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Nutanix, Inc. (NTNX)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to the Nutanix Q1 2024 Earnings Conference Call. At this time, all participants on a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to turn the conference over to your speaker for today, Rich Valera, VP of Investor Relations. Please go ahead.

Richard Valera

Vice President-Investor Relations, Nutanix, Inc.

Good afternoon, and welcome to today's conference call to discuss first quarter fiscal year 2024 financial results. Joining me today are Rajiv Ramaswami, Nutanix's President and CEO; and Rukmini Sivaraman, Nutanix's CFO. After the market close today, Nutanix issued a press release announcing first quarter fiscal year 2024 financial results. If you'd like to read the release, please visit the Press Releases section of our IR website.

During today's call, management will make forward-looking statements, including financial guidance. These forward-looking statements involve risks and uncertainties, some of which are beyond our control, which could cause actual results to differ materially and adversely from those anticipated by these statements. For a more detailed description of these and other risks and uncertainties, please refer to our SEC filings, including our annual report on Form 10-K for fiscal year ended July 31, 2023, as well as our earnings press release issued today. These forward-looking statements apply as of today and we undertake no obligation to revise these statements after this call. As a result, you should not rely on them as representing our future views.

Please note, unless otherwise specifically referenced, all financial measures we use on today's call, except for revenue, are expressed on a non-GAAP basis and have been adjusted to exclude certain charges. We have provided to the extent available reconciliations of these non-GAAP financial measures to GAAP financial measures on our IR website and in our earnings press release.

Nutanix will be participating in the Raymond James TMT and Consumer Conference in New York City on December 5, and the Barclays Global Technology Conference in San Francisco on December 6. We hope to see you at one of these events. Finally, our second quarter fiscal 2024 quiet period will begin on Wednesday, January 17.

And with that, I'll turn the call over to Rajiv. Rajiv?

Rajiv Ramaswami

President, Chief Executive Officer & Director, Nutanix, Inc.

Thank you, Rich. And good afternoon, everyone. We delivered a solid first quarter with results that came in ahead of our guidance. The uncertain macro backdrop that we saw in our first quarter was largely unchanged compared with the prior quarter. However, we saw steady demand for our solutions, driven by businesses prioritizing their digital transformation and infrastructure modernization initiative, and looking to optimize their total cost of ownership.

Taking a closer look at the first quarter, we were happy to have exceeded all our guided metrics. We delivered record quarterly revenue of $511 million, exceeding a $2 billion annualized run rate for the first time, and grew our ARR 30% year-over-year to $1.7 billion. We also had another quarter of strong free cash flow generation, aided by good linearity. Overall, our first quarter financial performance was a strong start to our fiscal year.

Our federal business is typically strong in our first quarter, and this one was no exception. We saw wins with several different agencies across all three of our expansion vectors, including additional capacity for existing workloads, capacity for net new workloads, and adoption of additional portfolio products. The wins also included expansion into the public cloud with entry too, on AWS, and our first win with a large existing customer for GPT-in-a-Box, our recently introduced turnkey solution for deploying generative AI. We view the breadth and diversity of our wins with this important customer as a testament to our ability to expand within our largest customers.

Another notable win in the quarter was with a global 2000 bank in the Asia-Pacific region. This customer, who signed a significant expansion agreement, selected Nutanix as their sole platform for their future modernization initiative and planned buildout of multiple new data centers. This was a departure from the historical dual vendor strategy. They chose our Nutanix Cloud Platform, including Nutanix cloud management, to run their containerized business critical applications, leveraging its simplicity and built in automation for infrastructure as a service. They also adopted Nutanix's database service for managing and deploying their databases throughout their organization. We see this win as a great example of our ability to partner with the largest and most demanding companies in the world as they look to modernize and grow their businesses.

Generating leverage from our partners remains a key focus. And towards this end, I'm excited with the early progress we've seen with our recently launched Cisco partnership. This past quarter, our joint solution was made generally available to be sold by both sales forces. We also saw good customer interest and secured a few wins for this new offering, which were conversions of customers who had previously been planning to purchase Cisco's HyperFlex. While it's still early days in this partnership, I'm encouraged by what we've seen so far.

