

Proofpoint, Inc. (PFPT)

\$106.93 (As of 06/18/20)

Price Target (6-12 Months): **\$112.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/09/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: F

Growth: A

Momentum: A

Summary

Proofpoint's first-quarter results reflected strong demand for its next-generation cloud security and compliance platform, and expansion of the international business. Ongoing migration to the cloud and high renewal rates were also positives. Also, Proofpoint recently concluded a small acquisition of security awareness startup, Defense Works, which is expected to boost its portfolio. Robust demand for Email Fraud Defense, Threat Response and PSAT are positives as well. However, the company faced contraction in the deal pipeline due to certain projects being postponed by enterprises, particularly those belonging to industries most affected by the coronavirus pandemic, such as energy, travel, hospitality, retail and certain segments of healthcare. Proofpoint also slashed its 2020 revenue guidance to reflect uncertainties related to the pandemic.

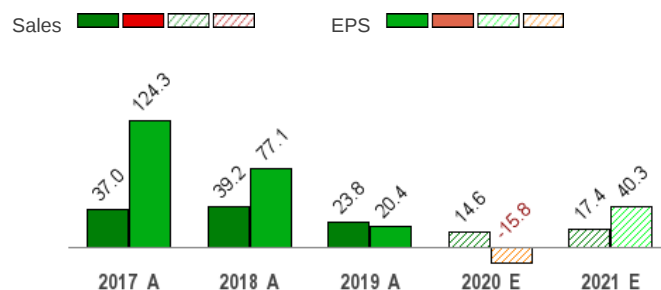
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$133.58 - \$83.81
20 Day Average Volume (sh)	758,716
Market Cap	\$6.1 B
YTD Price Change	-6.8%
Beta	1.36
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Security
Zacks Industry Rank	Top 33% (83 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	40.7%
Last Sales Surprise	1.3%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	07/23/2020
Earnings ESP	0.0%
P/E TTM	59.4
P/E F1	71.8
PEG F1	2.5
P/S TTM	6.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	283 E	293 E	300 E	319 E	1,195 E
2020	250 A	253 E	251 E	265 E	1,018 E
2019	203 A	214 A	227 A	243 A	888 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.46 E	\$0.51 E	\$0.56 E	\$0.60 E	\$2.09 E
2020	\$0.38 A	\$0.32 E	\$0.34 E	\$0.37 E	\$1.49 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 06/18/2020. The reports text is as of 06/19/2020.

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).

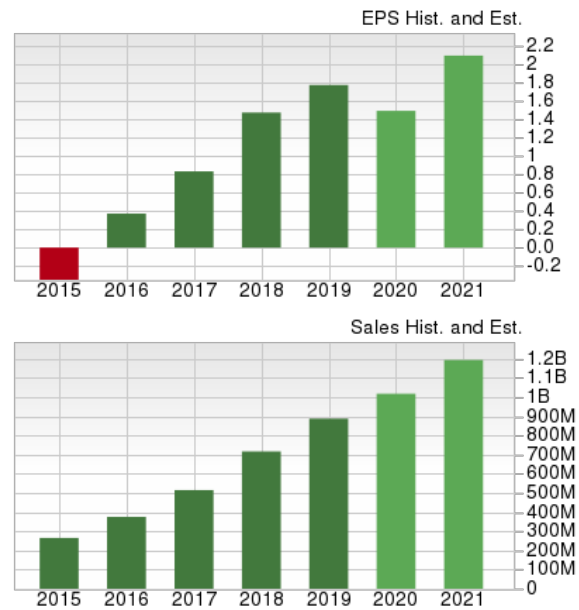
The company is in the process of transitioning to a subscription-based business model.

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 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 data security is expected to grow 26% year over year to \$72 billion in 2020. 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 98.5% 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 \$946 million as of Mar 31, 2020. 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 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.

Last Earnings Report

Proofpoint's Q1 Earnings Top Estimates, View Slashed

Proofpoint reported first-quarter 2020 non-GAAP earnings of 38 cents per share, which beat the Zacks Consensus Estimate by 40.74%. However, the figure decreased 5% year over year.

Revenues came in at \$249.8 million, which beat the consensus mark by 1.27% and increased 23% year over year.

The top-line growth can be attributed to strong demand for its next-generation cloud security and compliance platform, ongoing migration to the cloud, solid international growth, and high renewal rates.

However, the company faced contraction in the deal pipeline due to certain projects being postponed by enterprises, particularly those belonging to industries most affected by the coronavirus pandemic, such as energy, travel, hospitality, retail and certain segments of healthcare.

