Fortinet – Analyst Day 2021
Keith Jensen, CFO
March 9, 2021

Slide 1: Analyst Day – Finance Update

Good morning, everybody. Thank you very much for being here today for Fortinet's analyst and investor day. And I am indeed Keith Jensen, our CFO.

Slide 2: Safe Harbor Statement

As I begin our presentation, I'd like to share our safe Harbor slide and highlight that I'll be making forward looking statements today.

These forward looking statements are subject to risks and uncertainties, which could cause actual results to differ materially from those projected. All statements made today reflect our opinions only as of the date of this presentation and we undertake no obligation and expressly disclaim any obligation to update forward looking statements in light of new information or future events.

Slide 3: Agenda

Let's take a quick look at the agenda. I'll start by highlighting our investment thesis. Discuss several of our industry and company specific growth drivers. And then review our financial performance for the past several years. I'll wrap up by highlighting how the diversification of our business model and customer base has led to our very consistent and highly predictable financial performance.

Finally, I'll conclude by providing our medium-term financial model and we'll follow the presentation with a 30-minute Q and A session with our senior management team.

Slide 4: Investment Thesis

Throughout this presentation, you will hear several recurring themes about the cybersecurity market, what uniquely positions Fortinet as an industry leader, and the drivers of our consistent and sustainable growth, profitability, and cash flow generation.

Cybersecurity is a massive market with growth driven by long-term secular tailwinds. Fortinet is an industry leader with our proprietary ASIC technology and integrated platform, enabling us to secure people, devices and data anywhere and in any form factor.

Our revenue is diversified across geographies, customer segments and industry verticals.

With service revenue representing nearly two-thirds of total revenue, we have a sizeable recurring revenue base driving sustainable and predictable financial results, and a margin profile that leads to significant free cash flow.

Slide 5: Who We Are

Fortinet's history of innovation has spanned more than 20 years.

Our strategy of build versus buy, consistent financial performance and conservative financial policies have led us to where we are today.

More than $3 billion in annual buildings, free cash flow of over $900 million, non-GAAP gross margins approaching 80%, non-GAAP operating margins in excess of 25%, and having just reported our 11th consecutive year of GAAP profitability.

Our strategy of balanced growth and profitability was recognized by both Moody's and S&P. These credit rating companies recently graded Fortinet as a strong triple B investment grade company

And importantly, 30% of all network security firewall units in the world have the Fortinet label more than the next three companies combined.

We have over 500,000 customers worldwide and are approaching 700 U.S. patents.

In summary, that's who we are.

Slide 6: Fortinet Framework

This slide illustrates the results from our balanced growth and profitability strategy.

Not only did our revenue growth outpaced market growth for each of the last four years, we also increased our non-GAAP operating margin 950 basis points during that same period.

Slide 7: Solid Organic Growth at Scale

Fortinet's almost all organic revenue growth for each of the last three years has been approximately 20%. Our higher margin, more predictable service revenue grew at a three-year CAGR of 22% for the period ended December 31, 2020 and service revenue now represents nearly two thirds of our total revenue.

Despite the pandemic, 2020 product revenues growth held firm at over 16%. In the group of major network security companies, such as Checkpoint and Palo Alto, Fortinet was the only company to post double digit, year over year product revenue growth in 2020.

Slide 8: Growth Drivers

Okay. I'd like now to discuss several growth drivers that have contributed to our strong performance over the past several years and then we expect to drive our growth as we go forward.

Slide 9: One Opportunity – TAM $93B by 2024

There are many drivers behind the growth in the cybersecurity industry. But simply put its about bad actors getting more and more sophisticated while targeting a continually expanding attack surface of edges that include: data centers, WANs, LANs, public and private clouds, 5G, OT, and IOT.

Given this backdrop, we estimate our total addressable market will grow from $65 billion in 2020 to approximately $93 billion in 2024, representing a 10% 4-year CAGR.

Importantly, the TAM estimates excludes related services such as our FortiCare Support and FortiGuard Security updates.

Central to the $93 billion TAM is network security, at $48 billion. Network security largely includes physical and virtual next-gen firewalls as well as secure infrastructure, components of 5G and SASE and SD-WAN.

In SD-WAN Fortinet is at the epicenter and growing dramatically.

Our continued focus on organic innovation means we have, and we will continue to, add capabilities to our security fabric platform and our integrated operating system, including Zero Trust security capabilities, Cloud security, and Security Operations.

