UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 or 15(d) of
The Securities Exchange Act of 1934

Date of Report (Date of earliest event reported)

May 21, 2020

PALO ALTO NETWORKS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**001-35594**	**20-2530195**
(State or other jurisdiction of incorporation)	**(Commission File Number)**	**(IRS Employer Identification No.)**

3000 Tannery Way
Santa Clara, California 95054
(Address of principal executive office, including zip code)

(408) 753-4000
(Registrant's telephone number, including area code)

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

☐ Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

☐ Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

☐ Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

☐ Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, $0.0001 par value per share	PANW	New York Stock Exchange

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Item 2.02 Results of Operations and Financial Condition.

On May 21, 2020, Palo Alto Networks, Inc. (the "Company") issued a (1) press release announcing its financial results for its fiscal third quarter ended April 30, 2020, which is furnished herewith as Exhibit 99.1, and (2) a Letter to Stockholders, which is furnished herewith as Exhibit 99.2, each such exhibit which is incorporated herein by reference.

Forward Looking Statements

Exhibit 99.2 furnished under Item 9.01, contains forward-looking statements within the meaning of United States securities laws, that involve risks, uncertainties and assumptions, including statements regarding the potential economic effects of the COVID-19 pandemic, length of time for consumers and enterprises to recover from the effects caused by COVID-19, our expectations of the long-term trends in the global economy and cybersecurity market, and our ability to emerge from this pandemic in a stronger position. Many of these assumptions relate to matters that are beyond our control and changing rapidly, including, but not limited to, the timeframes for and severity of social distancing and other mitigation requirements, the impact of COVID-19 on our customers' purchasing decisions and the length of our sales cycles, particularly for customers in certain industries highly affected by COVID-19.There are a significant number of factors that could cause actual results to differ materially from statements made including: developments and changes in general market, political, economic, and business conditions; the duration and global impact of COVID-19; our ability as an organization to acquire and integrate other companies, products or technologies in a successful manner; risks associated with managing our growth; the risks associated with new products and subscription and support offerings, including the discovery of software bugs; our competitive position; our ability to attract and retain new customers; shift in priorities or delays in the development or release of new subscription offerings, or the failure to timely develop and achieve market acceptance of new products and subscriptions as well as existing products and subscription and support offerings; rapidly evolving technological developments in the market for security products and subscription and support offerings; and length of sales cycles.

Additional risks, uncertainties and assumptions that could affect our financial results are included under the captions "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Quarterly Report on Form 10-Q filed with the SEC on February 25, 2020, which is available on our website at investors.paloaltonetworks.com and on the SEC's website at www.sec.gov. Additional information will also be set forth in other filings that we make with the SEC from time to time. All forward-looking statements in each of Exhibits 99.1 and 99.2 are based on information available to us as of the date hereof, and we do not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

Exhibit No.	Description of Exhibit
99.1	Press release dated as of May 21, 2020.
99.2	Letter to stockholders dated as of May 21, 2020

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

PALO ALTO NETWORKS, INC.

By: /s/ NIKESH ARORA

Nikesh Arora

Chief Executive Officer

Date: May 21, 2020

Exhibit 99.1

Palo Alto Networks Reports Fiscal Third Quarter 2020 Financial Results

- *Fiscal third quarter revenue grows 20% year over year to $869.4 million*
- *Billings increase 24% year over year to $1.0 billion*
- *Deferred revenue grows 28% year over year to $3.4 billion*

SANTA CLARA, Calif. - **May. 21, 2020** - Palo Alto Networks (NYSE: PANW), the global cybersecurity leader, announced today financial results for its fiscal third quarter 2020, ended April 30, 2020.

Total revenue for the fiscal third quarter 2020 grew 20% year over year to $869.4 million, compared with total revenue of $726.6 million for the fiscal third quarter 2019. GAAP net loss for the fiscal third quarter 2020 was $74.8 million, or $0.77 per diluted share, compared with GAAP net loss of $20.2 million, or $0.21 per diluted share, for the fiscal third quarter 2019.

Non-GAAP net income for the fiscal third quarter 2020 was $114.6 million, or $1.17 per diluted share, compared with non-GAAP net income of $130.1 million, or $1.31 per diluted share, for the fiscal third quarter 2019. A reconciliation between GAAP and non-GAAP information is contained in the tables below.