Moreover, existing and new customers shortened the duration of contracts in an attempt to conserve cash during these uncertain times. This resulted in an 11% sequential decline in billed contract duration, partially compensated by pricing gains stemming from the elimination of the customary 10% discount for three-year prepaid transactions.

Additionally, Proofpoint recently concluded a small acquisition of security awareness startup, Defense Works, for less than \$5 million. The financial impact of the acquisition is expected to be negligible.

Top-Line Details

Total billings during the quarter grew 23% year over year to \$238 million. Also, renewal rates soared above 90%.

Subscription revenues (98.7% of total revenues) came in at \$244.1 million, up 22.3% from the year-ago quarter. Hardware and services revenues (1.3%) jumped 67.6% year over year to \$5.7 million.

The company has stopped reporting results for its advanced threat and compliance-oriented products as it believes that the data are 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, management remains optimistic about PSAT's prospects, which are expected to drive growth and boost capabilities of the new segment in the cybersecurity market.

Proofpoint continues to expand abroad. Its international business grew 29% year over year and accounted for 20% of total revenues in the first quarter. However, the coronavirus-induced downturn in Europe was an overhang.

Operating Details

Non-GAAP gross profit advanced 24% from the year-ago quarter to \$197.7 million. Non-GAAP gross margin improved 100 basis points (bps) to 79%, driven by a strong revenue performance.

Proofpoint's non-GAAP operating income rose 10.9% to \$25.4 million.

Balance Sheet & Cash Flow

As of Mar 31, 2020, the company's cash, cash equivalents and short-term investments were \$946 million compared with \$890.9 million as of Dec 31, 2019.

The company generated operating cash flow of \$92.2 million compared with \$76.4 million in the previous quarter. Free cash flow was \$79.8 million compared with \$65.1 million in the prior quarter.

Guidance

Proofpoint updated its 2020 revenue guidance to reflect uncertainties related to coronavirus impacts. The company now expects revenues of \$1.005-\$1.030 billion, down from the previous projection of \$1.060-\$1.067 billion.

Non-GAAP gross margin is projected to be 79%.

Non-GAAP earnings per share are anticipated in a band of \$1.41-\$1.46, lower than its previous guidance.

Free cash flow is envisioned in the range of \$85-\$135 million, down from \$178-\$182 million expected previously, due to an estimated expense of \$25 million for the construction of the new company headquarters.

The guidance includes \$20 million of payment to the repatriation of ObserveIT's intellectual property and \$35 million in net cash operating costs from the acquisition of ObserveIT.

Capital expenditures are expected to be approximately \$94 million for 2020.

Quarter Ending 03/2020

Report Date	May 07, 2020
Sales Surprise	1.27%
EPS Surprise	40.74%
Quarterly EPS	0.38
Annual EPS (TTM)	1.80

For the second quarter of 2020, Proofpoint anticipates revenues of \$251-\$255 million.

Non-GAAP gross margin is estimated to be 79%. Non-GAAP earnings per share are anticipated in a band of 38-41 cents.

Free cash flow is estimated in the range of break-even to \$10 million.

Capital expenditures are expected to be approximately \$12 million for second-quarter 2020, including \$5 million for the building of Proofpoint's new headquarters.

Recent News

On Jun 9, Proofpoint bolstered its enterprise security offerings by enhancing its Enterprise Archive solution to offset three key challenges, namely legal discovery, regulatory compliance and end user email access. The Proofpoint Enterprise Archive solution is deployed by numerous organizations to simplify e-discovery and monitoring, and reduce relevant costs.

On Feb 25, Proofpoint launched new integrated, end-to-end solutions to help combat business email compromise (BEC) and email account compromise (EAC) attacks by combining Proofpoint's leading secure email gateway, advanced threat protection, threat response, email authentication, security awareness training, and cloud account protection.

On Jan 22, 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, Proofpoint's Email Protection won the CRN 2019 Product of the Year Awards in the web and email security category.

Valuation

Proofpoint's shares have decreased 0.8% in the year-to-date (YTD) period and 3.7% over the trailing 12 months. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have rallied 4.1% and 1.2%, respectively, YTD. Over the past year, while the Zacks sub-industry has increased 6.9%, the sector increased 15.2%.

The S&P 500 Index has declined 8.2% YTD and increased 3% in the past year.

