CLOUDFLARE®

Current Price: $ 99.92
Target Price: $117.61
Upside: 17.70%

Israel Alonge, Kayla Rotondo, Oliver Vulliez

Ticker: NET

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Executive Summary

1   Strong internal customer base growth provides an efficient revenue driver

2   Dominant CDN provider with scalable architecture and large global network provide opportunity for expansion

3   AI tailwind to drive Workers AI utilization and sustain high future growth

Company Overview

7.59M Users

945 Large Company Customers

4.1M Customers

Background

- Cloud Cybersecurity Company
- Established in July 2009
- Headquartered in San Francisco, California

Description

Cloudflare Inc. is an American company that creates and develops software solutions. As a leading connectivity cloud company, they supply cloud cybersecurity, DDoS mitigation, Delivery network services, ICANN-accredited domain registration services. Their goal is to build a better internet for their customers.

Strategy

- Cloudflare creates a simple and cost-efficient process for modern enterprises to move and transition to manage multi-cloud, hybrid cloud, and SaaS solutions on a global scale.
- Protects entire corporate networks to help customers build Internet-scale applications successfully while also accelerating Internet and website applications. They also ensure to keep off DDoS attacks and prevent Hackers
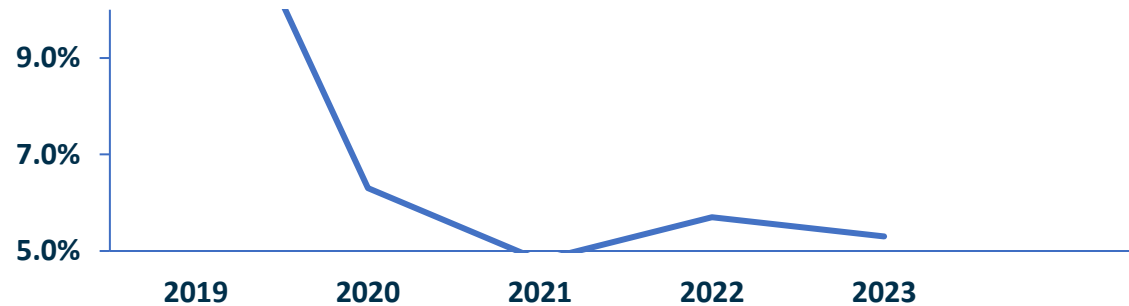
Management

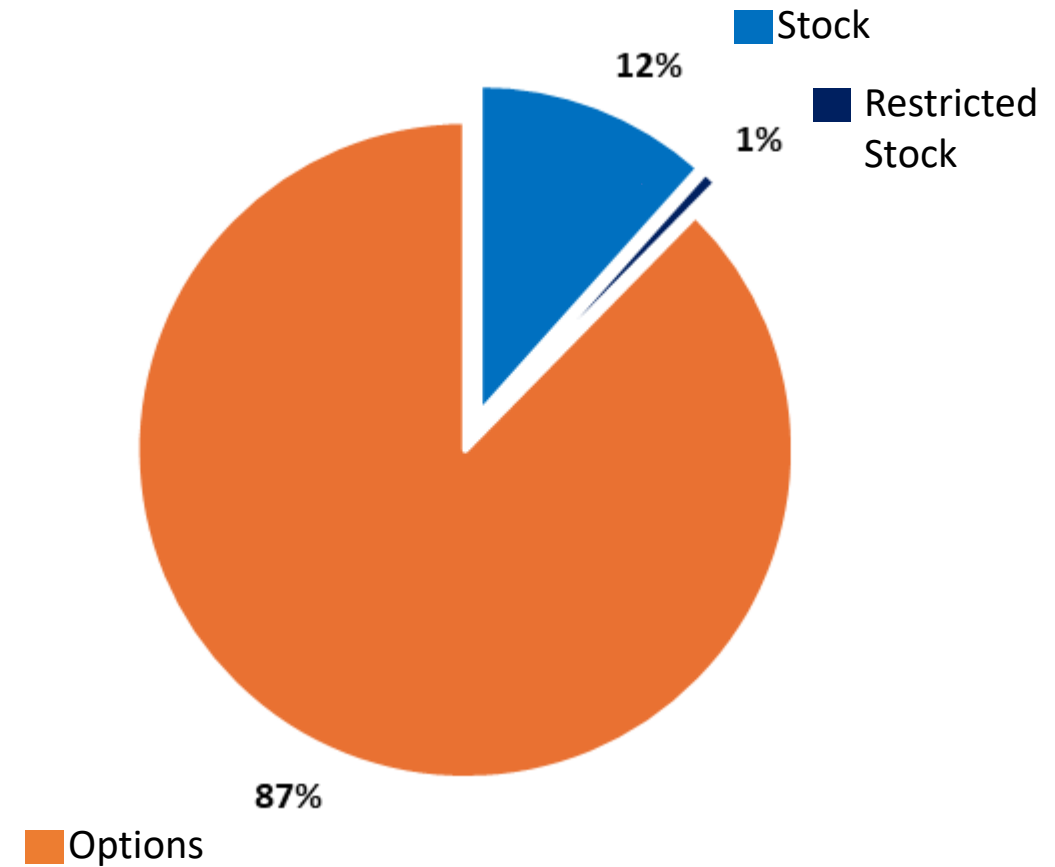**Mark Anderson**
COS (2019)

