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A 5% beat on product revs driven by stability in the core and reassuring commentary on Iceberg tables impacts likely spurs a relief rally. However, we need to see evidence SNOW maintains a leadership position in this new Intelligence Cloud world before getting more fundamentally positive. EW.

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Key takeaways

- Q3 product revenue growth of 29% YoY was above expectations and the beat magnitude rose from ~3% in Q2 to ~5% in Q3
- Q4 product revenue guidance of 23% YoY came well ahead of consensus, inspiring growth bottomed assuming a similar product revenue beat
- The expanded beat magnitude and near-term setup, traction on the data engineering opportunity, and limited Iceberg headwinds bias us more positively near-term
- That said, an uneven beat cadence, limited FY26 upside, and a fundamentally changing data warehouse market keep us from getting more constructive
- At 11x EV/CY26 revs or 0.51x growth-adjusted, below Large Caps at 0.66x, remain on the sidelines looking to garner conviction in long-term positioning
- **COMPANY DATA**
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    - Snowflake Inc. (SNOW.N, SNOW UN)
    - Software |United States of America

Stock Rating	Equal-weight
Industry View	Attractive
Price target	$190.00
Shr price, close (Nov 20, 2024)	$129.12
Mkt cap, curr (mm)	$47,274
52-Week Range	$237.71-107.13

One Quarter Does Not Make a Trend, But That Was a Really Solid Quarter. Against a rising wall of worry, Snowflake's solid Q3 print likely brings a large sigh of relief for investors as: 1) accelerating query volumes largely stabilized product revenue growth – +28.9% in Q3 versus +29.5% in Q2, 2) Snowpark remains firmly on track to represent 3% of revenues in FY25 or ~$100 million in revenues, 3) despite >500 accounts having adopted Iceberg tables, the company sees higher query volumes more than offsetting any reductions in storage revenues (which remained at 11% of product revenues) and 4) a Q4 guide at 23% YoY, which would imply stable product revenue growth in the forward quarter if Snowflake puts up the same magnitude of beat as Q3. Additionally, after talking up investment (and talking down margins) earlier in the year, Snowflake looks to have found areas for efficiency improvements to help offset new investments. This dynamic left overall QoQ headcount growth at 193, well below the average of 313 adds seen in the first half of the year, and enabled operating margins at 6.3% to exceed consensus by 290 bps (although still down 350 bps YoY). A stabilized core business, steadily increasing contributions from Data Engineering solutions, new found operating leverage in the model, management talking to "shoots of grass" in the AI portfolio and the stock still trading at a discount to the large cap group average EV/Sales/Growth multiple (even after hours) seems to beg the question ***'why not get more constructive on the shares here?***'

Three dynamics keeping us on the sidelines for now (albeit with a positive bias):

1. **Still Working to Define the Trendline**: Through this year, we have seen a 5% product revenue beat in Q1, a 2% beat in Q2 and now bounced back to a 5% beat in Q3. It would be easier to call Q2 an outlier if we had a better sense of what dragged on performance in the quarter, or vice versa what drove the rebound in Q3. This may just be the inherent volatility investors should expect in a consumption based pricing model.

2. ***Consensus for FY26 May Still Be Too High***. While seeing increased stability in product revenue growth in the quarter and the biggest QoQ add of product revenues in the company's history (+$71 million, up 22% YoY) on a year-to-date basis incremental product revenues are up 7% YoY (adjusting for the leap year). Assuming a similar product revenue beat in Q4, and a 7% growth in incremental product revenues in FY26, puts the forward year product revenue growth at 24% YoY or spot in-line with current consensus.

3. **The Data Warehouse Market is Fundamentally Changing**. With the architectures and supporting technologies within the Data Management business evolving so quickly (see our report, 'The Intelligence Cloud Emerges for the Era of AI Applications', 05/30/24), stability in the core analytics business may not be enough for investors to get fundamentally on board with the story. Over the past year, we have seen Snowflake accelerate their pace of innovation, expand their core data architecture materially, bolster the Data Engineering capabilities of the platform and build out tooling specific to the GenAI use case. This quarter shows promising signs of traction, with Data Engineering solutions now at a $200 million revenue run-rate, >500 customers adopting Iceberg tables and >3,200 customers exploring the AI tooling Snowflake has brought to market. A firmer conviction in Snowflake's positioning within this new Intelligence Cloud world remains key to gaining conviction in the durability of growth going forward.

Bottom Line: Tactically Positive, Strategically Still on the Fence. Accelerating query volumes, net positive initial impacts from Iceberg tables, and solid uptake of the broadening set of Data Engineering tools within the installed base all make it easier to get on board with a near-term stabilization in product revenue growth. Garnering conviction Snowflake will maintain the same competitive momentum in this new Intelligence Cloud landscape as they enjoyed in the traditional analytics world remains a work in progress. That said, even at after hours prices, trading at 10.6X EV/CY26 Sales or 0.5X EV/Sales/Growth valuation does not feel stretched against a median Large Cap Software EV/Sales/Growth multiple at 0.66X. Moving our basis year out to CY26, with a slightly lowered discount rate, but lower expectations on FCF margins expansion takes our price target from $175 to $190. We remain on the sidelines looking for additional evidence of traction across the broader solution portfolio to garner conviction in that long-term positioning.

What Worked Well in F3Q:

- **Strongest Beat on Product Revenue YTD.** Product revenue of $900 million beat by ~5.5% - the largest beat YTD. This resulted in YoY growth 29% which implies <100 bps of YoY decel compared to Q2 growth of ~30%.
- **Query Volume Growth Accelerates.** Average daily query volume for the month of October was 6.3 billion, up 75% YoY. We estimate that total query volume in Q3 was up 71% YoY compared to 69% in Q2.
- **Large Customer Performance Improves QoQ.** Snowflake added 18 Global 2000 customers in Q3 vs. just 3 in Q2 bringing the total to 754 (+8% YoY). The company added 32 customers spending in excess of $1 million in product revenue – up from 26 added in Q2, brining the total to 542 which was up 25% YoY.
- **Q4 Product Revenue Guidance Ahead of Consensus.** Q4 product revenue guidance of $906-$911 million, which implies growth of +23%, was ahead of MSe/cons of $884/$894 million. Management guided Q4 product revenue ~+1% QoQ at the midpoint, below the ~3%% QoQ guide the same period the prior year.
- **Q3 Margins Ahead of Estimates.** Operating margin of 6.3% was well ahead of MSe/consensus of 2.9%/3.4%, reflecting top-line outperformance and slower than expected hiring.

What We Are Watching:

- **New Customer Additions Slow QoQ.** The company added 404 net-new customers in Q3 (vs. 441 net new customers in Q2) bringing the total 10,618, which was up 20% YoY.
- **Revenue per Query Declines.** While query volume growth accelerated in Q3, we estimate that revenue per query declined -24% YoY vs. -23% YoY in Q2, as the mix shifted towards "lighter" queries.
- **Q3 FCF Misses and Reiterated FY25 FCF Margins.** Q3 FCF of $87 million was well below MSe/consensus $116/$116 million. For FY25, management reiterated its FCF margin outlook of 26% while operating margin guidance was raised from ~3% to ~5%.