The stock is currently trading at 5.57X forward 12-month sales, which compares to 7.61X for the Zacks sub-industry, 3.87X for the Zacks sector and 3.5X 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 6.72X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$112 price target reflects 5.85X 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	5.57	7.61	3.87	3.50
	5-Year High	9.42	8.85	3.87	3.50
	5-Year Low	4.18	5.32	2.32	2.53
	5-Year Median	6.72	6.63	3.11	3.02
P/B TTM	Current	9.93	8.07	4.19	3.54
	5-Year High	130.5	10.01	5.37	4.55
	5-Year Low	8.62	4.25	3.15	2.84
	5-Year Median	26.43	6.44	4.27	3.63
EV/Sales TTM	Current	7.7	7.85	3.90	2.82
	5-Year High	11.61	10.68	4.43	3.43
	5-Year Low	4.1	4.89	2.58	2.11
	5-Year Median	8.12	6.83	3.58	2.80

As of 06/18/2020

Industry Analysis Zacks Industry Rank: Top 33% (83 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Fortinet, Inc. (FTNT)	Outperform	1
Check Point Software Technologies Ltd. (CHKP)	Neutral	3
CyberArk Software Ltd. (CYBR)	Neutral	3
FireEye, Inc. (FEYE)	Neutral	3
Palo Alto Networks, Inc. (PANW)	Neutral	3
Qualys, Inc. (QLYS)	Neutral	3
Radware Ltd. (RDWR)	Neutral	3
VMware, Inc. (VMW)	Neutral	3

Industry Comparison Industry: Security				Industry Peers		
	PFPT	X Industry	S&P 500	CYBR	FEYE	QLYS
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	3	3	3
VGM Score	B	-	-	F	F	B
Market Cap	6.13 B	3.88 B	21.93 B	3.88 B	2.78 B	3.94 B
# of Analysts	13	11	14	9	11	6
Dividend Yield	0.00%	0.00%	1.93%	0.00%	0.00%	0.00%
Value Score	F	-	-	D	F	D
Cash/Price	0.15	0.10	0.06	0.29	0.36	0.08
EV/EBITDA	87.96	32.90	12.69	39.65	-32.02	32.90
PEG Ratio	2.48	2.51	2.97	4.64	24.43	NA
Price/Book (P/B)	10.98	10.42	3.02	5.99	4.25	10.20
Price/Cash Flow (P/CF)	44.75	39.84	11.62	47.76	NA	39.84
P/E (F1)	71.66	48.19	21.45	56.84	268.74	40.54
Price/Sales (P/S)	6.55	7.04	2.33	8.72	3.07	11.85
Earnings Yield	1.39%	2.07%	4.37%	1.76%	0.40%	2.46%
Debt/Equity	1.43	0.68	0.77	0.76	1.49	0.00
Cash Flow (\$/share)	2.39	2.13	7.01	2.13	-0.18	2.54
Growth Score	A	-	-	D	D	B
Hist. EPS Growth (3-5 yrs)	NA%	10.02%	10.87%	19.96%	NA	45.41%
Proj. EPS Growth (F1/F0)	-15.90%	-6.18%	-10.65%	-35.38%	-7.27%	7.08%
Curr. Cash Flow Growth	127.88%	45.71%	5.46%	28.60%	-24.85%	27.15%
Hist. Cash Flow Growth (3-5 yrs)	55.69%	37.87%	8.55%	40.13%	13.41%	34.15%
Current Ratio	1.61	1.50	1.29	6.25	1.50	1.82
Debt/Capital	58.81%	41.80%	45.14%	43.05%	59.80%	0.00%
Net Margin	-18.85%	8.29%	10.53%	11.64%	-28.60%	22.48%
Return on Equity	-10.15%	6.60%	16.06%	9.76%	-18.26%	19.56%
Sales/Assets	0.46	0.48	0.55	0.40	0.32	0.51
Proj. Sales Growth (F1/F0)	14.66%	5.02%	-2.61%	5.02%	-0.09%	11.64%
Momentum Score	A	-	-	D	B	A
Daily Price Chg	-2.54%	-0.69%	-0.07%	-0.56%	-2.73%	-1.98%
1 Week Price Chg	-1.81%	-5.01%	-7.25%	-6.91%	-5.21%	-5.00%
4 Week Price Chg	-4.71%	2.22%	6.92%	4.64%	8.54%	-7.70%
12 Week Price Chg	4.56%	15.51%	16.91%	8.98%	5.33%	15.51%
52 Week Price Chg	-7.28%	-4.21%	-5.63%	-22.60%	-16.15%	12.73%
20 Day Average Volume	758,716	758,716	2,574,456	427,690	4,972,041	505,847
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	-0.73%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	0.41%	-0.73%
(F1) EPS Est 12 week change	4.01%	-2.77%	-14.21%	-49.11%	-42.81%	-3.34%
(Q1) EPS Est Mthly Chg	0.00%	0.09%	0.00%	0.00%	1.20%	0.32%

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	A
VGM Score	B

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.

Disclosures

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