Our solutions include the complete range of form factors and delivery methods, including physical and virtual appliances, Cloud, SaaS and perpetual software, as well as hosted and non-hosted solutions.

Together, they provide a range of security solutions and form factors, enabling broad, integrated protection for hybrid environments and the expanding digital attack surface.

Slide 10: Most Deployed Network Security

Fortinet has shipped over 30% of all firewalls and currently has over 500,000 customers, evidence of our sizable footprint.

Nearly one out of every three firewalls deployed globally carries the Fortinet name. This sizeable deployment provides us with invaluable insights into evolving threats and vulnerabilities, which allows us to drive real-time updates to our customers of all sizes and geographies.

The inherent economics of scale that come with 30% of units deployed price, drives lower unit costs, and may stress the competition as we annually add over 50,000 net new customers.

Slide 11: Secure SD-WAN

The past few years, SD-WAN has shown to be a driver for both network security market and for Fortinet.

We offer a unique product that combines security and SD-WAN functionality in a single appliance.

Because of this, our SD-WAN billings increased to over 11% of our total buildings in 2020 from almost zero in 2018.

Analysts believe the SD-WAN market will grow at 30 to 40% in each of the next few years; looking at our pipeline growth, we tend to agree. And at the same time, we expect to continue to grow faster than the market.

It's important to note that SD-WAN is a feature in the FortiGate operating system. For us SD-WAN is yet another firewall use case. And, like other firewall use cases, customers often attach a variety of fabric platform products.

Slide 12: Moving Up Market

Another growth area for Fortinet has been the move up market into larger enterprises.

While expanding into larger enterprises represents an opportunity and a journey, these two bar graphs illustrate our success thus far -- we’ve seen the number of deals over $500K and $1M and the related billings grow steadily.

Slide 13: FortiGate and Non-FortiGate Billings

This slides shows consistent annual and largely organic billings growth clustered around 20% for the last four years, resulting in 2020 total billings of over $3 billion dollars.

FortiGates and the Non-FortiGate Fabric billings grew at compound annual rate of 17% and 35%, respectively.

We believe the 35% growth rate is affirmation of our broad and integrated platform strategy.

Next, we're going to take a closer look at the Non-FortiGate Fabric platform.0

Slide 14: Non-FortiGate Fabric Platform Billings

These bars provide a closer look at billings contribution from the Fabric Platform. The balanced growth between Infrastructure and Cloud Fabric drove 2020 combined billings to 39% resulting in total billings of $743 million.

Driven by 3-year compound annual growth rates in the mid-30%'s, Cloud offerings generated billings of $237M for 2020 and Infrastructure Fabric products such as Analyzer, Manager, Endpoint, Mail, Sandbox and Secure Access products, etc. generated billings of slightly over $500M.

It's worth noting that Cloud and Infrastructure Fabric billings are on pace to be a $1 billion business as we exit this year.

Slide 15: Key Fabric Platform Solutions

This slide provides a summary of cloud and Infrastructure Fabric products.

And, it's a bit of an eyesore, I know, but I included here to make Peter happy because he often gets asked what's in cloud and what's in fabric for each by the analyst. Let's move on.

Slide 16: Margin, Cash Flow and Capital

So far I've shared how Fortinet's diversified business and financial model drives consistent billings and revenue growth.

We have also looked at several growth drivers that we believe will contribute to future growth.

Now let's turn to profitability.

Slide 17: Improving Product and Service Gross Margin

We continue to drive increases in our product gross margin thru growth in our cloud-delivered and software solutions, and meaningful improvements in our hardware bill of materials.

At the same time services gross margin is benefitting from the mix shift to 24x7 support and the economies of scale.

Taken together we've improved our total gross margin and maintained our reputation for Price for Performance leadership. This leadership may pressure competitors' pricing when competing with us and mitigate discounting pressures on us.

Slide 18: Improving Margins while Investing in Future Growth

Improvements in Gross Margin and expense leverage has resulted in strong Operating Margin growth.

And while we have been increasing our margin, we continue to invest in future growth including increasing our sales capacity. For example, in 2020 we increased our sales and marketing headcount by a 22% -- very similar to our 22% CAGR from 2017 to 2020.

At the end of 2020, sales and marketing accounted for just over 50% of our headcount.

Slide 19: Growing Deferred Revenue and Free Cash FLow

With our growth -- and a business model that bills and collects cash up front for service contracts -- we continue to consistently grow our deferred revenue, free cash flow, and FCF margin.

