Fortinet Q2 2025 Earnings Prepared Remarks

<u>Aaron Ovadia, Senior Director, Investor Relations</u>

Thank you and good afternoon everyone. I am pleased to welcome everyone to our call to discuss Fortinet's financial results for the second quarter of 2025.

Joining me on today's call are Ken Xie, Fortinet's Founder, Chairman, and CEO, Christiane Ohlgart, our CFO, and John Whittle, our COO.

Ken will begin our call today by providing a high-level perspective on our business. Christiane will then review our financial results for the second quarter of 2025 before providing guidance for the third quarter and updating the full year. We will then open the call for questions.

During the Q&A session, we ask that you please limit yourself to one question and one follow up question to allow others to participate.

Before we begin, I'd like to remind everyone that on today's call we will be making forward-looking statements and these forward-looking statements are subject to risks and uncertainties which could cause actual results to differ materially from those projected.

Please refer to our SEC filings, in particular the risk factors in our most recent Form 10-K and Form 10-Q, for more information.

All forward-looking statements reflect our opinions only as of the date of this presentation and we undertake no obligation, and specifically disclaim any obligation, to update forward-looking statements.

Also, all references to financial metrics that we make on today's call are non-GAAP, unless stated otherwise. Our GAAP results and GAAP to non-GAAP reconciliations are located in our earnings press release and in the presentation that accompany today's remarks, both of which are posted on our investor relations website.

As a reminder, this is a live call that will be available for replay via webcast on our investor relations website. The prepared remarks will also be posted on the Quarterly Earnings section of our investor relations website following today's call.

Lastly, all references to growth are on a year-over-year basis, unless noted otherwise.

I will now turn the call over to Ken.

Ken Xie, Founder, Chairman and CEO

Thank you, Aaron, and thank you to everyone for joining our call.

We are pleased with our strong second quarter performance, beating both our billings and operating margin guidance. Building on this business momentum, we are raising our full year billings outlook.

In the second quarter, billings grew by 15% and revenue grew by 14%, and we achieved a strong non-GAAP operating margin of 33%.

Our strong top-line results were driven by continued momentum among large enterprise customers, with the total value of deals over $1 million increasing by more than 50%. This growth reflects the strength and value of our innovation, the rising global demand for our integrated solutions, and the impact of our go-to-market investments.

Additionally, our recent investments in the fast-growing markets of Unified SASE and AI-driven Security Operations are continuing to deliver strong returns as billings for both grew by over 20%, to a combined 35% of total billings.

Fortinet's strong momentum in SASE has been recognized by industry analysts, as we were recently named a Leader in the 2025 Gartner Magic Quadrant for SASE Platforms, while also ranking #1 in the secure branch network modernization case. We are the only vendor in the report that is also recognized in five different network security Magic Quadrants, which all run on our unified FortiOS.

We continue to be the only vendor that has developed all the core SASE capabilities in a single operating system, FortiOS, including Next-Gen Firewall, SD-WAN, ZTNA, Secure Web Gateway, CASB, and DLP. This native integration of Next-Gen Firewall, SD-WAN, and SASE is becoming the New-Generation SASE Firewall, making it easy for customers to adopt and upgrade while reducing complexity and operating costs, enhancing user experience, and ensuring integrated, hybrid secure access across both on-premises and cloud environments.

Our success in Unified SASE reflects the value customers place in our New-Generation SASE Firewall, beginning with their investment in our industry-leading FortiGate firewall built on our FortiASIC. From there, most large enterprises expand into our secure SD-WAN capabilities before advancing to our FortiSASE solution. As a result, 13% of our large enterprise customers have purchased FortiSASE, an increase of over 60% year over year.

Furthermore, we have invested around $2 billion to build and operate a globally owned infrastructure, spanning around 5 million square feet across data centers, NOC and SOC customer support centers, executive briefing centers, and research and development facilities. This large-scale footprint gives us a competitive advantage in delivering FortiSASE, FortiCloud, and other cloud services. By owning and managing our infrastructure, we ensure better customer experience, better cost efficiency, stronger data sovereignty, and high performance at scale. We also leverage our FortiStack technology to provide enhanced security and better management across our SaaS services.

Today, we announced that we are expanding our FortiCloud offering with three new services: FortiIdentity, FortiDrive, and FortiConnect. These services are natively integrated into the Fortinet Security Fabric, providing centralized visibility, consistent policy enforcement, and real-time threat protection across users, devices, applications, data, and AI agents.

In OT Security, where we achieved billings growth of over 20%, we were recently named the Overall Leader in the Westlands Advisory IT/OT Network Protection

Platform Navigator 2025 report for the third time in a row, earning the highest ranking in both strategic direction and technical capability.

We continue to invest in our AI capabilities, which we began developing more than 15 years ago and hold over 500 issued and pending AI patents, more than any other competitor. Our latest AI innovations include FortiAI-Protect for advanced threat detection, FortiAI-Assist for automating security tasks, and FortiAI-SecureAI for protecting AI infrastructure. As a result of our investments and recent innovations, our AI add-on solutions are the fastest growing part of our business.