Another positive development on the partner front in the first quarter was a significant expansion deal we signed with a North American managed service provider or MSP. This partner was increasing its capacity to handle the expected growth of its Nutanix-related business. We see this win as reflecting the growing traction we are seeing with our MSP partners.

On the product front, this quarter we announced important enhancements to the Nutanix Cloud Platform to strengthen its capabilities against ransomware attacks on unstructured data. These new features enable organizations to detect a threat, defend from further damage, and begin a one-click recovery process, all within 20 minutes of exposure. They build on the strength of the Nutanix Cloud Platform to protect and secure customers' most sensitive data across clouds. These enhancements reflect our ongoing commitment to investing in our platform.

In the past quarter, we continued to receive industry recognition for our Nutanix Cloud Platform, being recognized as a leader in the latest report from Forrester Research in this area. We view our position as one of only two companies named as a leader in this report as a reflection of a strong competitive position in the market.

Finally, it was a pleasure seeing many of you in person at our recent Investor Day. We were happy to be able to provide an update on a large and growing market opportunity to discuss our long-term vision of enabling portable applications, and to provide targets calling for an ARR compound annual growth rate of approximately 20% through fiscal year 2027, and generation of $700 million to $900 million of free cash flow in fiscal year 2027. We've received great feedback so far from our Investor Day, and look forward to continuing to drive towards the vision and targets we shared.

And with that, I'll hand it over to Rukmini Sivaraman. Rukmini?

Rukmini Sivaraman

Chief Financial Officer, Nutanix, Inc.

Thank you, Rajiv. I will first provide commentary on our Q1 2024 results, followed by the guidance for Q2 2024 and fiscal year 2024. Q1 2024 was a good quarter in which we exceeded the high end of the range on all guided metrics. ACV billings in Q1 was $287 million, above the guided range of $260 million to $270 million, and a year-over-year growth rate of 24%.

Revenue in Q1 was $511 million, higher than the guided range of $495 million to $505 million, and a year-over-year growth rate of 18%. The outperformance was driven partly by stronger-than-expected performance from our US federal government business, which grew significantly year-over-year in new ACV bookings. Our renewals performance also continued to be good.

ARR at the end of Q1 was $1.664 billion, representing a year-over-year growth rate of 30%. Similar to last quarter, we saw a modest elongation of average sales cycles relative to the year-ago quarter. Our average contract duration in Q1 was 2.9 years, slightly lower quarter-over-quarter and largely in line with our expectations due to the higher mix of US federal government business, which typically has lower contract duration.

Non-GAAP gross margin in Q1 was 85.9%, higher than our expectations due to higher revenue and a mix of factors leading to lower-than-expected cost of goods sold. Non-GAAP operating expenses were $360 million in Q1. Non-GAAP operating margin in Q1 was 15.6%, higher than our guided range of 9% to 11%, partly due to higher-than-expected revenue. Non-GAAP net income in Q1 was $85 million or EPS of $0.29 per share based on fully diluted weighted average shares outstanding of approximately 293 million shares. Linearity was good and DSOs based on revenue and ending ARR were 24 days in Q1.

Free cash flow in Q1 was $132 million, implying free cash flow margin of 26%, higher than our expectations largely due to better-than-expected bookings linearity. We saw a larger-than-expected proportion of Q1 bookings in the first two months of the quarter. And since our payment terms are typically 30 to 45 days, more of the bookings were billed and collected in Q1 than expected.

We ended Q1 with cash, cash equivalents and short-term investments of $1.571 billion, up from $1.437 billion in Q4 2023. Under the share repurchase program authorized by our board of directors at the end of August, we began repurchasing shares in Q1 through a 10b5-1 plan. Given the timing of the authorization, we were in the market repurchasing shares for only a portion of Q1.