“The world will likely be in a state of transition over the next 12 to 18 months due to the COVID-19 pandemic. We believe this will prompt key trends to accelerate, including remote working models, shift to the cloud, and focus on AI/ML and automation to drive effective cybersecurity outcomes,” said Nikesh Arora, chairman and CEO of Palo Alto Networks. “Palo Alto Networks is well positioned to leverage the acceleration of these trends, with our significant and ongoing investments to transform our company into a multi-product, integrated platform provider of cybersecurity solutions. As our performance this quarter demonstrates, we are entering this transition in a position of strength, and while the path might be bumpy, we believe we will emerge stronger as we continue providing the best security solutions for our customers.”

Financial Outlook

Palo Alto Networks provides guidance based on current market conditions and expectations.

For the fiscal fourth quarter 2020, we expect:

- Total billings in the range of $1.190 billion to $1.210 billion, representing year-over-year growth of between 13% and 14%.
- Total revenue in the range of $915 million to $925 million, representing year-over-year growth between 14% and 15%.
- Diluted non-GAAP net income per share in the range of $1.37 to $1.40, which incorporates approximately $8 million of net expense, or $0.06 per share, related to the acquisition of CloudGenix, using 96.0 million to 98.0 million shares.

For the full year fiscal 2020, we expect:

- Total billings in the range of $4.102 billion to $4.122 billion, representing year-over-year growth of 18%.
- Total revenue in the range of $3.373 billion to $3.383 billion, representing year-over-year growth between 16% and 17%.
- Diluted non-GAAP net income per share in the range of $4.78 to $4.81, using 98.0 million to 100.0 million shares.
- Adjusted free cash flow margin of approximately 27% - 28%, which excludes cash flow associated with the additional investment in our headquarters in Santa Clara and a cash payment associated with a litigation-related settlement.

Guidance for non-GAAP financial measures excludes share-based compensation-related charges, including share-based payroll tax expense, acquisition-related costs, amortization expense of acquired intangible assets, litigation-related charges, including legal settlements, gains (losses) related to facility exit, non-cash charges related to convertible notes, foreign currency gains (losses), and income and other tax effects associated with these items, along with certain non-recurring expenses. We have not reconciled diluted non-GAAP net income per share guidance to GAAP net income (loss) per diluted share because we do not provide guidance on GAAP net income (loss) and would not be able to present the various reconciling cash and non-cash items between GAAP net income (loss) and non-GAAP net income, including share-based compensation expense, without unreasonable effort. Share-based compensation expense is impacted by the company's future hiring and retention needs and, to a lesser extent, the future fair market value of the company's common stock, all of which is difficult to predict and subject to constant change. The actual amounts of such reconciling items will have a significant impact on the company's GAAP net income (loss) per diluted share.

Stockholder Letter

Palo Alto Networks issued a stockholder letter today, which can be found on the “Investors” section of the company’s website at investors.paloaltonetworks.com.

Earnings Call Information

Palo Alto Networks will host a video webcast for analysts and investors to discuss its fiscal third quarter 2020 results and outlook for its fiscal fourth quarter and full year 2020 today at 4:30 p.m. Eastern time/1:30 p.m. Pacific time. Open to the public, investors may access the webcast, supplemental financial information and earnings slides from the “Investors” section of the company’s website at investors.paloaltonetworks.com. A replay will be available three hours after the conclusion of the webcast and archived for one year.

Forward-Looking Statements

This press release contains forward-looking statements that involve risks, uncertainties, and assumptions including statements regarding (1) our financial outlook for the fiscal fourth quarter and full year fiscal 2020 and (2) the length of the transition and changes caused by COVID-19, including the acceleration of certain trends, and our ability to leverage this acceleration and emerge from this transition in a position of strength. Many of these assumptions relate to matters that are beyond our control and changing rapidly, including, but not limited to, the timeframes for and severity of social distancing and other mitigation requirements, the impact of COVID-19 on our customers’ purchasing decisions and the length of our sales cycles, particularly for customers in certain industries highly affected by COVID-19. There are a significant number of factors that could cause actual results to differ materially from statements made in this press release, including: developments and changes in general market, political, economic, and business conditions; the duration and global impact of COVID-19; our ability as an organization to acquire and integrate other companies, products or technologies in a successful manner; risks associated with managing our growth; the risks associated with new products and subscription and support offerings, including the discovery of software bugs; our competitive position; our ability to attract and retain new customers; shift in priorities or delays in the development or release of new subscription offerings, or the failure to timely develop and achieve market acceptance of new products and subscriptions as well as existing products and subscription and support offerings; rapidly evolving technological developments in the market for security products and subscription and support offerings; and length of sales cycles.