Slide 20: Fortinet is a Top 10% S&P 500 Free Cash Flow Leader

To put our strong free cash flow conversion into context, we've benchmarked our Free Cash Flow margin against the S&P 500 constituents.

Our top 10% standing is a testament to our business model driving strong deferred revenue growth, our ability to grow margins with our ASIC advantage, and efficient working capital management.

Slide 21: Strategic Capital Allocation and Investment

As for our capital allocation policies, we have a clear hierarchy of uses of cash and free cash flow; in order: Debt reduction when necessary, reinvesting in the company through R&D, CapEx investments, and other organic initiatives. Investing in inorganic alternatives (M&A) with a focus on smaller-scale acquisitions with minimal execution risk, returning excess capital to shareholders through opportunistic share repurchases.

Slide 22: Strategic Capital Allocation and Investment

Our free cash flow generation has not been the result of any let up and investments in our business.

Our that high level of liquidity has enabled us to internally finance our R&D spending and, where appropriate, fund tuck-in M&A. We've invested over $1 billion on innovation since 2016 and $160 million on several tuck-in acquisitions.

In 2020, we bought back $1.1B of our stock and since 2016 have repurchased 32.5M shares for $2B.

From the start of 2016 to the end of 2020, Fortinet stock price has increased 377%, over 3 times better performance than the other two pure-play network security companies.

As we work to transition to a more efficient balance sheet, last month we issued investment grade bonds totaling $1.0B with an average annual interest rate of 1.6%.

Slide 23: Consistency, Predictability and Visibility

As I've stated today, our diversified business model has resulted in consistent company performance and a more predictable financial model. The next three slides highlight the consistency and predictability associated with Fortinet.

Slide 24: Driving Consistent Execution

These four graphs illustrate the consistency of Fortinet's operational metrics.

Whether you are looking at discount rates, average contract term, renewal rates or service attach rates each of them have consistently tracked within narrow bands over the past 3-years.

Slide 25: Revenue by Geography

Our revenue by Geography shows almost perfect consistency for all three of the geographies year over year. And, as would be expected, they have posted very similar CAGRs from 2017 to 2020.

Slide 26: Billings Mix

As I stated previously, our consistent and predictable performance is the result of a very diversified customer base, whether that's by Customer Size, Geography, or Industry Vertical.

To illustrate our customer diversity, I would note in the past four years, no single customer represented greater than 2% of billings in any single quarter

The geographic diversification is especially interesting. We have customers in over 80 countries that individually represent less than 3% of our billings, yet in total represent 50% of our billings. This diversity helps mitigate the impact of country specific events that impact local economies.

At the same time, this diversity drives our need for a broad solution set as our customers are not easily pigeonholed into one type of security solution. For example, large U.S. enterprises may have strong financial resources, regulatory runway, internet access, and housing arrangements appropriate for remote work and learning.

These same advantages may not exist across all geographies, customer sizes, or industries.

Slide 27: Guidance for Q1'21 and 2021

Just a quick recap of the first quarter and 2021 guidance that we provided on February 4th. As noted in the footnotes, we expect the recent bond issuance to impact 2021 EPS by approximately 5 cents per share.

Slide 28: Additional Modeling Points

A couple of additional modeling points, and as a reminder my slides will be posted on our investor relations website. And now I'd like to share our medium term financial targets.

Slide 29: Mid-Term Model: 2021 - 2023

Over the next three years we expect continued growth and looking out to 2023, we expect billings of at least $5B and total revenue of at least $4B.

Based on 2020 actuals, these projections equate to 3-year CAGRs for both of approximately 17%.

As for margins, we expect our Non-GAAP gross margin in 2023 to be approximately 80% and our Non-GAAP Operating Margin to be at least 25%.

Thru 2020, we achieved the rule of 40 in 9 out of the 11 years that we've been a publicly traded company. We define the rule of 40 as revenue growth plus Non-GAAP operating margin. And, as we look beyond 2023, our Long-term target is to continue to achieve the Rule of 40.

Slide 30: Investment Thesis

Q&A Session

Now I would like to invite Ken Patrice, John and Peter to join me for the Q&A session. Peter.

We're opening up the questions. Thank you, Keith and congratulations for making it through that sharing your screen. And so we're going to start with the Q and A. Just like before, please raise your hand.

If you have a question also, if you could lower your hand after asking the question. So just cleans up the queue a little bit. I appreciate that. Um, we're gonna start with Adam Tindle from Raymond James as the first question. He was left over from the last one. So go ahead, Adam.

