BEHIND THE NUMBERS
EARNINGS QUALITY & DIVIDEND SUSTAINABILITY RESEARCH

BTN Research

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Citrix Systems EQ Update- 9/20 Qtr.

Current EQ Rating*	Previous EQ Rating
4-	4-

6- "Exceptionally Strong"
5- "Strong"
4- "Acceptable"
3- "Minor Concern"
2- "Weak"
1- "Strong Concerns"

Note that a "+" sign indicates the earnings quality improved in the most recent quarter while a "–" sign indicates deterioration

*For an explanation of the EQ Review Rating scale, please refer to the end of this report

We are maintaining our earnings quality rating of 4- (Acceptable)

CTXS reported non-GAAP EPS of $1.38 in the 9/20 quarter which was 13 cps ahead of consensus targets. Revenue came in about 1% higher than the hurdle. The company guided to full-year revenue of $3.34 billion which was slightly ahead of the consensus view of $3.27 billion. Likewise, EPS guidance was for $6.20-$6.40 with the then-consensus outlook falling at the low end of that range at $6.18. Despite the seemingly strong results, the stock has been pummeled by the market largely due to disappointing growth in its SaaS subscription bookings as customers appear to be reluctant to make long-term subscription license commitments in the current environment. Whether this will be temporary is beyond the scope of this report. However, from a pure earnings quality perspective, we view the increase in deferred revenues and unbilled revenue as positives.

What deteriorated?

- We note that quarterly cash from operations declined to $112 million from $147 million in the year-ago quarter. Cash flow growth is key given the shift to longer-term contracts being billed upfront. The main culprit for the decline was an

approximate 45% million decline in cash from receivables as DSOs rose by 14 days. We suspect this is a matter of the timing of collections in the current environment and expect a reversal in the next quarter.
(Concern level: LOW)

What improved?

- Deferred revenue days of sales rose in the quarter for the first time since the shift to subscription deals began. Previously, the expiration of maintenance contracts under perpetual licenses was driving down deferred revenue faster than new subscription deals were adding to it. This has appeared to reverse.

- While growth in annualized recurring SaaS revenue disappointed in the quarter, subscription ARR (annualized recurring revenue) growth remained north of 50% as did the growth in unbilled revenue. Going forward, any reversal in deferred revenue growth or unbilled revenue growth should be viewed with caution.

What to watch

- Ironically, if the company had experienced stronger subscription-based bookings in the 9/20 quarter, revenue growth would likely have been weaker as more of these revenues would have been deferred. The company has warned that the 3/21 quarter will face a difficult sales comp given that the 3/20 quarter contained an unusual degree of perpetual deals from customers rushing to adopt remote work applications at the start of COVID. These were recognized upfront and provided a more immediate boost to revenue.

- Rising stock-based compensation was a 10 cps drag on EPS growth in the quarter.

SaaS Revenue Growth Disappoints, but Deferred Revenue Rose

The key to the CTXS story is the company's shift to subscription-based cloud revenue which is recognized over time from on-premises software which is recognized upfront. Despite CTXS beating EPS forecasts and guiding towards a strong fourth quarter, the market punished the stock due to a deceleration in the growth of SaaS (software as a service) cloud-based subscription bookings. The following table shows

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Subscription ARR	$1,027	$949	$837	$743
SaaS ARR	$630	$590	$555	$520
Total ARR	$1,657	$1,539	$1,392	$1,263
Subscription ARR growth	52.8%	54.6%	50.3%	40.7%
SaaS ARR growth	36.1%	41.1%	48.0%	48.6%
Total ARR Growth	46.0%	49.1%	49.4%	43.8%

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Subscription ARR	$672	$614	$557	$528
SaaS ARR	$463	$418	$375	$350
Total ARR	$1,135	$1,032	$932	$878

ARR (annualized recurring revenue) represents the annualized value of all of the company's subscription contracts as of the end of the quarter. We see that total ARR growth fell to 46% due to a marked deceleration in the growth of SaaS ARR which has continued for three quarters. This seems to be the key point of concern for the market as it indicates that fewer customers are migrating to the long-term, cloud-based subscription services and are opting instead for on-premises licenses This is causing some to doubt the longer-term growth story of moving to a more sustainable, predictable revenue source. However, there is also the possibility that customers are simply delaying making a long-term commitment in the current environment and will make a move to cloud-based contracts later. Making that determination is beyond the scope of this EQ Review.