Additional risks and uncertainties that could affect our financial results are included under the captions “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Quarterly Report on Form 10-Q filed with the SEC on February 25, 2020, which is available on our website at investors.paloaltonetworks.com and on the SEC’s website at www.sec.gov. Additional information will also be set forth in other filings that we make with the SEC from time to time. All forward-looking statements in this press release are based on information available to us as of the date hereof, and we do not assume any obligation to update the forward-looking statements provided to reflect events that occur or circumstances that exist after the date on which they were made.

Non-GAAP Financial Measures and Other Key Metrics

Palo Alto Networks has provided in this press release financial information that has not been prepared in accordance with generally accepted accounting principles in the United States (GAAP). The company uses these non-GAAP financial measures and other key metrics internally in analyzing its financial results and believes that the use of these non-GAAP financial measures and key metrics are useful to investors as an additional tool to evaluate ongoing operating results and trends, and in comparing the company’s financial results with other companies in its industry, many of which present similar non-GAAP financial measures or key metrics.

The presentation of these non-GAAP financial measures and key metrics are not meant to be considered in isolation or as a substitute for comparable GAAP financial measures and should be read only in conjunction with the company’s consolidated financial statements prepared in accordance with GAAP. A reconciliation of the company’s historical non-GAAP financial measures to their most directly comparable GAAP measures has been provided in the financial statement tables included in this press release, and investors are encouraged to review these reconciliations.

Non-GAAP net income and net income per share, diluted. Palo Alto Networks defines non-GAAP net income as net income (loss) plus share-based compensation-related charges, including share-based payroll tax expense, acquisition-related costs, amortization expense of acquired intangible assets, litigation-related charges, including legal settlements, gains (losses) related to facility exit, non-cash charges related to convertible notes, and intellectual property restructuring-related charges. The company also excludes from non-GAAP net income the foreign currency gains (losses) and tax effects associated with these items in order to provide a complete picture of the company’s recurring core business operating results. The company defines non-GAAP net income per share, diluted, as non-GAAP net income divided by the weighted-average diluted shares outstanding, which includes the potentially dilutive effect of the company’s employee equity incentive plan awards and the company’s convertible senior notes outstanding and related warrants, after giving effect to the anti-dilutive impact of the company’s note hedge agreements, which reduces the potential economic dilution that otherwise would occur upon conversion of the company’s convertible senior notes. Under GAAP, the anti-dilutive impact of the note hedge is not reflected in diluted shares outstanding. The company believes that excluding these items from non-GAAP net income and net income per share, diluted, provides management and investors with greater visibility into the underlying performance of the company’s core business operating results, meaning its operating performance excluding these items and, from time to time, other discrete charges that are infrequent in nature, over multiple periods.

Billings. Palo Alto Networks defines billings as total revenue plus the change in total deferred revenue, net of acquired deferred revenue, during the period. The company considers billings to be a key metric used by management to manage the company's business given the company's hybrid-SaaS revenue model, and believes billings provides investors with an important indicator of the health and visibility of the company's business because it includes subscription and support revenue, which is recognized ratably over the contractual service period, and product revenue, which is recognized at the time of shipment, provided that all other conditions for revenue recognition have been met. The company considers billings to be a useful metric for management and investors, particularly if sales of subscriptions continue to increase and the company experiences strong renewal rates for subscriptions and support.

Investors are cautioned that there are a number of limitations associated with the use of non-GAAP financial measures and key metrics as analytical tools. In particular, the billings metric reported by the company includes amounts that have not yet been recognized as revenue. Additionally, many of the adjustments to the company’s GAAP financial measures reflect the exclusion of items that are recurring and will be reflected in the company’s financial results for the foreseeable future, such as share-based compensation, which is an important part of Palo Alto Networks employees’ compensation and impacts their performance. Furthermore, these non-GAAP financial measures are not based on any standardized methodology prescribed by GAAP, and the components that Palo Alto Networks excludes in its calculation of non-GAAP financial measures may differ from the components that its peer companies exclude when they report their non-GAAP results of operations. Palo Alto Networks compensates for these limitations by providing specific information regarding the GAAP amounts excluded from these non-GAAP financial measures. In the future, the company may also exclude non-recurring expenses and other expenses that do not reflect the company's core business operating results.