Adam TIndle, Raymond James

Adam, you're still on mute. Okay. Yep. Can you hear me now?

Okay. I was going to say my congrats to Keith as well for the screen share, but I did want to, uh, ask a question maybe for Ken or John. Earlier today, you introduced the industry's first hyperscale data center firewall. You talked about how the NP 7 chip is the equivalent of 10 high end CPU's. And I'm wondering with that context in place do you envision perhaps hyperscale companies becoming more meaningful customers over time? I'm asking that because we often hear investor fear over public cloud as a potential threat to Fortinet. But wondering if there's an aspect where you can flip that narrative and sell into the Amazons and Microsoft's of the world, whether it's chip license or product directly.

Ken Xie:

Uh, yeah, the answer definitely is Yes. Uh, we working with a hyperscale customer and also a big service provider and enterprise, uh, to, uh, um, to have our advantage on the chip. Especially they have a huge computing power advantage, um, uh, like, uh, use in their, their environment, whether in the data center, in their campus or in the, in the, uh, in the service provider network in the cloud.

Adam Tindle

Thanks. And do you think that can be meaningful over time or is that, is that something that has changed today with NP7? Is that a new message?

Ken Xie:

Uh, yeah, we still in, the middle of our ramp-up NP7 with our own product refreshment. We do have a few cases working with some big, whether the provider or some, some call provider, try to see how to using NP7 in their own kind of environment to build together with the other product.

Um, but it's, uh, like I said, we'd be also kind of a few because NP7 also tightly working with FortiOS. Um, and then with other, uh, that's also the reason when we release the FortiOS 7.0. We keep adding a lot of other feature is all come from a huge competitive advantage from ASIC, which the general-purpose CPU has difficult to compete.

So we do have the same CPU as any other competitor, but because that's a huge advantage, competitive advantage come from ASIC so easy for us to add more functioning OS and, uh, and also apply some of these, uh, huge competitive advantage through certain service provider, it is definitely on of our direction going forward. Uh, but there's a lot of detail need to work with them and also try to see, uh, what was the ROI and also, uh, like, uh, was the position going forward. So it's, uh, uh, whether a call provider, service providers it's a huge market working with for long-term and also keep the same strategies going forward. Uh, I say probably will still take a couple years to be meaningful. Uh, right now it's still in a little bit early stage.

Adam Tindle

Understood. Thank you, Ken.

Ken Xie

Thank you.

Peter S

Thank you, Adam. Next up is Mandeep Singh from Bloomberg and on deck is a Sterling Auty from JP Morgan.

Mandeep Singh - Bloomberg

Great. Uh, thanks for taking my question.

So I was wondering if you can, uh, tell me what sort of product headwind you see on the MPLS side with the workloads moving to the cloud. And who do you view as the main competitor on the cloud workload security side? Is it Zscalar, CrowdStrike, or more of the firewall as a service vendors?

Peter Salkowski

John, maybe that's a question more appropriate for you?

John Maddison

Yeah. So, um, MPLS, you know, is, is gradually being replaced by SD-WAN. So that MPLS displacement is working really well for us. You saw some of the revenue numbers from, from Keith and that's, just going to continue. I think right now the market is still only 50%, and so that's a, that's a huge market opportunity for us. Um, in terms of the workloads in the cloud, the cloud security marketplace is so fragmented. We've got some native cloud, you've got a bunch of startups doing the container security. It's just, there's just hundreds of vendors in there. It'll shake out eventually.

Again, we have a, more of a platform solution in the cloud, across the network, the platform itself, and the applications. We'll work with native solutions. We also partners. Uh, so I just think it's very fragmented. And if you look at the market sizing there, it's tiny still. Um, so that marketplace is just really emerging still.

Peter Salkowski

Thanks, John. Next up is Sterling Auty from JP Morgan and then Saket Kalia from Barclays.

Sterling Auty, J.P. Morgan

Thanks, hi guys. So you showed, Keith in your presentation, headcount growth in sales and marketing. I think the CAGR was around 20 or 22%. Looking forward. The medium term, you know, targets has 17% growth in billings and revenue. I'm curious, what kind of sales and marketing headcount growth do you anticipate being necessary to support that 17% CAGR going forward?

Keith Jensen

Yeah, I think the, uh, I think we're very pleased with how the business model works out for us, you know, starting with a gross margin at 80%. And being able to stay above 25% as we continue to add sales count, headcount capacity. You know, the real question is that the trade off between capacity and productivity, you know, as this year plays out and as the, as the next several years play out in terms of the midterm model. Uh, so I think the headline is that the model works, you know, with the hiring that we've, we've shown in the margins that we're delivering.