I would like to thank our employees, customers, partners, and suppliers worldwide for their continued support and hard work. I'll now turn the call over to Christiane.

Christiane Ohlgart, CFO

Thank you, Ken, thank you Aaron, and good afternoon, everyone.

As Ken mentioned, Fortinet's growth and momentum are strong. We beat our billings and operating margin guidance for the second quarter and raised our full year billings outlook.

Total billings grew by 15% to $1.78 billion, driven by 21% growth in Unified SASE and 31% growth in SecOps. Unified SASE and SecOps now account for 24% and 11% of total billings, respectively, up 1 point each.

Our strong billings growth was driven by continued momentum in expanding into the large enterprise, as the number of deals greater than $1 million increased by 29%, while their total dollar value grew by 51%.

Among our top 5 verticals, financial services, the vertical with arguably the most sophisticated and discerning security purchasers, led the way with billings growth of over 30%.

In addition, we continued to expand our customer base - over 6,900 new organizations chose our unified, single FortiOS platform to power their cybersecurity strategy. The robust growth in new customers is a clear testament to our strong position in the SMB market, driven by the continued commitment and loyalty of our channel partners.

Total RPO grew by 12% to $6.64 billion, while current RPO grew by 15% to $3.45 billion.

With regards to ARR, Unified SASE increased by 22% to $1.15 billion and SecOps increased by 35% to $463 million. Within Unified SASE, FortiSASE, our SSE solution, delivered strong results with ARR growth of over 100% while the customer base expanded by 65%.

Furthermore, adoption momentum has remained strong as 13% of our large enterprise customers have purchased FortiSASE, highlighting our continued expansion of FortiSASE in our customer base.

As a reminder, the typical customer journey begins with the purchase of our FortiGate firewall. From there, customers often expand to our integrated Secure SD-WAN solution before adopting our single-vendor SASE offering, reflecting the growing convergence of security and networking. Over 50% of our FortiSASE customers also leverage our SD-WAN solution, while 90% of our large enterprise FortiSASE customers began their journey with SD-WAN, reflecting the value of our integrated platform approach and the convergence of security and networking.

Total revenue grew by 14% to $1.63 billion, led by EMEA with growth of 18%, while the Americas and APAC both grew by 11%.

Product revenue increased by 13% to $509 million, benefiting from upgrade buying and strong growth in Operational Technology. We saw growth in all geos as we continue to lead the cybersecurity industry in product revenue.

Software license revenue grew at a high-teens rate and accounted for a high-teens percentage of total product revenue.

Service revenue grew by 14% to $1.12 billion. Service billings grew by 17%, our highest growth rate in the past 6 quarters, reflecting many enterprise agreement renewals, as our loyal customers continue to invest in our solutions and benefit from our strong track record of innovation.

Now, I'd like to highlight some 7-figure deals that demonstrate how customers are adopting FortiSASE, consolidating networking and security, and expanding their overall footprint with Fortinet…

First, an educational institution in APAC purchased solutions across all three of our pillars, including FortiSASE for 3,000 users. This customer chose Fortinet over the competition for our simplified, flexible, and consistent security enforcement, enabling secure access to both on-premises and cloud applications while delivering a seamless user experience. By leveraging FortiOS and FortiSASE, the school achieves superior performance, reduced total cost of ownership, and simplified operations through our integrated security platform.

Next, in an expansion and displacement deal, a leading retailer with 1,700 locations significantly increased their investment in Fortinet, purchasing solutions across all three pillars, including FortiAPs, FortiSwitches, and FortiAIOps. Already a FortiGate customer with firewalls deployed at every location, the retailer selected FortiAPs for all sites and FortiSwitches for 600 locations, with the remainder planned for early 2026. This customer chose Fortinet for our integrated FortiOS operating system, which enables seamless convergence of networking and security. As part of the deployment, they adopted FortiAIOps to proactively manage their access points and switches, leveraging our AI-driven capabilities to improve operational efficiency.

In another large deal, a top U.S. school district expanded its footprint with the purchase of FortiGates, FortiSwitches, and FortiAPs as part of a 350-plus site refresh, displacing multiple vendors. Already utilizing solutions across all three of our pillars, including FortiSASE, the district continues to invest in Fortinet to drive deeper network segmentation, stronger security outcomes, and greater infrastructure resiliency. Due to their continued consolidation on Fortinet products, they're realizing significant operational benefits, including simplified guest access, accelerated deployments, and more efficient upgrade cycles, all managed through our unified FortiOS platform.

Lastly, a technology company upgraded a portion of their high-end firewalls as a result of the upcoming 2026 end-of-support deadline and expanded their deployment with additional FortiGate appliances in the data center. They selected Fortinet for our FortiOS operating system, which enables streamlined operations while delivering a lower total cost of ownership.

Turning to margins and cash flow….