Matthew Prince
CEO (2003)

Thomas Seifert
CFO (2009)

ROIC

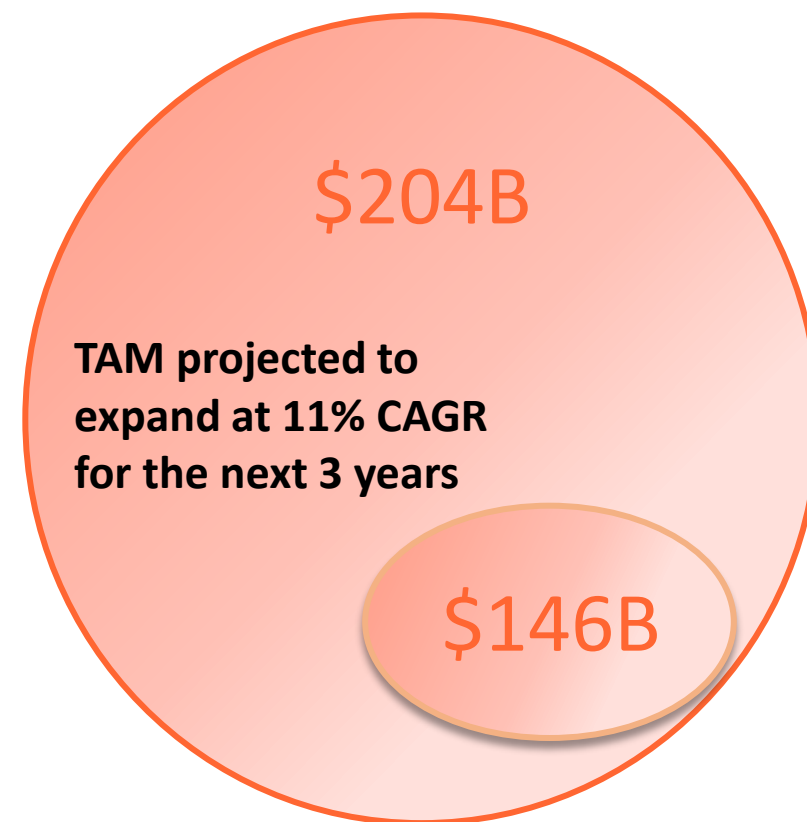## Compensation Breakdown

Stock

Restricted Stock

Options

12%

1%

87%

Market

Cloud Software Industry Overview

- Cloud Software companies create programs and applications that are stored, managed, and available through the cloud
- The cloud consists of servers in data centers all over the world and storing information in the cloud saves companies money and adds convenience for users
- $625.61 billion industry and projected to rise to $2.49 Trillion by 2032

Growth Drivers

- Cybersecurity, AI, and edge computing
- Their Secure Access Service Edge offers a fast and cost-efficient solution to maintaining branch offices and remote workers
- Increased cloud and security spending with larger presence of AI projects
- Their high internet speeds and penetration rates drive their long-term growth

