increased interest in new archiving features like supervision, eDiscovery and analytics visualization, particularly from firms in regulated industries such as healthcare and financial services and the features are driving demand.

Proofpoint's archiving pipeline continued to strengthen on the back of its cloud-based delivery model. However, given the complexity of these deals, the company expects that it might take a few quarters for them to mature and contribute to results.

Additionally, archiving deals maturing in the third quarter included a large North American bank, which bought a three-year prepaid subscription for a high amount for 18,000 users; a large Canadian bank that purchased a three-year high-value prepaid subscription for 55,000 users; and a technology company that expanded their subscription for 50,000 users.

Operating Details

Non-GAAP gross profit advanced 25.4% from the year-ago quarter to \$181 million. Non-GAAP gross margin improved 200 basis points (bps) to 80%, driven by a strong revenue performance.

Proofpoint's non-GAAP operating income surged 49.3% to \$33.9 million. Non-GAAP operating margin expanded 260 bps to 14.9%.

Balance Sheet & Cash Flow

Proofpoint exited the quarter with cash and cash equivalents and short-term investments of approximately \$1.05 billion compared with the previous quarter's balance of \$182.7 million.

The company generated operating cash flow of \$68.6 million compared with \$43.4 million in the previous quarter. Free cash flow summed \$58.6 million compared with \$35 million reported in the second quarter of 2019.

Guidance

Quarter Ending **09/2019**

Report Date	Oct 24, 2019
Sales Surprise	1.23%
EPS Surprise	22.50%
Quarterly EPS	0.49
Annual EPS (TTM)	1.81

Encouraged by its strong third-quarter performance, Proofpoint raised full-year 2019 guidance. For 2019, the company expects revenues of \$882.3-\$884.3 million, up from the previous projection of \$878.5-\$880.5 million. Billings expectation remains in the range of \$1.064-\$1.068 billion. Non-GAAP gross margin is projected to be 79%.

Non-GAAP earnings per share are now anticipated in the band of \$1.72-\$1.75. Previously, the company had projected this metric to be \$1.61-\$1.64.

Free cash flow is envisioned in the range of \$200.5-\$202.5 million, up from \$196-\$198 million expected previously, which includes \$8.4 million tax payment associated with the acquisition of Meta Networks.

Capital expenditures are expected to be approximately \$38 million for full-year 2019.

For the fourth quarter of 2019, Proofpoint anticipates revenues of \$237.5-\$239.5 million and billings of \$339-\$343 million.

Non-GAAP gross margin is estimated to be 79%. Non-GAAP earnings per share are anticipated in the band of 47-50 cents. Free cash flow is estimated in the range of \$58.2-\$60.2 million.

Capital expenditures of \$1 million and depreciation of \$9 million are expected to remain overhangs on the margins in the fourth quarter.

Management is optimistic about its progress to increase its total addressable market to more than \$13 billion in the coming years.

Note: The EPS data mentioned in the text of this section differs from the rest of report due to the difference in calculation or consideration of one-time items.

Valuation

Proofpoint's shares have lost 2.2% in the past six months and 35.3% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Technology sector are up 9.4% and up 13.3% in the past six months, respectively. Over the past year, the Zacks sub-industry and sector have gained 23.9% and 30.6%, respectively.

The S&P 500 Index has jumped 9.6% in the past six months, and 24.6% in the past year.

The stock is currently trading at 6.4X forward 12-month sales, which compares to 7.86X for the Zacks sub-industry, 3.59X for the Zacks sector and 3.48X 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 6.96X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$128 price target reflects 6.4X 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	6.4	7.86	3.59	3.48
	5-Year High	9.42	8.96	3.59	3.48
	5-Year Low	4.18	5.32	2.3	3.54
	5-Year Median	6.96	6.76	3.01	3
P/B TTM	Current	11.94	4.09	4.71	4.43
	5-Year High	130.5	4.18	4.91	4.45
	5-Year Low	8.66	2.85	3.09	2.85
	5-Year Median	30.63	3.42	4.02	3.6
EV/Sales TTM	Current	7.7	8.05	4.22	3.25
	5-Year High	11.61	10.68	4.22	3.3
	5-Year Low	4.1	5.26	2.56	2.16
	5-Year Median	8.12	6.93	3.44	2.8