Moving on to Q2, our guidance for Q2 2024 is as follows. ACV billings of $295 million to $305 million, revenue of $545 million to $555 million, non-GAAP gross margin of 85% to 86%, non-GAAP operating margin of 14% to 16%, fully diluted shares outstanding of approximately 297 million shares.

The updated guidance for full year fiscal year 2024 is as follows. ACV billings of $1.08 billion to $1.10 billion, representing year-over-year growth of 14% at the midpoint of the range; revenue of $2.095 billion to $2.125 billion, representing year-over-year growth of 13% at the midpoint; non-GAAP gross margin of approximately 85%; non-GAAP operating margin of 11.5% to 12.5%; free cash flow of $340 million to $360 million, representing free cash flow margin of 16.6% at the midpoint of the range. This updated fiscal year 2024 guidance is higher than our previously provided fiscal year 2024 guidance across all metrics.

I will now provide some additional commentary regarding our fiscal year 2024 guidance. First, we are seeing continued new and expansion opportunities for our solutions despite the uncertain macro environment. However, as we mentioned previously, we have continued to see a modest elongation of average sales cycles. Our fiscal year 2024 new and expansion ACV performance outlook assumes some impact from these macro dynamics. Second, the guidance assumes that our renewals business will continue to perform well. And a reminder that while our available to renew, or ATR pool, continues to grow year-over-year, it is growing at a slower pace in fiscal year 2024 but is expected to reactivate in fiscal year 2025 based on our current view.

Third, the full year guidance assumes that average contract duration would be flat to slightly lower compared to fiscal year 2023, as renewals continue to grow as a percentage of our billings. A reminder that the full year ACV billing is not the sum of the ACV billings of the four quarters due to contracts with durations less than one year.

We expect full-year ACV billings to be about 5% to 6% lower than the sum of the four quarters' ACV billing. Finally, a few thoughts on seasonality for the remainder of the fiscal year. Based on our current view, we expect the trend in top-line metrics in Q3 relative to Q2 to be more or less similar to what we saw in fiscal year 2023. A reminder that operating expenses tend to be slightly higher in Q3 versus Q2, all else being equal, as Q3 includes the full impact of calendar year resets to payroll taxes.

In closing, we are pleased with our Q1 results exceeding guidance and to raise our top-line and bottom-line guidance for the full fiscal year. With that, operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question for today will be coming from Pinjam Bora (sic) [Pinjalim Bora] of JPMorgan. Your line is open.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Hey. Thank you. This is Pinjalim. Thank you for taking the questions and congrats on the quarter, guys. Rajiv, I was surprised to hear your first customer for GPT-in-a-Box, so that's what I'm going to ask. Maybe add a little bit more color around what this company is doing with GPT-in-a-Box. Is this more of a test dev kind of an environment or are they looking to actually do something in production using GPT-in-a-Box? Are you seeing similar deals in the pipeline? How should we think about uplift in ACV? A number of questions. Just surprised to see a new customer signing up so quickly.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yes, Pinjalim. So, thanks for the question. It's still early days for GPT-in-a-Box. And actually, we've seen good inbound interest from customers and fellow prospective ecosystem partners. Now, we did land that first win for GPT-in-a-Box. It is a federal agency. And the use cases are along the lines of what we've talked about.

A lot of use cases have to do with sort of document retrieval, looking for patterns, looking for potential criminal activity, etcetera, right, and that's along the lines of what this particular agency was looking to do. Now, from an operating perspective, it's still very early days for us. It's still early to really comment on when it's going to be a meaningful contribution to our numbers at this point. And so, that's what I can say about GPT now.

Perhaps it might be worth recapping a little bit on a broader basis of how we see this market for us, if that makes sense. So, for us, I look at AI – I've sort of said this at our Investor Day, but there's three parts to it. First is landing new applications. A lot of companies looking at new applications like this particular customer and many others, landing there on our platform, and there, again, I think AI applications are going to run where the data is.

