

Pure Storage's Financial Strength: 10% Net Cash Position

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About this article

Ticker PSTG	Analyst rating BUY	Price at publication \$40.96	Last price \$55.33	Change since publication 35.08%	S&P 500 change since publication 5.08%
Days since publication 36					

Summary

I find Pure Storage's investment case compelling, focusing on its valuation dynamics.

Despite a recent adjustment in revenue growth projections, transitioning from mid-teens to 8-10% CAGR, Pure Storage's updated guidance hints at around 22% non-GAAP operating margins in fiscal 2025.

The valuation, at 22x free cash flow, gains appeal when considering Pure Storage's robust financial position, with nearly 10% of its market cap consisting of net cash.

I am Michael Wiggins De Oliveira. I am an inflection investor. I recommend stocks at the point their prospects improve. I lead the investing group [Deep Value Returns](#).



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Investment Thesis

Pure Storage (NYSE:[PSTG](#)) is renowned for its comprehensive lineup of all-flash storage solutions. At the heart of their product portfolio are high-performance, all-flash arrays crafted to accommodate diverse workloads, including mission-critical applications. Simplicity and efficiency in data storage stand out as key focal points in Pure Storage's approach.

The bull case for Pure Storage is found in its strong free cash flows, together with the fact that it holds close to \$1.4 billion of net cash on its balance sheet.

Even though this investment thesis is not blemish-free, I contend that there's a lot to like in this name.

Rapid Recap,

Back in October, I said in a [bullish analysis](#),

I make the case that paying approximately 18x forward free cash flows is reasonable. Yes, there are some minor pesky detractions to this investment thesis, but overall there are a lot more positives than negatives when it comes to this stock.

Stock Covered	PSTG
Analyst's rating at publication	BUY
Price at publication	\$35.62
Change	15.61%
S&P 500 change	13.21%
Analyst's rating history	



Author's work on PSTG

Since that time, the share price has marginally outperformed the S&P500 ([SPY](#)). Indeed, while this may not be a particularly strong performance, I declare that the bull case is now even more clear, this is no longer a growth story, but rather a highly profitable tech company. Thus, here's why I'm bullish on PSTG.

Why Pure Storage? Why Now?

Pure Storage is a leading provider of innovative data storage solutions with a mission to simplify data consumption and interaction. They focus on key market trends, including the adoption of the cloud operating model, the rise of modern cloud-native applications, and the shift towards modernizing data infrastructure through all-flash technology. The company offers a diverse range of products and subscription services designed to support both structured and unstructured data in hybrid cloud environments. Centered around flash-based systems, their technology emphasizes top performance, reliability, and cost-efficiency.