Total gross margin increased by 10 basis points to 81.6% and exceeded the high-end of the guidance range by 60 basis points, due to strong execution and cost control.

Product gross margin of 67.8% increased by 180 basis points as inventory related charges normalized.

Service gross margin of 87.8% was down by 80 basis points, due to increased investments associated with the expansion of our hosted security solutions.

Operating margin of 33.1% decreased by 200 basis points, while being 60 basis points above the high-end of our guidance range. The year over year decline reflects increased investments in sales headcount, the absorption of costs from recent acquisitions, and foreign exchange headwinds stemming from a weaker U.S. dollar, as most of our operating expenses are denominated in foreign currencies.

Free cash flow was $284 million, and Adjusted Free Cash Flow was $428 million, up $104 million. Cash generation in the first half of the year was very strong with Adjusted Free Cash Flow reaching $1.27 billion, representing a margin of 40% year-to-date.

Infrastructure investments were $168 million, up $145 million, as we continue to build out our infrastructure footprint to support FortiSASE, FortiCloud, and other services.

We repurchased approximately 4.6 million shares of our common stock for an aggregate cost of $401 million in the second quarter. The remaining share buyback authorization as of today is approximately $1.6 billion.

Before moving on to guidance, I'd like to provide an update on our firewall upgrade cycle and the broader macroenvironment...

During our Analyst Day last November, we shared that approximately 650,000 firewall units will reach end-of-service by the end of 2026, followed by another cohort of 350,000 low-end units in 2027. While the 2027 cohort is less significant than the 2026 cohort in terms of product revenue due to its lower price point, firewall upgrade discussions offer valuable opportunities to engage with both our customers and channel partners, allowing us to showcase our ongoing innovation in FortiOS. By upgrading to our New-Generation SASE Firewalls, customers gain enhanced security capabilities and benefit from our unified platform approach.

We estimate that we are approximately 40% to 50% of the way through the 2026 upgrade cycle at the end of the second quarter, based on the remaining active units and service contracts, and we expect continued upgrade activity for the remaining devices over the next 6 quarters. Our focus and open communication regarding the refresh allow us and our channel partners to have conversations with our customers around both the upgrade and the customers' overall security strategy, benefiting us longer term.

Despite ongoing uncertainty surrounding tariffs and the global economic outlook, we have not experienced a negative impact on our business. The cybersecurity market and the demand for our solutions remain strong and resilient.

Now moving onto guidance…

As a reminder, our third quarter and full year outlooks, which are summarized on slides 17 and 18, are subject to the disclaimers regarding forward-looking information that Aaron provided at the beginning of the call.

For the third quarter, we expect:

- Billings in the range of $1.760 billion to $1.840 billion, which at the midpoint represents growth of 14%,
- Revenue in the range of $1.670 billion to $1.730 billion, which at the midpoint represents growth of 13%,
- Non-GAAP gross margin of 80.0% to 81.0%,
- Non-GAAP operating margin of 32.5% to 33.5%,
- Non-GAAP earnings per share of $0.62 to $0.64, which assumes a share count between 772 and 776 million,
- Infrastructure investments of $110 to $130 million,
- A non-GAAP tax rate of 18%, and
- Cash taxes of $60 to $90 million.

As a result of our strong results in the first half of the year, we are pleased to have raised the midpoint of our full year billings guidance by $100 million. We maintained our total revenue guidance while adjusting the revenue mix by shifting $50 million from service to product revenue.

Despite this shift towards product revenue for the full year, we maintained our gross margin range and slightly increased our operating margin guidance midpoint. We continue to remain on track to achieve the 'Rule of 45' in 2025 for the 6th consecutive year.

For the full year, we expect:

- Billings in the range of $7.325 billion to $7.475 billion, which at the midpoint represents growth of 13%,
- Revenue in the range of $6.675 billion to $6.825 billion, which at the midpoint represents growth of 13%,
- Service revenue in the range of $4.550 billion to $4.650 billion, which at the midpoint represents growth of 14%,

- Non-GAAP gross margin of 79.0% to 81.0%,
- Non-GAAP operating margin of 32.0% to 33.5%,
- Non-GAAP earnings per share of \$2.47 to \$2.53, which assumes a share count of between 773 and 777 million,
- Infrastructure investments of \$380 to \$430 million,
- Non-GAAP tax rate of 18%, and
- Cash taxes of between \$400 million and \$450 million, which is \$125 million lower than our prior expectation primarily due to new tax law changes.

I'll now hand the call back over to Aaron to begin the Q&A session.

Closing Remarks: Aaron Ovadia, Senior Director, Investor Relations

Thank you. I'd like to thank everyone for joining today's call.

We will be attending investor conferences hosted by Deutsche Bank, Citi, and Goldman Sachs during the third quarter. The fireside chat webcast links will be posted on the Events and Presentations section of our investor relations website.

If you have any follow-up questions, please feel free to contact me.

Have a great rest of your day!