About Palo Alto Networks

Palo Alto Networks, the global cybersecurity leader, is shaping the cloud-centric future with technology that is transforming the way people and organizations operate. Our mission is to be the cybersecurity partner of choice, protecting our digital way of life. We help address the world's greatest security challenges with continuous innovation that seizes the latest breakthroughs in artificial intelligence, analytics, automation, and orchestration. By delivering an integrated platform and empowering a growing ecosystem of partners, we are at the forefront of protecting tens of thousands of organizations across clouds, networks, and mobile devices. Our vision is a world where each day is safer and more secure than the one before. For more information, visit www.paloaltonetworks.com.

Media Contact:

Mara Mort
Senior Director of Corporate Communications, Palo Alto Networks
Mobile: 1-415-850-8645
mmort@paloaltonetworks.com

Investor Relations Contact:

David Niederman
Vice President of Investor Relations, Palo Alto Networks
Office: 1-669-400-7323
dniederman@paloaltonetworks.com

Palo Alto Networks, Inc.
Preliminary Condensed Consolidated Statements of Operations
(In millions, except per share data)
(Unaudited)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2020	2019	2020	2019
Revenue:				
Product	$ 280.9	$ 278.4	$ 758.6	$ 790.5
Subscription and support	588.5	448.2	1,699.4	1,303.3
Total revenue	869.4	726.6	2,458.0	2,093.8
Cost of revenue:				
Product	73.3	78.0	207.1	233.7
Subscription and support	185.0	126.9	502.0	357.3
Total cost of revenue	258.3	204.9	709.1	591.0
Total gross profit	611.1	521.7	1,748.9	1,502.8
Operating expenses:				
Research and development	196.3	139.1	552.2	380.8
Sales and marketing	388.4	339.0	1,129.0	973.6
General and administrative	82.9	62.3	228.9	192.6
Total operating expenses	667.6	540.4	1,910.1	1,547.0
Operating income (loss)	(56.5)	(18.7)	(161.2)	(44.2)
Interest expense	(19.4)	(20.6)	(57.3)	(63.9)
Other income, net	8.1	18.2	35.1	47.2
Income (loss) before income taxes	(67.8)	(21.1)	(183.4)	(60.9)
Provision for (benefit from) income taxes	7.0	(0.9)	24.7	0.2
Net loss	$ (74.8)	$ (20.2)	$ (208.1)	$ (61.1)
Net loss per share, basic and diluted	$ (0.77)	$ (0.21)	$ (2.14)	$ (0.65)
Weighted-average shares used to compute net loss per share, basic and diluted	96.7	94.4	97.2	94.1

Palo Alto Networks, Inc.
Reconciliation of GAAP to Non-GAAP Financial Measures
(In millions, except per share amounts)
(Unaudited)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2020	2019	2020	2019
GAAP net loss	$ (74.8)	$ (20.2)	$ (208.1)	$ (61.1)
Share-based compensation-related charges	173.5	145.8	504.2	436.0
Acquisition-related costs[(1)]	4.9	2.9	15.3	20.0
Amortization expense of acquired intangible assets	19.2	14.6	53.7	38.0
Litigation-related charges[(2)]	1.8	3.1	1.8	9.2
(Gain) loss related to facility exit [(3)]	—	4.1	(3.1)	4.1
Non-cash charges related to convertible notes[(4)]	15.8	17.2	47.0	56.3
Foreign currency (gain) loss associated with non-GAAP adjustments	(0.6)	0.5	(0.1)	0.6
Income tax and other tax adjustments related to the above	(25.2)	(37.9)	(71.0)	(110.6)
Non-GAAP net income	$ 114.6	$ 130.1	$ 339.7	$ 392.5
GAAP net loss per share, diluted	$ (0.77)	$ (0.21)	$ (2.14)	$ (0.65)
Share-based compensation-related charges	1.78	1.48	5.10	4.45
Acquisition-related costs[(1)]	0.05	0.03	0.16	0.21
Amortization expense of acquired intangible assets	0.20	0.15	0.55	0.40
Litigation-related charges[(2)]	0.02	0.03	0.02	0.10
(Gain) loss related to facility exit [(3)]	0.00	0.04	(0.03)	0.04
Non-cash charges related to convertible notes[(4)]	0.16	0.18	0.48	0.60
Foreign currency (gain) loss associated with non-GAAP adjustments	(0.01)	0.01	0.00	0.01
Income tax and other tax adjustments related to the above	(0.26)	(0.40)	(0.73)	(1.18)
Non-GAAP net income per share, diluted	$ 1.17	$ 1.31	$ 3.41	$ 3.98
GAAP weighted-average shares used to compute net loss per share, diluted	96.7	94.4	97.2	94.1
Weighted-average effect of potentially dilutive securities[(5)]	1.1	5.2	2.5	4.6
Non-GAAP weighted-average shares used to compute net income per share, diluted	97.8	99.6	99.7	98.7