Previously I said,

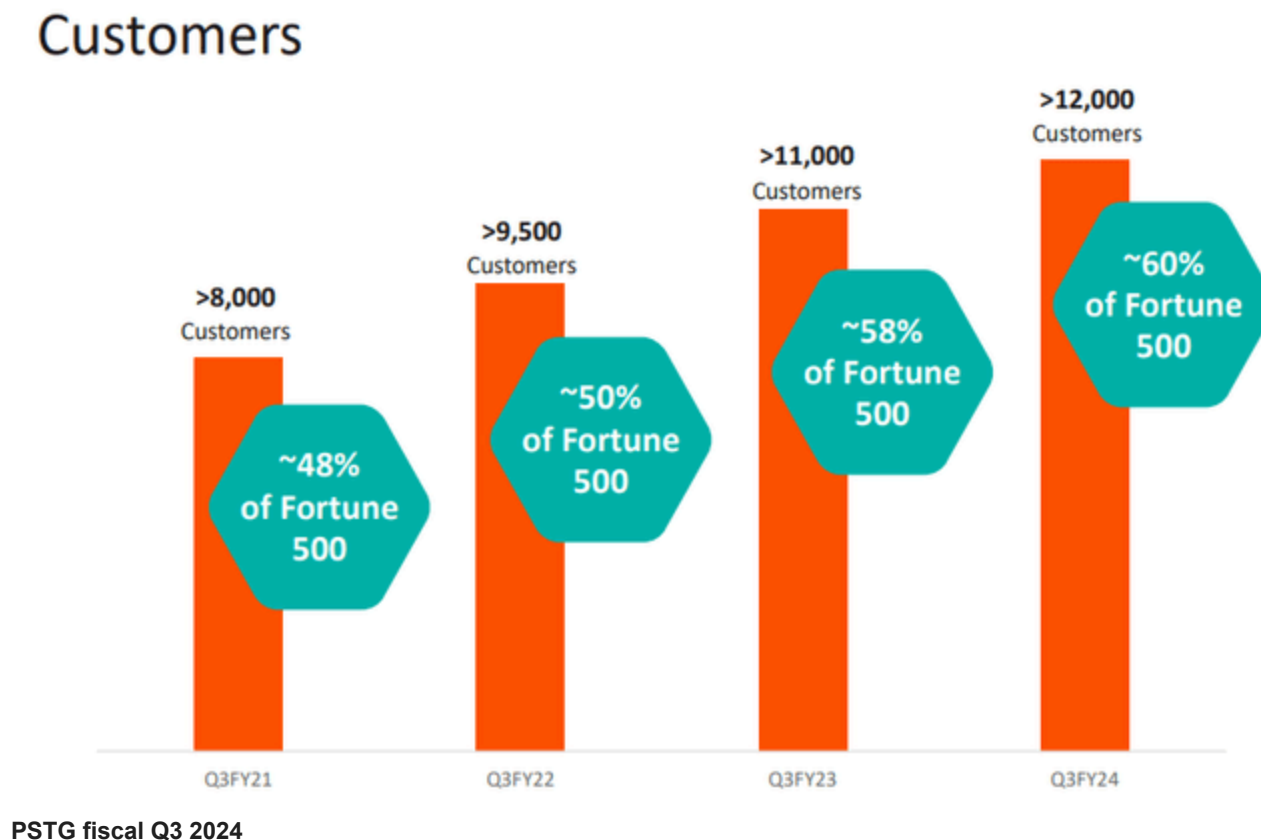
Pure Storage's Evergreen//One platform seeks to streamline customers' data storage and management processes while delivering customers a STaaS business model (storage as a service). Put another way, Pure Storage's Evergreen//One doesn't truly operate on a subscription basis. Rather, they charge customers to access Pure Storage's solutions as a service. In plain English this model charges for actual usage, it's a consumption-based model.

In my experience, I've not found many success stories for companies that charge more per usage. While this type of business model sounds enticing, what happens is that customers are charged more, the more they use the platform. And by the nature of that, it curtails future usage, as nobody likes to be left with an unexpected bill at the end of a period.

During the [earnings call](#) management openly addresses the impact of the change in its business model, stating that

[...] the shift to the consumption model has just continued to be very, very strong. And as you know, this is a model that we've been investing in for well over five years. It's one that we had staked a lot of our anticipation in and moving forward with, but this year has just been very strong. And one could say that it's the macro that has driven greater interest in a consumption model, I think, for obvious reasons, for the customer.

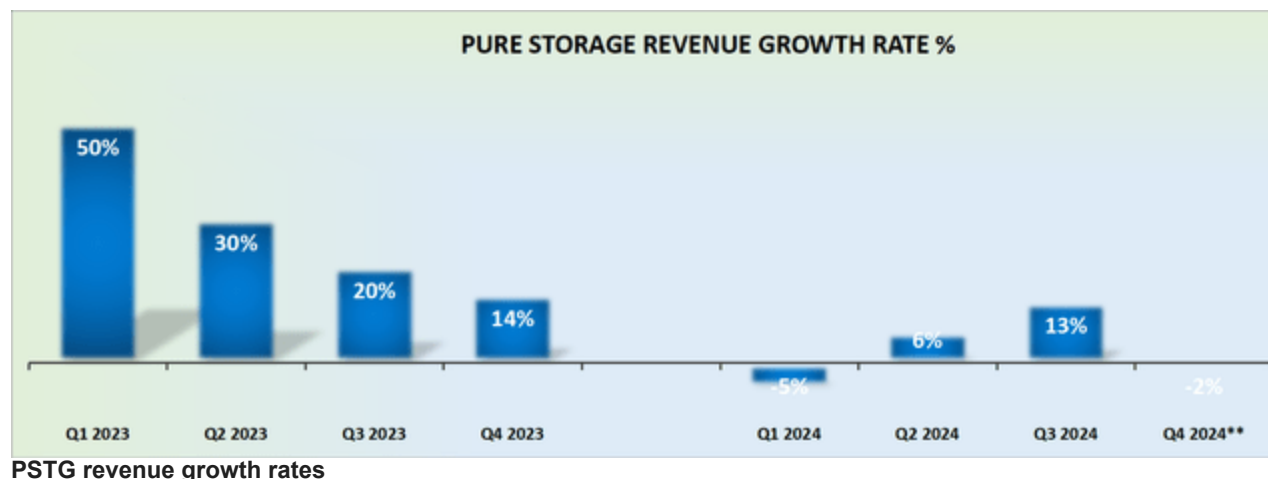
To put my mind at ease, rather than simply relying on management's rhetoric, I like to see how the customer adoption curve is performing, see below.