As of 01/07/2020

Industry Analysis Zacks Industry Rank: Top 36% (91 out of 254)



Top Peers

Fortinet, Inc. (FTNT)	Outperform
Check Point Software Technologies Ltd. (CHKP)	Neutral
CyberArk Software Ltd. (CYBR)	Neutral
FireEye, Inc. (FEYE)	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 Neutral	X Industry	S&P 500	CYBR Neutral	FEYE Neutral	QLYS Neutral
VGM Score	D	-	-	C	C	B
Market Cap	6.85 B	3.94 B	23.82 B	4.83 B	3.94 B	3.24 B
# of Analysts	9	10.5	13	10	13	7
Dividend Yield	0.00%	0.00%	1.8%	0.00%	0.00%	0.00%
Value Score	F	-	-	F	F	D
Cash/Price	0.16	0.11	0.04	0.11	0.27	0.09
EV/EBITDA	406.20	40.42	13.92	75.43	-41.14	35.32
PEG Ratio	2.24	2.22	2.00	2.77	10.73	NA
Price/Book (P/B)	11.52	9.10	3.32	8.51	5.60	8.99
Price/Cash Flow (P/CF)	113.61	47.81	13.58	74.86	NA	42.58
P/E (F1)	64.68	41.30	18.86	47.09	118.04	33.61
Price/Sales (P/S)	8.13	8.13	2.63	11.70	4.52	10.43
Earnings Yield	1.56%	2.27%	5.30%	2.12%	0.83%	2.98%
Debt/Equity	1.31	0.00	0.72	0.00	1.36	0.00
Cash Flow (\$/share)	1.08	1.08	6.94	1.71	-0.26	1.97
Growth Score	A	-	-	B	A	A
Hist. EPS Growth (3-5 yrs)	NA%	14.71%	10.56%	18.69%	NA	50.78%
Proj. EPS Growth (F1/F0)	10.33%	11.30%	7.49%	4.45%	545.18%	9.00%
Curr. Cash Flow Growth	59.09%	59.09%	14.83%	83.76%	-43.87%	32.73%
Hist. Cash Flow Growth (3-5 yrs)	48.18%	23.40%	9.00%	54.74%	10.10%	46.39%
Current Ratio	1.93	1.78	1.23	3.46	1.53	1.78
Debt/Capital	56.68%	0.00%	42.92%	0.00%	57.63%	0.00%
Net Margin	-14.56%	9.33%	11.08%	16.09%	-29.44%	20.27%
Return on Equity	-10.85%	7.41%	17.16%	12.94%	-20.06%	18.15%
Sales/Assets	0.56	0.50	0.55	0.54	0.31	0.50
Proj. Sales Growth (F1/F0)	20.82%	14.51%	4.15%	18.48%	7.41%	14.51%
Momentum Score	F	-	-	B	D	A
Daily Price Chg	1.51%	0.89%	-0.22%	1.03%	3.24%	-1.40%
1 Week Price Chg	3.34%	0.90%	-0.30%	2.16%	3.24%	-1.26%
4 Week Price Chg	7.43%	7.43%	2.11%	6.61%	12.10%	-2.41%
12 Week Price Chg	-7.23%	13.67%	5.70%	21.58%	19.43%	5.87%
52 Week Price Chg	37.06%	16.48%	22.84%	64.78%	9.33%	9.14%
20 Day Average Volume	449,744	449,744	1,570,747	527,392	2,734,669	291,503
(F1) EPS Est 1 week change	-25.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-25.00%	0.00%	0.00%	0.00%	-0.76%	0.00%
(F1) EPS Est 12 week change	9.09%	5.22%	-0.53%	6.87%	10.00%	17.72%
(Q1) EPS Est Mthly Chg	-34.48%	0.00%	0.00%	0.00%	0.80%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	F
VGM Score	D

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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