(1) Consists of acquisition transaction costs, share-based compensation related to the cash settlement of certain equity awards, and costs to terminate certain employment, operating lease, and other contracts of the acquired companies.

(2) Consists of the amortization of intellectual property licenses and covenant not to sue.

(3) Consists of a cease-use loss of $4.1 million related to the relocation of the company’s headquarters during the three and nine months ended April 30, 2019 and a gain of $3.1 million related to the early termination of the company’s previous headquarters leases during the nine months ended April 30, 2020.

(4) Consists primarily of non-cash interest expense related to the company’s convertible senior notes. Also includes a non-cash loss of $2.6 million during the nine months ended April 30, 2019 related to early conversions of the convertible notes during the period.

(5) Non-GAAP net income per share, diluted, includes the potentially dilutive effect of employee equity incentive plan awards and convertible senior notes outstanding and related warrants. In addition, non-GAAP net income per share, diluted, includes the anti-dilutive impact of the company’s note hedge agreements, which reduced the potentially dilutive effect of the convertible notes by 0.8 million shares for the three and nine months ended April 30, 2019.

Palo Alto Networks, Inc.
Calculation of Billings
(In millions)
(Unaudited)

	Three Months Ended April 30,		Nine Months Ended April 30,	
	2020	2019	2020	2019
Total revenue	$ 869.4	$ 726.6	$ 2,458.0	$ 2,093.8
Add: change in total deferred revenue, net of acquired deferred revenue	146.0	95.3	453.7	339.1
Billings	$ 1,015.4	$ 821.9	$ 2,911.7	$ 2,432.9

Palo Alto Networks, Inc.
Preliminary Condensed Consolidated Balance Sheets
(In millions)
(Unaudited)

	April 30, 2020	July 31, 2019
Assets		
Current assets:		
Cash and cash equivalents	$ 1,484.7	$ 961.4
Short-term investments	554.1	1,841.7
Accounts receivable, net	668.8	582.4
Prepaid expenses and other current assets	306.4	279.3
Total current assets	3,014.0	3,664.8
Property and equipment, net	357.2	296.0
Operating lease right-of-use assets	263.8	—
Long-term investments	151.2	575.4
Goodwill	1,812.9	1,352.3
Intangible assets, net	380.6	280.6
Other assets	522.1	423.1
Total assets	$ 6,501.8	$ 6,592.2
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 52.3	$ 73.3
Accrued compensation	174.9	235.5
Accrued and other liabilities	253.9	162.4
Deferred revenue	1,854.6	1,582.1
Total current liabilities	2,335.7	2,053.3
Convertible senior notes, net	1,477.0	1,430.0
Long-term deferred revenue	1,516.0	1,306.6
Long-term operating lease liabilities	344.6	—
Other long-term liabilities	83.8	216.0
Stockholders' equity:		
Preferred stock	—	—
Common stock and additional paid-in capital	1,855.7	2,490.9
Accumulated other comprehensive loss	(2.0)	(3.7)
Accumulated deficit	(1,109.0)	(900.9)
Total stockholders' equity	744.7	1,586.3
Total liabilities and stockholders' equity	$ 6,501.8	$ 6,592.2