$204B

TAM projected to expand at 11% CAGR for the next 3 years

$146B

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Product Offerings

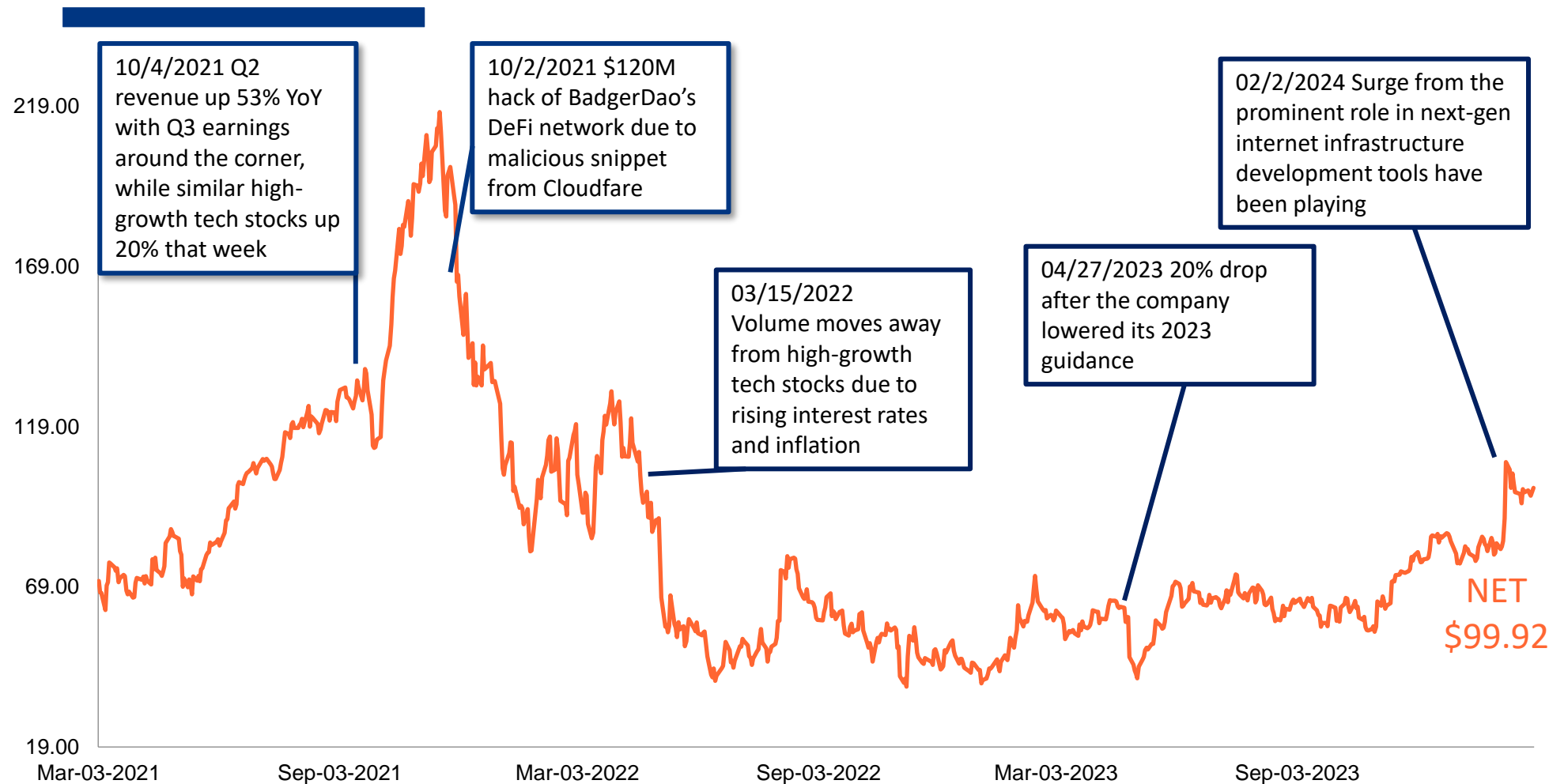|	CDN	Network Security	Storage	Zero Trust
Cloudflare	Offer a 50% reduction in loading times; decreases distance between where content is stored and where needs to go	Provides user-friendly interface and simplified setup processes, making it accessible to wide ranges of users	Their R2 storage permits developers to store large amounts of unstructured data without costly fees	Enforces default-deny access controls across could, filters DNS and HTTP traffic, without performance tradeoffs. Integrated, unified backend architecture
Competitors	Azure	zscaler	amazon S3	verizon
Cloudflare Advantage	Works to decrease loading times through stratification	Offers a comprehensive security platform with advanced features that may require more specialization	Cloudflare monthly storage costs are $0.008 per GB cheaper and free tier offers greater benefits	Blocks cyber attacks and gives trusted user secure access. Services are stitched together and not unified.

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Annotated Stock Price

CLOUDFLARE

Key Takeaways

10/4/2021 Q2 revenue up 53% YoY with Q3 earnings around the corner, while similar high-growth tech stocks up 20% that week

10/2/2021 $120M hack of BadgerDao's DeFi network due to malicious snippet from Cloudfare

03/15/2022 Volume moves away from high-growth tech stocks due to rising interest rates and inflation

04/27/2023 20% drop after the company lowered its 2023 guidance

02/2/2024 Surge from the prominent role in next-gen internet infrastructure development tools have been playing

NET $99.92

Q3 2021 Surge to ATH: Cloudflare stock doubled in 2020, with a Q3 earnings anticipation and historic numbers.
Nov '21 - Jan '22 Decline: Hacked in Nov, -26% in Jan due to tech stock exodus amid geopolitical tensions.
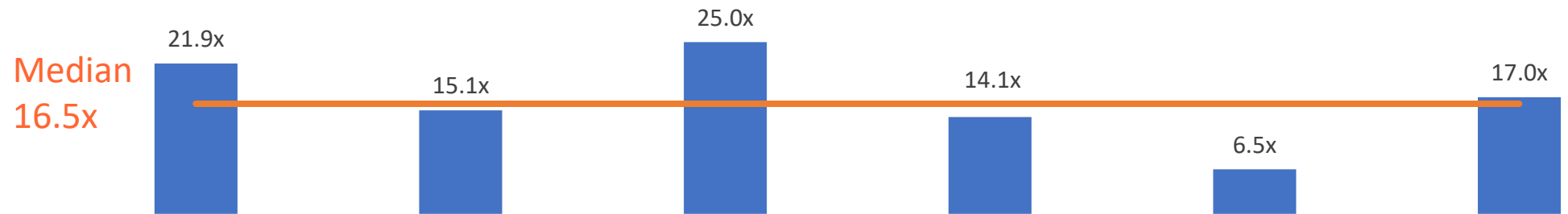**Apr-May '23: 20% Drop:** Integration challenges led to a stock drop after lowering 2023 guidance.
Feb '24: $79 to $110 Gain: Cloudflare's strategic approach, cybersecurity role, and AI contribute to growth