Sterling Auty

Got it. Thank you.

Peter S

We next have Saket Kalia from Barclays.

Saket Kalia, Barclays

Can you hear me? Okay, Peter? Okay. Great. Uh, Keith, thanks for the, for the, um, color on, on medium term targets. Maybe the question that I've got as part of that is, can you just talk about how you envision that 5 billion in billings, roughly, um, in terms of FortiGate versus non FortiGate and, and maybe related to that, how have you sort of thought broad brush about product revenue as part of that kind of longer-term forecast?

Keith Jensen

Yeah, I think the, uh, the split between FortiGate and non-FortiGate, we expect that the, uh, as, as noted before it's an after what we've seen in the numbers thus far as an affirmation of the strategy, uh, we expect to see continued affirmation of the platform strategy. And I think that message has been clear throughout the presentations today, including John as well.

Um, you know, looking at longer-term mix between product and services. The second part of the question Saket, I mean, it's just like any other quarter in terms of guidance that the revenue. Uh, from service revenue is very visible and predictable, and I think you could probably pencil that out and then reverse engineer, you know, what that number implies about product revenue growth.

Saket Kalia

Got it. Thank you.

Peter Salkowski

Okay. My next outfit is, uh, Gregg Moskowitz followed by Tal Liani.

Gregg Moskowitz, Mizuho Securities

All right. Thanks Peter. Hi everyone. Uh, so I actually had a follow up to Saket's question.

So, uh, my question is actually a follow to Saket's. And so as workloads continue to shift to the cloud and as security correspondingly moves more towards cloud and cloud subscriptions, does that create more uncertainty as it relates to that $5 billion plus, um, billings target for 2023? Or do you feel very comfortable in terms of, uh, you know, kind of getting there, uh, regardless of how things sort of unfold over the next couple of years or so. Thank you.

Keith Jensen

Yeah, I think I would probably say that in regardless of how things play out, keep in mind that in that fabric number that we're talking about, that includes a set from SaaS revenues and some other things of that nature.

Um, so it won't be, it won't be new to us to see some of that mixed shift that you're kind of inferring if you were a little bit, uh, to the non-FortiGate part of the business.

Gregg Moskowitz

All right. That's helpful.

Peter Salkowski

Thank you. All right, Tal Liani, you're up next, followed by, uh, Brian Essex from Goldman Sachs.

Tal Liani, Bank of America

Yes. Hi. Um, I'm going to ask two questions that were asked before.

The first one is Saket asked a good question and of the 5 billion, how much is FortiGate versus non-FortiGate? And you gave an answer that is entirely in line with a target, but can you elaborate? How, what is in your view? What is FortiGate and non-FortiGate in the 5 billion? And the second question, um, can, um, I asked this question before.

I'm going to expand it. Um, Fortinet has a price advantage, uh, in the FortiGate products. Uh, you're you're anywhere from 40, even more than 40% cheaper than competition. What is your main selling point with SASE? Meaning can you maintain, um, price advantage, uh, in SASE versus other SASE solutions? Uh, uh, and what is the basis for any price, price difference in, uh, if, if yes, or if not, can you also discuss.

Uh, what's the main, um, basic basically selling point or what's the main advantage versus other SASE solutions that may try to offer a similar service. Thanks.

Keith Jensen

Okay, I'll take the first part of that. And then maybe hand off the second part about, uh, the SASE pricing advantages and other concepts like that for John.

I think if you look at those slides, as we're going through the exercise of putting them together, it really becomes very apparent how consistent the business has been. Whether you're looking at revenues by geography, whether or not you're looking at that product service mix, whether not you're looking at the FortiGate versus the non-FortiGate part of the mix of the business. And so with that backdrop in mind, I would expect that those trends that you're seeing those charts, right, are going to continue. We really don't see something that's disruptive. That's going to charge a shift dramatically from what we've seen in our trends, whether that's product versus services or whether that's FortiGate versus non-FortiGate. John, do you want to talk about SASE, the long, lots of, lots of comments on SASE there.

Ken Xie

Yeah, this is Ken. I can answer definitely the answer is Yes. So we're keeping maintain the pricing advantage, uh, whether SASE or some FortiGate or other product. Because all come from huge architecture advantage to computing power advantage that we have over competitors. And that's gave us better performance, lower cost and the same time of, uh, better gross margin.