As you can see above, despite the customer adoption curve clearly slowing down with time, last quarter still saw approximately 9% increase in customers. This reassures me that despite the change to a consumption-based business model, customers are still eagerly flocking to Pure Storage's platform.

Given this background, let's now delve into Pure Storage's financials.

Revenue Growth Rates Surprise, What's Next?



In my previous analysis, I said,

[Pure Storage] is now coming close to being 15 years old which, in the tech industry, is a pretty long time. Particularly when we consider that Pure Storage is ultimately offering a somewhat commoditized storage solution.

That being said, I believe that if Pure Storage can continue to grow at around 13% to 15% CAGR, that means there's still substantial steam left in the tank.

With the benefit of hindsight, this was categorically the wrong call to make on Pure Storage. Indeed, since I penned those words, Pure Storage updated its guidance which is decidedly unenticing. At least on the surface.

This was a business that was previously expected to grow in a sustainable fashion by close to 15% CAGR per year. However, its fiscal [Q4 2024 guidance](#) appears to reflect sustainable revenue growth rates somewhere in the ballpark of 8% to 10% CAGR in the near term, rather than the mid-teens revenue growth rates I previously assumed.

If this investment finished here, I would not continue to recommend this business. But in fact, there's more to this thesis than immediately meets the eye.

PSTG Stock Valuation -- 22x Free Cash Flow

When Pure Storage updated its guidance, the company gave investors the belief that approximately 22% non-GAAP operating margins could be on the cards in fiscal 2025.

As a point of reference, fiscal Q3 2024 saw non-GAAP operating margins of 22.2%, which was 440 basis points higher than Pure Storage had previously guided Q3 2024 to deliver.

Consequently, when Pure Storage guides for fiscal Q4 to see around 19% non-GAAP operating margins, one similarly presumes that management is being conservative, and 20% non-GAAP operating margins could ultimately be reported.

Along these lines, together with some cost-cutting and right-sizing of its operations in fiscal 2025 (starting in February 2024), it appears possible that Pure Storage's free cash flow margins could reach around 19%.

Consequently, I believe that Pure Storage could make around \$600 million of free cash flow in the coming year, leaving the stock priced at 22x free cash flow.

But the real icing on the cake isn't its valuation alone. The fact of the matter is that Pure Storage's market cap is made up of nearly 10% net cash, providing the company with ample flexibility to return capital to shareholders as well as embracing some bolt-on acquisitions.

The Bottom Line

In wrapping up my assessment, Pure Storage emerges as a captivating investment prospect, particularly noteworthy for its valuation. Although the company recently adjusted its revenue growth projections, transitioning from the initially anticipated mid-teens to a more conservative 8-10% CAGR, the investment thesis remains compelling.

Despite Pure Storage offering a somewhat commoditized storage solution, the updated guidance hinting at around 22% non-GAAP operating margins in fiscal 2025 introduces an appealing element.

The valuation aspect becomes even more enticing at 22x free cash flow, especially considering the company's strong financial position. With nearly 10% of its market cap comprising net cash, Pure Storage enjoys substantial flexibility for potential shareholder returns and strategic acquisitions. This financial strength adds an attractive layer to the investment opportunity, making Pure Storage a potentially lucrative prospect in my view.

This article was written by



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Michael Wiggins De Oliveira is a tech specialist with a passion for the energy transition. Leveraging his expertise as an inflection investor, Michael excels in analyzing numerous companies to identify optimal investment opportunities with a balanced risk-reward ratio. His insightful approach has garnered a substantial following, exceeding 40,000 followers on platforms like Seeking Alpha and beyond.

Michael is the leader of the investing group [Deep Value Returns](#). Features of the group include: Insights through his concentrated portfolio of value stocks, timely updates on stock picks, a weekly webinar for live advice, and "hand-holding" as-needed for new and experienced investors alike. Deep Value Returns also has an active, vibrant, and kind community easily accessible via chat. [Learn more](#).

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