Comparable Companies Valuation

Median 16.5x

	21.9x	15.1x	25.0x	14.1x	6.5x	17.0x

Company	CLOUDFLARE	zscaler	CROWDSTRIKE	paloalto NETWORKS	okta	DATADOG
Market Cap	$33,738	$32,520	$75,550	$97,710	$17,940	$43,220
TEV	33,500	26,518	72,410	96,740	13,010	41,560
Revenue	3,624	5,250	22,410	6,890	6,050	2,130
Revenue Growth	65.1%	35%	28.9%	22.3%	21.8%	25%
Paying Costumers	168,000	5,600	23,019	80,000	17,000	15,200
Gross Margin	77.6%	77.5%	75.1%	74.7%	75.17%	82.22%
Dollar-based Based Net Retention	116%	125%	120%	125%	111%	130%
5 Yr. Beta	1.09	0.85	1.05	1.26	1.15	1.17
FCF Margin	14%	52%	33%	41%	21%	37%

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Organic Customer Growth

Sales Force

- Goal of 130% DNR
- Revamped sales team with addition of Mark Anderson
- Pay-as-you-go model
- 189,000 paying customers
- 2,756 large customers making up 64% of revenue

Significant Growth in Large Customer Cohorts

$100K+ Customers
49% CAGR
2020 2021 2022 2023

$500K+ Customers
70% CAGR
2020 2021 2022 2023

$1M+ Customers
56% CAGR
2020 2021 2022 2023
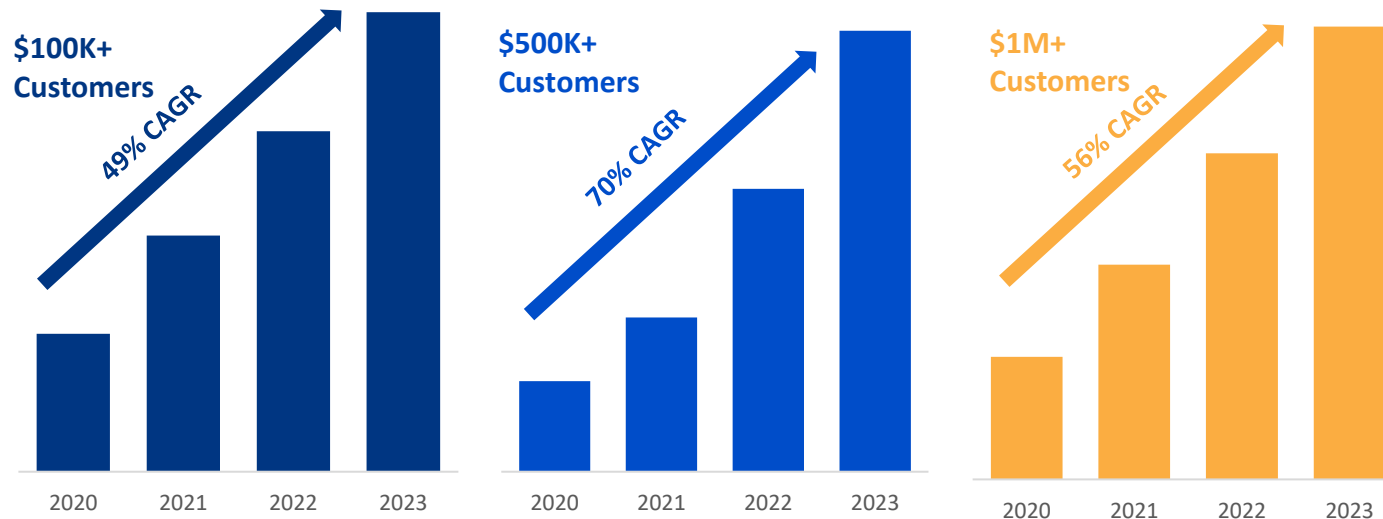
Strong Dollar-Based Net Retention

	Q4 '22	Q1 '23	Q2 '23	Q3 '23	Q4 '23
	122%	117%	115%	116%	115%

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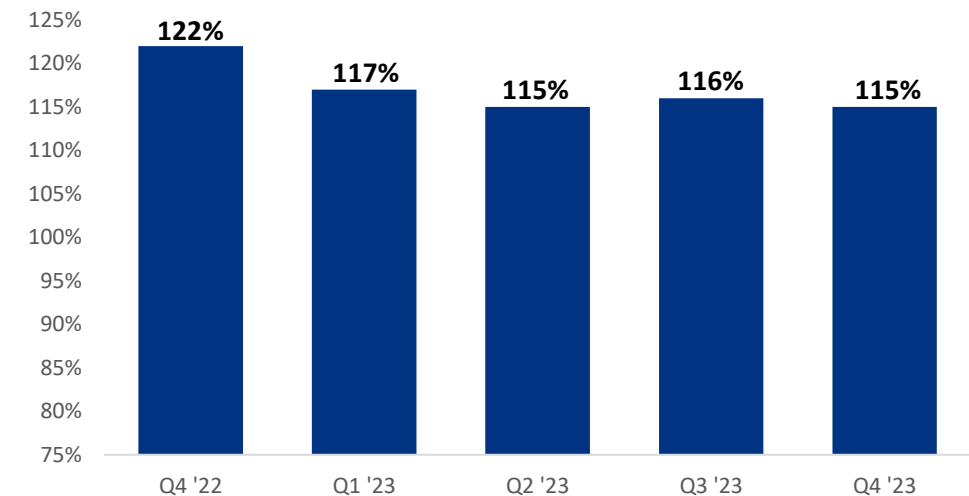
AI Tailwind