Exhibit 99.2

Dear Stockholders: **May 21, 2020**

While our usual cadence for stockholder letters is in the fall, given the unique circumstances of the time we find ourselves in, I thought it would be appropriate to extend additional communication. As I write, over 5 million cases of COVID-19 have been diagnosed globally, impacting virtually every country, company and person in the world. Amid the pain and uncertainty, people are adapting to a new reality – finding new ways to work and developing new social norms. Palo Alto Networks has long been a company at the forefront of change and innovation. In many ways, that spirit of innovation has better prepared us to weather such a crisis. The work that we have been doing over the past few years to move security to the cloud, expand online customer support resources, and offer virtual training to our customers and employees now serves as a strong foundation while the crisis catalyses us to accelerate our efforts.

The current conversation around the world is centered on the health crisis, and it will continue to evolve as science and policy eventually overcome the COVID challenge. In the early months of the pandemic, I have tried to focus our attention internally to how this affects life for Palo Alto Networks and our customers in the near to midterm, and also the potential lasting impacts to our business. A clear understanding of those factors will allow us to leverage our advantages and come through this unprecedented event stronger and more resilient than before. In this letter, I wish to provide insight into how Palo Alto Networks is addressing this new normal and what we expect and are planning for the near future.

Global Outlook: Long-Term Trends

I speak with leaders across many industries daily to discuss not just their cybersecurity needs and plans but also how they are reacting to the current circumstances. There are several short-term impacts that they are all dealing with: declining revenue, employees working from home and uncertainty around how long this will last. It is clear that not one company out there is exempt from the phenomenon we are dealing with. Everyone’s situation is definitely unique, but from my conversations, I have gleaned some insights that inform our view into how this may unfold, for both Palo Alto Networks and the world at large.

Global Economy: Just a few short weeks ago, the world economy was firing on all cylinders, and we now face large parts of the world being shut down, disrupting supply chains, and impacting consumer behavior and consumer confidence. Until this confidence is restored, likely by a vaccine, treatment and widespread testing, we will have a slow build back to former levels. We at Palo Alto Networks are planning for a 12-18 month time frame for recovery on the consumer end and its flow through impact to our enterprise-level customers. As we see it, consumer spending is ~70% of GDP, so until the consumer recovers, enterprises will definitely share the impact, oftentimes with a delay compared with the consumer impact.

How Does the Workplace Change: There are some aspects that may be permanently affected, specifically the paradigm of employees reporting to the office every day. We believe it is highly likely that various permutations of work from home become the new normal, with not every employee reporting to the office every day and a much broader degree of choice bestowed on individuals to decide where they want to work. To this end, we are striving to address this proactively.

Announcing FLEXWORK: We do not believe the right answer for us all is to stay home forever, nor is it for all of us to rush to work as things open up. We have established a new program at Palo Alto Networks we are calling FLEXWORK, a new way of working for Palo Alto Networks and perhaps for all of us. Initially ***valid till the end of the year***, we will monitor the adoption and behaviors of the workforce to see how we can adapt it for the future. We just published a post on the Palo Alto Networks blog with more details on FLEXWORK[1].

We will continue to open offices around the world as local regulations allow, prioritizing the well-being of our employees as we do so. The significant longer term change we envisage is that our employees must be given the choice regarding how to be most effective in their work. With **FLEXWORK**, a few essential employees will be

[1] https://blog.paloaltonetworks.com/2020/05/flexwork/

encouraged to come in to work, while others will choose how many days they wish to spend in our offices. For employees choosing to work in the office, we will ensure social distancing and all local safety regulations. Over this calendar year, we'll follow how our teams experience and utilize this new policy, and take the opportunity to rethink our workspaces. We're conscious that the gyms, cafes and micro-kitchens that have become the norm in many companies now provide reasons for our employees to be cautious. Some or many of these perks may have to be rethought for the future. Finally, we will help employees enhance their home workspaces, making resources available for key items such as office chairs, external monitors and the like.

We are a company that is guided by our employees, and we will continue to listen to them as we navigate this time together.