And, for the SASE, we are also the first one, integrating SASE zero trust into the OS level. So I don't see any other competitor doing that yet. It is to take a multiple year effort. Uh, we, we first integrated SD-WAN, some other CASB and, and then the other product was SASE integrated with the OS the same thing for the zero trust. Uh, which will make it not only well price advantage, but also easy to manage. And it has more function, and that can be also using like enterprise can deploy themselves and also service provider. They can either deploy themselves. Instead of today's solution, you had to have multiple paths and kind of different OS solution to handle that. So it would be more easy to manage and provide better security, more function compared with competitor and at the same time has a price advantage and the cost advantage.

Tal Liani

And if you're very successful with SASE, let's say you're extremely successful out of the gate. Does it make an impact on margins? Meaning your expenses are tied to a relationship with AT&T. Does it have a fixed element that might pressure margins, uh, at the beginning and later on, can you talk about how your margin progression would be, uh, with SASE?

Ken Xie

I think, if you look into this SASE compared to some upon stay deployed, probably on average, there are maybe like three to four times more expensive.

But it's the benefits really is kind of a goes through whether the vendor or service provider that helped in the manage that, uh, but with this FortiOS 7.0 because it all integrate together. So that enables some enterprise, bigger enterprise, and also some service provider may well handle themselves.

So that's what helping like drive better business model and a better margin for the wider the service provider or maybe positive benefit to the service provider or to the enterprise themself.

So that's for us really integrating OS levels is just the first step. And then we also are keeping pushing to the ASIC level. We'll keep it increased the performance of this SASE component and make an even better, more kind of a cost advantage compared to the other, whether they have a different box or different kind of part of a infrastructure or a computer, or we have a same OS or even go to the ASIC level. So that's take a lot of investment, but it's a benefit also is huge in the long term.

Tal Liani

Got it. Thank you.

Peter Salkowski

Thanks. Brian Essex, you're up. Ben Bollin, you're on deck.

Brian Essex, Goldman Sachs

All right. Great. Thank you, Peter. Um, you know, this one's maybe, maybe for Ken or John, um, you know, particularly as we see the roll-outs of new products in the, in the levers for growth ahead, catalyst for product cycle tailwinds. Um, how do you think about, um, penetrating the market by segment in terms of, you know, entry-level, mid-level, high end? It looks like you're getting great success at the high end of the market.

Um, Is that where you see things going forward or is this more of a developed for the high-end and let the technology trickle down type of strategy. Just trying to understand, you know, where you might be spending money to, uh, more effectively penetrate the market and where you see the best reward.

Ken Xie

Uh, yeah, this is Ken. I think that's a good question. And also it's a good strategy as direction we moving forward. We also have a rare chance to have a Patrice, CIO, here on the call to answer question. I think Patrice can give some more detail. Then maybe Patrice can go ahead.

Patrice Perche

Yeah. Thank you, Ken.

Definitely. We had a very strong footprint, uh, across the three segments from, uh, mid to high and also the service product space. I would have to say that depending on, we are reading all these segments. But definitely the aim is also to capture more of these very large part of the enterprise segment.

So we putting a bit more effort here, especially North America, uh, and we really align the segment approach across the board. So, and we leverage, in fact, the, uh, the technology, uh, providing the same kind of architecture for the medium, the large and the very larger enterprise customer.

Because the platform that we deliver. That's the beauty on the platform is that we can deliver on different form factor, both software, virtual, or appliance with a different form factor with the appliance as well. So that's matched all, all the different dilemma. Definitely we will leverage this more segmented approach with much more focus as we move forward.

John Maddison

Just one, just one comment on the entry, mid and high-end. Just remember our entry level. We built our own SD-WAN chip in our appliances and that's driven a lot of that business as well. So I think across all of those segments, entry, mid for segmentation and high-end for hyperscale are all very relevant marketplaces.

We built a differentiating technology for whether it be the system on a chip, whether it be the SPU or, or, or the content processor.

Brian Essex

Great. Patrice, Ken, and John, thank you.

Peter Salkowski

Next up is Ben Bollin from Cleveland Research followed by Fatima Boolani from UBS.

Ben Bollin, Cleveland Research

Thanks, Peter. Uh, Keith, I wanted to ask a question about, uh, gross margin and operating margin framework for the midterm model. Could you take us through how you think about the potential lever supporting no upside or downside, I suppose, uh, to those figures? Uh, do you have any incremental investments built in your assumptions? Opex as you have more diversity and go to market or supporting fabric? And last is any thoughts on the productivity of your sales folks as they progress from new to experience and are selling more applications? Thanks.