Despite the disappointment in SaaS growth, the company saw its deferred revenue days of sales increase for the first time since the switch to cloud-based services began:

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
SaaS Subscription Revenue	$138.000	$131.000	$122.000	$113.000
Support and Services Revenue	$417.348	$425.546	$419.851	$439.584
Total Estimated Revenue Booked Over Time	$555.348	$556.546	$541.851	$552.584
Total Deferred Revenue	$1,692.304	$1,787.630	$1,754.803	$1,795.791
Total Deferred Revenue Days of Sales	280.4	292.3	294.7	299.0

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
SaaS Subscription Revenue	$101.000	$91.000	$85.000	$78.000
Support and Services Revenue	$441.971	$452.210	$442.515	$461.299
Total Estimated Revenue Booked Over Time	$542.971	$543.210	$527.515	$539.299
Total Deferred Revenue	$1,615.572	$1,744.714	$1,756.717	$1,834.572
Total Deferred Revenue Days of Sales	273.7	292.3	299.7	313.0

The table above shows that total deferred revenue days of estimated revenue booked over time increased to 280 days from 273 in the year-ago quarter. Remember that in addition to subscription revenue that has been deferred, deferred revenue also contains deferred amounts from maintenance contracts tied to perpetual licenses. As customers have moved away from perpetual licenses, these maintenance deferrals have declined and more than offset the increase in revenue deferred under new subscription agreements. However, CTXS has appeared to reach an inflection point where deferred revenue is now increasing as new subscriptions build. We view this as a positive for earnings quality.

Ironically, the slowdown in SaaS revenue is likely resulting in higher sales growth than would be posted if more long-term subscriptions were signed. This is due to the on-premises revenue being recognized upfront rather than over time. The company has even warned that the first quarter may see a slowdown in revenue growth as the 3/20 quarter saw an increase in perpetual deals due to customers flocking to its remote working solutions in response to the onset of COVID shutdowns.

Remaining Contract Value Continues to Grow

While the company prefers to draw attention to ARR, by adding unearned revenue and unbilled revenue we can get another perspective of the total value of revenue under contract that has yet to be recognized. The following table shows this breakdown for the last 8 quarters:

	9/30/2020	6/30/2020	3/31/2020	12/31/2019
Unbilled Revenue	$916	$867	$779	$705
growth	63.8%	79.0%	104.8%	108.2%
Total Deferred Revenue	$1,692	$1,788	$1,755	$1,796
growth	4.7%	2.5%	-0.1%	-2.1%
Total	$2,608	$2,655	$2,534	$2,501
growth	19.9%	19.1%	18.6%	15.1%

	9/30/2019	6/30/2019	3/31/2019	12/31/2018
Unbilled Revenue	$559	$484	$380	$338
Total Deferred Revenue	$1,616	$1,745	$1,757	$1,835
Total	$2,175	$2,229	$2,137	$2,173

We see that deferred revenue growth turned positive in the last two quarters as discussed above. Also, unbilled revenue growth is still growing north of 60%, driven by the signing up of long-term subscription deals. While SaaS ARR growth may have disappointed, the growth in the pool of future revenues under contract is far from lackluster.

Explanation of EQ Rating Scale

6- "Exceptionally Strong"	Indicates uncommonly conservative accounting policies to the point that revenue and earnings are essentially understated relative to the company's peers. Higher possibility of reporting positive earnings surprises
5- "Strong"	Indicates the company has no areas of concern with its reported results and we see very little risk of the company disappointing due to recent results being overstated from aggressive reporting in recent periods.
4- "Acceptable"	Indicates the company may have exhibited a minor "red flag", but the severity of the issue is not yet a concern. Minimal risk of an earnings disappointment resulting from previous earnings or cash flow overstatement
3- "Minor Concern"	Indicates the company has exhibited either a larger number of or more serious warning signs than companies receiving a 4. The likelihood of an immediate earnings or cash flow disappointment is not considered to be high, but the signs mentioned deserve a higher degree of attention in the future.
2- "Weak"	Indicates the company's recently reported results have benefitted materially from aggressive accounting. Follow up work should be performed to determine the nature and extent of the problem. There is a possibility that upcoming results could disappoint as the impact of unsustainable benefits disappears.
1- "Strong Concerns"	Indicates that the company's recent results are significantly overstated and that we view a disappointment in upcoming quarters is highly likely.

In addition to the numerical rating, the EQ Review Rating may also include either a minus or plus sign. A minus sign indicates that our analysis shows the overall earnings quality of the company has worsened since the last review and there is a possibility the numerical rating will fall should the problem continue into the next quarter. Likewise, a positive sign indicates that the overall earnings quality is improving, and the company may see an upgrade in its numerical rating should the trend continue.

Key Points to Understand About the EQ Score

The EQ Review Rating is much more than a blind, quantitative scoring method. While we utilize proprietary adjustments, ratios, and methods developed over decades of earnings quality analysis, the foundation of all of our analysis is reading recent SEC filings, press releases, conference call transcripts and in some cases, conversations with managements.

The EQ Review Rating is not comparable to a traditional buy/sell rating. The Rating is intended to specifically convey the extent to which reported earnings may be over/understated. Fundamental factors such as forecasts for future growth, increasing competition, and valuation are not reflected in the rating. Therefore, a high score does not in itself indicate a company is a buy but rather indicates that recent results are a good indication of the underlying earnings and cash generation capacity of the company. A low score (1-2) will likely result in us performing a more thorough review of fundamental factors to determine if the company warrants a full-blown sell recommendation.

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