Edge Computing

- Brings computing as close as possible to the source of data
- Reduces latency and bandwidth use

Workers AI

- AI inference-as-a-service
- Serverless platform for scaling and deploying AI models
- Begin billing for non-beta models on April 1, 2024
- Optimizes Workers platform

AI Inference

- Follows AI training
- Models are now used to make predictions and produce results

○ Cloudflare Data Center City
● Cloudflare GPU City

End of 2023

CDN Dominance

CDN Market

- $23.25 billion market size
- 18.31% CAGR
- 1,758,127 customer domains - 55% market share of domains
- Used by 20% of all websites

Legend:
- Cloudflare
- Trendline for Cloudflare
- Akamai
- Trendline for Akamai
- Amazon CloudFront
- Trendline for Amazon CloudFront
- Fastly
- Trendline for Fastly
- Google Cloud CDN
- Trendline for Google Cloud CDN

y-axis: % of networks in which the provider is the fastest

Legend:
- Cloudflare
- Akamai
- CloudFront
- Fastly
- Google
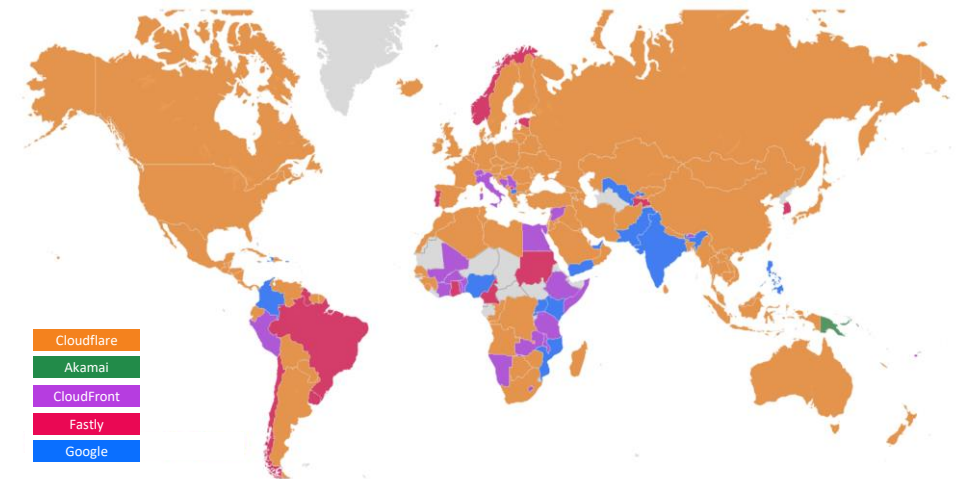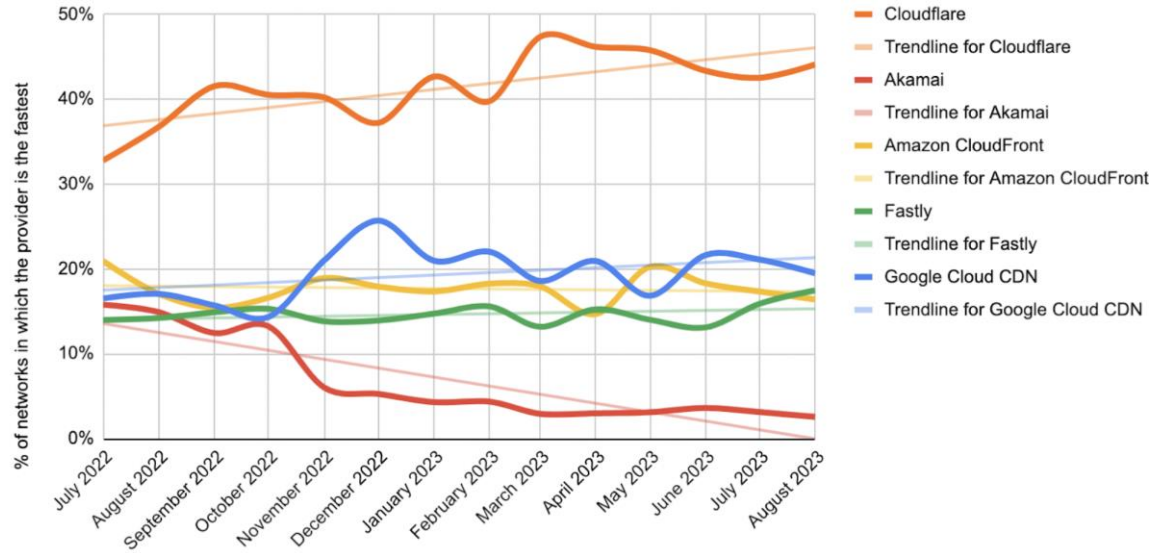
September 2023