Business Impact: The global economy will be substantially impacted by the shutdowns imposed by governments to slow the spread of COVID-19. GDP estimates for 2020 have been universally reduced, and it's highly likely the impact will persist at least through the end of next year, if not beyond. Certain industries such as travel and hospitality will see the largest contraction, and even high performers like technology will not be immune. It is crucial to note the importance of the consumer and also small businesses to the overall health of the economy. Many businesses that rely on consumer strength are likely to be impacted and will follow their own path to recovery, in some cases, pivoting their business more to online. We will need the consumer to return to the marketplace with confidence before global growth can truly resume. There will also be some industries and companies that are poised to benefit. We will likely see their plans and investments accelerate rapidly; we will also see new businesses emerge that we have not yet envisioned.

Technology: On the technology front, we expect businesses to accelerate their technology investments in digital transformation and all the underlying infrastructure and processes to support it. Automation, cloud adoption and remote work will all be prioritized with this focus. These trends will result in a change in networking architectures, which have long been built around security mostly within the context of the data center and users working from secured office premises. In this new architecture, security will become more multifactorial, ubiquitous and standardized.

Businesses that have relied on physical presence – and lots of labor – will need to focus on automation and accelerate their digital transformations across multiple areas, including logistics, pricing and many others. These transitions will be harder to execute until we establish this new rhythm around flexible working. In the new world, digital transformations can be accelerated by cloud transformations, and therefore we anticipate increased activity around our customers moving to the cloud. Remote work infrastructures will need to become more robust and necessary across most organizations; this is not a passing trend. Additionally, we expect a concurrent change in networking architectures to support cloud transformations. ***We see this as an opportunity for us to invest, not to be cautious.***

We also expect a renewed interest in homes being secured. As many of us split our time and work from home, enterprises are keen to ensure that employees are secured at home and not just in the office.

Business Practices: A final note on the overall business landscape: We may experience a contraction in the number of players in the cybersecurity ecosystem, specifically in the number of smaller providers. In these risk-averse times, we believe customers will prefer to work with larger, financially stable partners, who can be on call and help when things go wrong, which they invariably do. Given the uniquely fragmented nature of our industry, we are likely to see more demand by CTOs for reduction of security vendors in the IT stack and potential consolidation as a result. While we believe we are uniquely positioned in this environment, it will become important for the larger players in the industry to innovate.

Outlook for Cybersecurity

Cloud Security: With the acceleration away from physical infrastructure to the cloud, and the broad shift from physical workplaces to remote working, come changes to the attack surface and bad actors. Novel attack vectors will be developed specifically for the cloud. We may see employees rely more on non-corporate-approved IT applications for video, messaging and file sharing, along with the cybercriminals following those pathways seeking opportunities. And to make things harder, cybersecurity has yet to catch up with many of the emergency changes that organizations have rushed to implement. We believe the pace of major data breaches of cloud-delivered services will accelerate, as many InfoSec and DevOps organizations have not yet brought their cloud security posture to the level of their traditional data centers. This will prompt increased investment in cloud security, especially in technologies that secure multi-cloud and hybrid environments.

Artificial Intelligence, Machine Learning and Automation: Traditionally, information security organizations have been accustomed to operating with a high degree of control, as network architectures were clearly defined and slow to change. There has, however, been a substantial amount of integration needed on the customer end. Security has required large SOCs as well as a lot of manual intervention. This will have to change faster. The move to the cloud has introduced uncertainty, with new constituents like DevOps and a new set of vendors, namely the public cloud providers. While businesses accelerate their move away from physical infrastructure to the cloud, and from physical offices to remote work, cybersecurity will need to rely more on technologies that enable InfoSec organizations to operate under uncertainty, namely AI/ML and automation.

Working from Branches and Homes: Moving away from relying primarily on physical offices and physical data centers to emphasizing remote work and the cloud is also accelerating the redesign of wide area networks (WANs). This provides an opportunity to finally realize the long-held vision of networking and network security coming together, as detailed recently by Gartner in their new SASE, or secure access service edge, framework.

Looking Forward: The massive changes that are needed to fit cybersecurity to our new reality provide an opportunity for organizations to pay the technical debt they have accumulated over the last two decades. We believe they will take the opportunity to:

1) Significantly reduce the number of cybersecurity solutions and vendors they have by moving to platforms.
2) Implement consistent security across the entire infrastructure - physical, virtual, and cloud-delivered as well as across network, endpoint, and cloud.
3) Move security from being physical to being delivered in the form of SaaS.
4) Secure the cloud with a single platform.
5) Automate their security operations.
6) Do more for their customers, who will expect more from their security partners, and rightfully so.