Keith Jensen

Yeah, I think the, again, I would look at our trends in terms of margins and what you're seeing related to the services, gross margin, as well as the product gross margin. Each successive generation shift has shown the ability to take costs out of the bomb.

And I don't think there's really a reason to think that that's not going to be the case, to some extent, you know, going forward in the future. Um, you know, having a “hardware company” that's throwing off 80% gross margin or thereabouts is no small achievement. So it's probably a pretty good target for us to have.

And then it's just really that we want to continue to, to, to balance how much we leave in the operating margin line versus how much we care to invest for other ideas going forward. And for us investments, oftentimes it's the engineering team, as well as the sales team and the marketing team. And when you look at the sales team, you're getting very different times to productivity, If you will. Our salespeople that are focused on the channel, for example, can reach “productivity” very, very quickly, and actually be a creative to that margin. When you're hiring a true large enterprise salesperson, you're probably going to have to offer them a much longer runway. But I think important in that is that what you did not hear me say was moving anything, moving away from the channel at all. And I think in Patrice’s comments earlier today. He made a similar observation. The channel has been and will continue to be critical to our success. The fact that we're continuing to add sales headcount in no way suggests we're moving away from the channel, but rather partnering more closely with the channel.

And I don't know if Patrice wants to add some more to that?

Patrice Perche

Yeah, definitely. I can even take the example of, on the SASE and the SD-WAN leveraging the service provider. Uh, if you look worldwide, as John was mentioning, um, there was a quick, uh, I will say a solution that has been adopted by those large service providers, AT&T or NTT in Japan, uh, leveraging this, um, uh, proxy base, uh, covering the work-from-home needed. But long-term wise, the, they clearly have been asking us to work more closely on delivering and building, in fact, the solution that it can deliver themselves. So they own the network, they own the access. And, um, we, we want to leverage, like we leverage the very large enterprise reseller. Those service providers that, uh, we real long-term relationship, uh, which have been deploying SD-WAN and now we have SD-WAN and we are in the place of the age, we were Liberty to SASE. So that's a strategy that I think will deliver very great results. And that may create much more pressure on existing cloud provider that has to build and their infrastructure to compete with service provider, why they are not still making any money.

So it's, uh, will be very interesting future situation that will happen. And I have to say as well, the cloud services, when you deliver SASE or proxy-based SASE is very easy to displace because there is nothing to remove from the edge or from the core network, from the customer. And so it's just an OPEX, so it can be very quickly replaced.

So it's very more critical to own the infrastructure and to own, in fact, the edge and the core. So then you have a much stronger relationship and long-term engagement with your customer. So that's another element where we can come back very quickly, leveraging all the channel on these new trends.

Peter Salkowski

Hey Patrice, thanks Ben. Uh, next question up is from Fatima Boolani from UBS. Keith Bachman. You are on deck.

Fatima Boolani, UBS Securities

Thanks, Peter. Keith, my question is for you. I'm looking at the business and the revenue segmentation, where you've got about 40 Percent, pushing up against 40% of revenue from subscription revenue.

So your FortiGuard portfolio, can you maybe give us a refresher on how exactly you're going to market with FortiGuard today? Uh, vis-a-vis the bundles you have? Uh, I think I may have noticed some reconstitution of some of your bundles under user and device, and you know, some of these other disciplines.

So wondering if you can just give us a refresher on that and to the extent there's any pricing increases built into your forecast, especially as I think about the price performance advantage you have versus your competitors today.

Keith Jensen

Sure. Um, no, no price, no dramatic pricing increases are built into the model or into the guidance that, uh, pardon me, the targets that we just talked about. I just, as I kind of frame up the services conversation, uh, services is now at 65% of our business. Uh, that's split roughly 45%, 55% between FortiCare, traditional support and FortiGuard, the security part of the business. Uh, that mix has been very consistent for a few years now. It has not really changed, uh, when you look at it and I don't anticipate that that's going to change dramatically in the midterm period of time that we're talking about. I'm not really familiar with changes in the bundles. Maybe John Maddison has something there that I'm not thinking about.

John Maddison

Yeah, just a small change. We added SOC as a Service to the, uh, 360 bundle. 360 is the premium bundle, has everything in it. Uh, so that's just a small change there. Um, otherwise, you know, the bundles, the ATP, UTP, the three enterprise and 360, or remained the same.