Scalability

Global Network

- Data Centers in 300+ cities
- Within ~50 ms of 95% of internet-connected population
- Serves 20% of all internet traffic
- 248 tbps

Go-To-Market Model

Get customers

Add sales reps to service new customer segments

Spend marketing budget
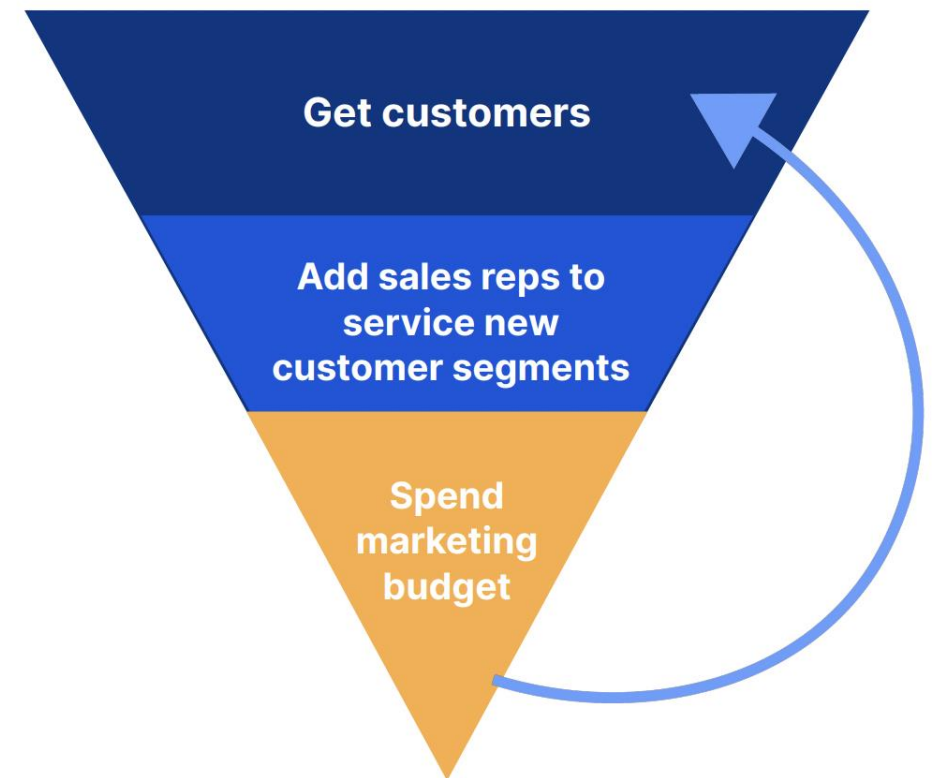
Wall Street Perspectives

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Bears

- February - 14/33 analysts gave the stock a hold rating
- Trading at premium
- Skepticism about attaining GAAP profitability

Bulls

- Argus increased price target by 55% to $124.00
- Gradually improved profitability metrics
- Revamped sales team

Valuation
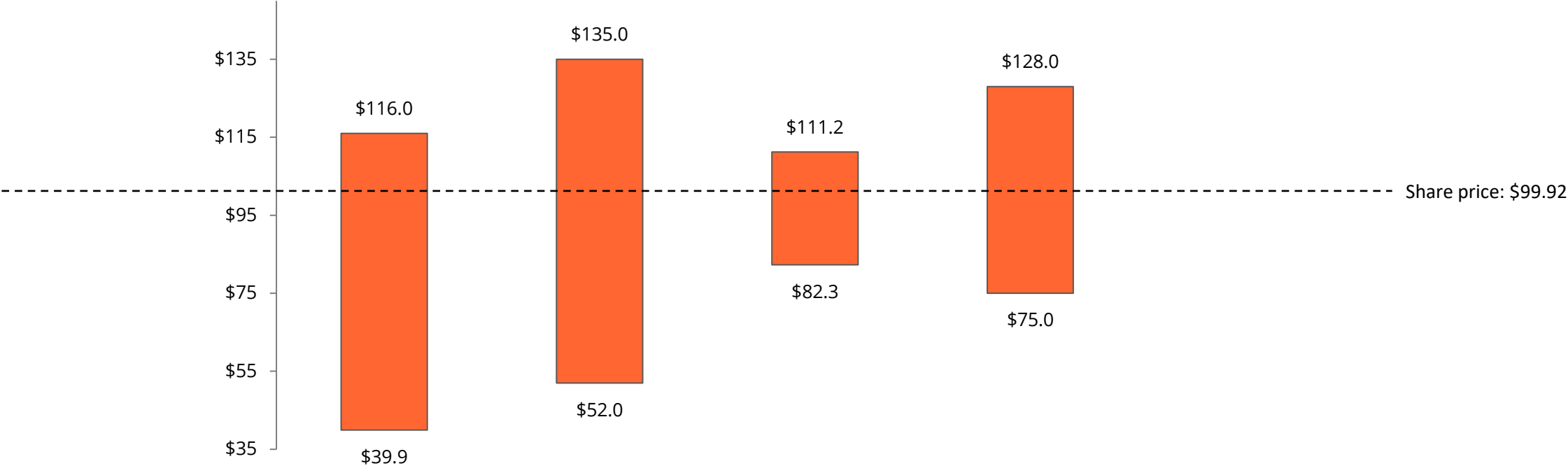
	52 - Week Low - High	Analyst Price Targets As of 3/3/2024	Discounted Cash Flow	Public Comparables EV / Revenue
	High	High	WACC	FY 2023A Revenue
	8.1	5.0	13.98%	$222.2
	Low	Low	Exit Multiple EV/EBITDA	Multiple Range
	3.5	12.0	11.4x - 15.4x	7.0x - 11.9x