Palo Alto Networks Strategy and Vision

Over the last two years, we have been working on our strategy to enable our customers to consolidate their cybersecurity deployments to achieve more optimal and efficient outcomes.

Strata: We've enhanced our network security platform, evolving our Next-Generation Firewall offering from the best Layer 7 security device to a robust platform with a broad set of services like sandboxing, Threat Prevention, Remote Access, URL Filtering, DNS Security, SD-WAN, DLP and soon-to-launch IoT Security. Each of these security services is best in class on its own, yet better when integrated together. These security services are then delivered across our hardware, software and cloud-delivered offerings, meeting customers' evolving architecture needs. This approach is working, and we continue to work hard to deliver the best network security platform.

Prisma SASE: Prisma Access, our cloud-delivered network security service, has been in the spotlight this past quarter, helping customers succeed in the new work-from-home environment. Prisma Access delivers our full set of network security services from the cloud and as a service. This has enabled customers to autoscale up to hundreds of thousands of remote workers and deploy over a weekend. Relatedly, the shift to the cloud is driving a change from backhaul network architectures to a direct-to-app architecture approach. By coupling Prisma Access with our recent acquisition of industry-leading SD-WAN provider CloudGenix, we will provide our customers with the best-in-class solution for securely connecting users to the applications they need, wherever they may be.

Prisma Cloud: We made a bet two years ago that the world would migrate to the cloud, and also that it would be a multi-cloud world, with most companies turning to multiple cloud providers as part of this migration. In the spirit of this vision, we set about acquiring the best businesses and products, and then rapidly integrated them with each other, creating the leading cloud security product in the marketplace and allowing us to get Prisma Cloud in the hands of over 1,500 customers as well as over 40% of the Fortune 100. We aren't finished enhancing Prisma Cloud, with four new integrated modules soon to be added. We believe Prisma Cloud will continue to be the industry leader, with the broadest set of capabilities and the ability to provide cloud security to all customers who are making their journey to the cloud.

Cortex: Finally, our excitement continues to grow for our Cortex products. We looked at the traditional cybersecurity category of endpoint detection and response (EDR), and wanted to expand our ability to detect, respond to and *prevent* the most sophisticated attacks. So we built a new market category – a category where we apply next-generation AI security analytics across multiple data sources and vendors to deliver superior performance to our customers in their security operations center (SOC). We called it Cortex XDR, and the response from customers, analysts and even competitors has been highly complimentary. Additionally, it is our fundamental belief that we need to fight automated attacks with automation, not with more SOC analysts. This has led us to continue to enhance our Cortex XSOAR product with the expansion to Threat Intel Management. We are now able to automate another key function of the SOC. When combined with XDR, we believe this is the beginning of our opportunity to become the SOC solution of the future.

With this momentum in place driving our innovation engine, we believe we are well on our way to achieving our vision of offering the broadest and most tightly integrated set of cybersecurity products available from any company in the market today.

Conclusion

In closing, I believe that our transformation efforts have been prescient over the last two years, even as we face extreme uncertainty due to the global shock caused by the pandemic. To indirectly quote one of my friends and a legendary business leader, the path to stability will be like the waves caused by a tuning fork. The ongoing wave oscillations could, in our estimation, take 12-18 months before moderating, and the impact could be bumpy over the next nine months. We were early in our anticipation of the need to work from home for our employees, and we focused on settling them first. We continue to believe that our excellence depends on their health, safety and motivation, and we intend to leave no stone unturned to keep them in that state. We announced no COVID layoffs early, not just to keep our employees secure but also to ensure we are using this opportunity to invest.

We at Palo Alto Networks continue to work on our transformation, support our customers and build on our product strategies, which have been welcomed by the market. We think we will emerge from this pandemic even stronger, propelled by our efforts and strategic position.

We have a strong balance sheet, robust cash flow generation and have accelerated our profitability plans as evident in our results this quarter. We hope to continue to progress our strategies to achieve our goal of being the largest, most comprehensive, integrated and innovative cybersecurity company in the world.

I am honored to have the opportunity to be a part of the team at Palo Alto Networks.

Nikesh Arora
Chairman & CEO
Palo Alto Networks, Inc.