Peter Salkowski

Thank you, Fatima. Next up is Keith Bachman from BMO and then Michael Terrance from KeyBank is on deck.

Keith Bachman, BMO

Okay. Thank you. I wanted to ask, um, about the non Forti side of the revenue, and if you could just highlight. In the recent 12 months, what have been the key drivers of those revenues? You had the slide up, the Peter slide, we'll call it. Um, what are the key drivers and, and how might that change or what's embedded in your expectations when you put out those three-year targets? What are the key drivers you think of the non Forti side of the, uh, the revenue? And embedded in my question is just wondering how important is incremental expansion associate with that non Forti side of either revenues or billings. And I think about areas such as CASB. And I don't think about Fortinet as a leader in CASB. How important is it to expand the portfolio with the non Forti side as you think about the next three years? Thank you.

Keith Jensen

Yeah, Keith, thanks for the question. I, you know, I keep looking at it each quarter for that, for the product, that's going to jump out if you will, and say, this is the one that is driving this number.

And truthfully, uh, it really is kind of a story of, uh, a rising tide lifting all boats. You know, I do believe that when you get into a secure, secure SD-WAN solution, secure branch, uh, where it brings along the switches and the secure switches and the access points. And those two combined are probably around a third of the non FortiGate, probably a little bit less than that.

Um, and then you really have just kind of a mix between software solutions, cloud solutions, and infrastructure fabric. The real growth driver there, I don't know is about adding more products to the non FortiGate suite, if you will. It's more about expanding into our customer base. Um, you know, the first sale for the company is not always a FortiGate firewall, but the clear majority of the time it is.

And I know we're seeing other instances where other products will sometimes sell first. But the tip of all use cases, we sell the firewall, whether it's a physical or virtual firewall, and over time we continue to expand. And it really, it plays back to some of John's commentary earlier today. About the platform strategy. About things like vendor fatigue and CISOs and CIO is going through a phase of rationalizing their security spending.

And that's being there now and can use as term of being more patient, if you will, and sometimes taking longer to get it right on a common operating system. All those things are driving the opportunity to view the fabric part of the business as an expansion opportunity.

Keith Bachman

Okay, thanks very much, Keith.

Peter Salkowski

Thank you Keiths, both of you. Next up is Michael Turits from KeyBank. This will probably be the last one as we're coming up on the bottom of the hour here, Michael, go ahead.

Michael Turits, Key Banc

Great guys. Thanks for getting me in, um, on margins, Keith, uh, the guide was 25 to 27% this year in the streets at 26. And you just got it quote over 25 going forward.

So how do you think about margin expansion and median and longer-term margin? So are we there yet, in other words, and that's it on margin expansion on EBIT side? How do you think about that in the next couple of years? Uh, and also I added, what about cashflow. Should whatever we're seeing in the EBIT margin direction, should we be seeing, uh, cashflow margins moving parallel?

Keith Jensen

Yeah. We framed the conversation, starting with the idea of balance growth and profitability, and sometimes like the same be doing it for several years. But I think the reality is you can see that Ken's been doing it for 10 years if not 20 years. Um, and we've been, I think very straight forward that some years we'd see the opportunity within that framework.

Uh, to tilt the bias one direction on the other. Then this is a year that we think that the tilt is towards growth. Uh, as you start looking out at 2022 or 2023, I don't know that we're really at this point, uh, taking a position, if you will, one way or the other, in terms of whether it's a year that's more conducive to growth or a year that's more conducive to profitability.

That's kind of a wait and see if you will. Uh, I don't think that it's just going to be a linear world for us in any way, shape or fashion as we go forward. Um, and then of course as free cash flow margin, I think it really does, you know, it ties to the growth and the billings number. It also ties to the continued improvement in that operating margin number.

And so as such, it'll be contingent upon where we're at within that framework each year between balance growth and profitability.

Michael Turits

Thanks, Keith.

Peter Salkowski

And I would add to that. I think part of that long-term target is the rule of 40 and the fact that, you know, between revenue growth and operating margin, we would expect those two to add up to at least 40, uh, as they have nine out of the last 11 years, uh, and expected to in 21 based on our guidance.

So with that, I'd like to thank everyone for attending today's analyst's day. As I noted earlier, our replay of this event, along with the copies of all the slide decks and transcripts of the events. Will be posted on the investor relations website. Hopefully quickly. I will get them out as quickly as I can. With that, thank you very much. Have a great day. If you have any follow up questions, please feel free to reach out to me. And I appreciate you for attending. Thank you very much. Have a good day.