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Risk

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Risks
• Inability to efficiently attract new customers and convert free customers to paying customers leading to continued net losses
• Ease of contract terminations due to pay-as-you-go model
• Concentrated revenue with large customers

3 Yr. Beta	Sharpe	Sortino	Treynor
2.48	0.07	0.10	0.001

Annotated P&L

Income Statement	2021A	2022A	2023A	2024P	2025P	2026P	2027P	2028P
Revenue	$656	$975	$1,297	$1,698	2,190	2,781	3,475	4,273
%YoY		*48.6%*	*33.0%*	*31.0%*	*29.0%*	*27.0%*	*25.0%*	*23.0%*
Cost of Revenue	(147)	(233)	(307)	(371)	(478)	(623)	(791)	(996)
% of Revenue	*22.4%*	*23.9%*	*23.7%*	*21.9%*	*21.8%*	*22.4%*	*22.8%*	*23.3%*
Gross Profit	**$509**	**$743**	**$990**	**$1,327**	**$1,712**	**$2,158**	**$2,685**	**$3,278**
Gross Margin %	*77.6%*	*76.1%*	*76.3%*	*78.2%*	*78.2%*	*77.6%*	*77.3%*	*76.7%*
SG&A	(447)	(642)	(817)	(1,036)	(1,292)	(1,585)	(1,912)	(2,265)
% of Revenues	*68.1%*	*65.8%*	*63.0%*	*61.0%*	*59.0%*	*57.0%*	*55.0%*	*53.0%*
R&D	(189)	(298)	(358)	(444)	(539)	(643)	(751)	(860)
% of Revenues	*28.9%*	*30.6%*	*27.6%*	*26.1%*	*24.6%*	*23.1%*	*21.6%*	*20.1%*
EBIT	**($127.3)**	**($197.3)**	**($185.5)**	**($152.5)**	**($119.6)**	**($70.3)**	**$21.6**	**$152.6**
EBIT Margin	*19.4%*	*-20.2%*	*-14.3%*	*-9.0%*	*-5.5%*	*-2.5%*	*0.6%*	*3.6%*

Key Observations

1. The conversion of free customers to paying customers will drive organic revenue growth in a addition to a reinvigorated sales approach with Mark Anderson

2. SG&A margin decrease is driven by ability to efficiently take advantage of already present large free customer base. Significant marketing investments for brand awareness, will decrease as a percentage of revenue as they become more known

3. $55 million increase came from due to 11% increase in headcount, overall hiring growth rate has slowed in each of last 5 years

Allocation

Commentary

- Dollar-cost averaging

- Time horizon: 4-7 years

- Sell Recommendation: AI Inference use cases increase for developers, attained profitability with the help of sustained growth from large customers

Appendix

Base Case

GGM Method	
Terminal Rate	**4.0%**
Sum of PV of Cash Flows	1,868
Terminal Value	12,016
PV of Terminal Value	6,247
Enterprise Value	**$8,116**
(+)Cash	1,674
(-)Debt	1,283
Equity Value	**$8,506**
Shares Outstanding	338
Implied Share Price	$25.19
Current Share Price	$97.48
Implied Upside	-74%

Exit Multiple Method	
Revenue Multiple	**15.0x**
Sum of PF of Cash Flow	1,868
Terminal Value	$64,099.49
PV of Terminal Value	$33,327.62
Enterprise Value	**$35,196**
(+)Cash	1,674
(-)Debt	1,283
Equity Value	**$35,586**
Shares Outstanding	338
Implied Share Price	$105.39
Current Share Price	$99.92
Implied Upside	5.48%

Bull Case

GGM Method	
Terminal Rate	**4.0%**
Sum of PV of Cash Flows	2,706
Terminal Value	19,327
PV of Terminal Value	10,049
Enterprise Value	**$12,755**
(+)Cash	1,674
(-)Debt	1,283
Equity Value	**$13,145**
Shares Outstanding	338
Implied Share Price	$38.93
Current Share Price	$97.48
Implied Upside	-60%

Exit Multiple Method	
Revenue Multiple	**15.0x**
Sum of PF of Cash Flow	2,706
Terminal Value	$83,395.72
PV of Terminal Value	$43,360.41
Enterprise Value	**$46,066**
(+)Cash	1,674
(-)Debt	1,283
Equity Value	**$46,457**
Shares Outstanding	338
Implied Share Price	$137.58
Current Share Price	$99.92
Implied Upside	37.69%

Bull Case

Income Statement	2021A	2022A	2023A	2024P	2025P	2026P	2027P	2028P
Revenue	$656	$975	$1,297	$1,751	2,363	3,167	4,212	5,560
%YoY		48.6%	33.0%	35.0%	35.0%	34.0%	33.0%	32.0%
Cost of Revenue	(147)	(233)	(307)	(383)	(516)	(709)	(958)	(1,295)
% of Revenue	22.4%	23.9%	23.7%	21.9%	21.8%	22.4%	22.8%	23.3%
Gross Profit	**$509**	**$743**	**$990**	**$1,368**	**$1,847**	**$2,457**	**$3,254**	**$4,264**
Gross Margin %	77.6%	76.1%	76.3%	78.2%	78.2%	77.6%	77.3%	76.7%
SG&A	(447)	(642)	(817)	(1,051)	(1,347)	(1,710)	(2,149)	(2,669)
% of Revenues	68.1%	65.8%	63.0%	60.0%	57.0%	54.0%	51.0%	48.0%
R&D	(189)	(298)	(358)	(448)	(558)	(685)	(826)	(980)
% of Revenues	28.9%	30.6%	27.6%	25.6%	23.6%	21.6%	19.6%	17.6%
EBIT	**($127.3)**	**($197.3)**	**($185.5)**	**($130.9)**	**($58.1)**	**$62.4**	**$278.9**	**$615.5**
EBIT Margin	19.4%	-20.2%	-14.3%	-7.5%	-2.5%	2.0%	6.6%	11.1%

Bear Case

GGM Method	
Terminal Rate	**4.0%**
Sum of PV of Cash Flows	1,555
Terminal Value	9,531
PV of Terminal Value	4,956
Enterprise Value	**$6,510**
(+)Cash	1,674
(-)Debt	1,283
Equity Value	**$6,901**
Shares Outstanding	338
Implied Share Price	$20.44
Current Share Price	$99.92
Implied Upside	-80%

Exit Multiple Method	
Revenue	
Multiple	**15.0x**
Sum of PF of Cash Flow	1,555
Terminal Value	$60,356.51
PV of Terminal Value	$31,381.51
Enterprise Value	**$32,936**
(+)Cash	153
(-)Debt	1,283
Equity Value	**$33,327**
Shares Outstanding	338
Implied Share Price	$98.70
Current Share Price	$99.92
Implied Upside	-1.22%

Bear Case

Income Statement	2021A	2022A	2023A	2024P	2025P	2026P	2027P	2028P
Revenue	$656	$975	$1,297	$1,692	2,165	2,716	3,340	4,024
%YoY		*48.6%*	*33.0%*	*30.5%*	*28.0%*	*25.5%*	*23.0%*	*20.5%*
Cost of Revenue	(147)	(233)	(307)	(370)	(473)	(608)	(760)	(938)
% of Revenue	*22.4%*	*23.9%*	*23.7%*	*21.9%*	*21.8%*	*22.4%*	*22.8%*	*23.3%*
Gross Profit	**$509**	**$743**	**$990**	**$1,322**	**$1,692**	**$2,108**	**$2,580**	**$3,086**
Gross Margin %	*77.6%*	*76.1%*	*76.3%*	*78.2%*	*78.2%*	*77.6%*	*77.3%*	*76.7%*
SG&A	(447)	(642)	(817)	(1,049)	(1,321)	(1,630)	(1,971)	(2,334)
% of Revenues	*68.1%*	*65.8%*	*63.0%*	*62.0%*	*61.0%*	*60.0%*	*59.0%*	*58.0%*
R&D	(189)	(298)	(358)	(442)	(533)	(628)	(722)	(810)
% of Revenues	*28.9%*	*30.6%*	*27.6%*	*26.1%*	*24.6%*	*23.1%*	*21.6%*	*20.1%*
EBIT	**($127.3)**	**($197.3)**	**($185.5)**	**($168.8)**	**($161.5)**	**($150.2)**	**($112.9)**	**($57.5)**
EBIT Margin	*19.4%*	*-20.2%*	*-14.3%*	*-10.0%*	*-7.5%*	*-5.5%*	*-3.4%*	*-1.4%*

Product Offerings

	amazon cloudfront	Google Cloud	Microsoft Azure	CLOUDFLARE
Product Description	- Delivers fast, secure websites - Accelerate dynamic content delivery and APIs - Stream live and on-demand video - Distribute patches and updates	- Increases web performance - Uses YouTube infrastructure to bring video streams and large file downloads closer to users for fast and reliable delivery	- Instant access via data warehousing - Application development - AI analyze images - Popular services free for 12 months	- At cost effective price people can develop applications and securely archive data with utmost security - Provides solutions for an organizations external-facing infrastructure to deliver security, performance, and reliability - Develop customer-based solutions