And some of the data will be in the public cloud, but others are going to be sensitive. They're going to be in the private cloud, in secure locations, for example. And for those types of situations, we can help with our GPT-in-a-Box platform to provide a turnkey solution for them, both fine tune and train models from their specific data as well as doing financing. That's the first piece in terms of landing new applications.

The second is, of course, about making our own products better. And we do, for example, a lot of telemetry that we gather from customers and we can use back in AI to analyze that, get insights. We have a product around operations management. In fact, that product is called AI operations. And so, again, there's a lot of AI behind it to make the operating environment and optimize the operating environment such as capacity planning, et cetera. That's the second vector.

The third vector is really using it internally itself to make things more efficient and run as more – automate more processes inside the company. We are starting that out, for example, with customer service on our end. So, that's the broader picture. It's still early days for us with Gen AI, but again, lots of interest and we'll continue to engage.

Pinjalim Bora
Analyst, JPMorgan Securities LLC
Q

Understood. One follow-up. In the channel, we have been hearing that Red Hat has kind of thrown its hat on for the VMware opportunity with OpenShift Virtualization technology. You obviously have a strong partnership with Red Hat. How do you kind of see that coopetition play out as both of you kind of go after the VMware opportunities?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Yes. In fact, I mean, I think the – this is actually the original thesis for the Red Hat partnership, that we complement each other very well, and they, from an OpenShift perspective, providing a complete platform for modern app development; and we, being the underlying infrastructure platform. And so, from their perspective, as they compete against VMware on the application side, we compete with VMware on the infrastructure side. So, the partnership was very good from that perspective, good synergies on our side.

Now, we have seen several customers adopt OpenShift on top of Nutanix. That continues. And we've seen G2K wins here as well with including G2K banks, for example, running OpenShift on the Nutanix platform. So, it's a good synergistic relationship. We look forward to doing more with them. So, in fact, this particular G2K bank in Asia-Pacific that I mentioned was a good example where they're running OpenShift on top of our cloud platform.

Pinjalim Bora
Analyst, JPMorgan Securities LLC
Q

Understood.

Operator: Thank you. One moment for the next question. And today our next question will be coming from Jim Fish of Piper Sandler. Your line is open.

James E. Fish
Analyst, Piper Sandler & Co.
Q

Hey, guys. Great quarter. Just wanted to build off the last one, ask it a little bit more directly. You guys have talked about like a little bit of VMware contribution here this quarter, but maybe you could walk us just through the pipeline, what's the pipeline looked now that the competitor's acquisition has officially closed over to Broadcom and [indiscernible] (23:18) from what we've heard in our channel checks at least about them kind of raising maintenance prices pretty significantly. So, can you just walk us through a little bit more detail on what you're seeing on the VMware pipeline itself going forward outside of just the Red Hat opportunity?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

For Sure, Jim. Good question. And, of course, very relevant given what just happened with the transaction closing. So, even just last quarter, we did close some additional deals that I would consider to be influenced by the Broadcom VMware transaction. In fact, again, going back to that bank win that we talked about, the G2K bank, and that is certainly influenced by this transaction. As we mentioned, it was a dual vendor strategy, but going forward, it's going to be a single vendor strategy with us.

Now, the timing and magnitude of these deals is unpredictable. And also, attributing the primary motivations for these deals also can be a bit nuanced, because we compete every day, right, even before all of these acquisitions you saw, but they're certainly contributing. Now, the transaction, of course, closed recently, but we don't expect that to have an immediate impact for us in terms of timing or potential risks. Clearly, many customers have signed multiyear ELAs with VMware prior to the deal closing. And for those that have signed, that gives them some time to evaluate options going forward.

There continues to be certainly a lot of concerns around all the stuff we've talked about in the past; pricing, increased pricing potentially, dropping support levels, etcetera. So, we have a significant pipeline of opportunities and it's growing, and a good degree of engagement with prospects driven by these concerns. It's just difficult to predict timing and magnitude of events, and we continue to expect some benefit from these, influenced by this transaction, and we certainly factored that in, into our guidance for this fiscal year.

James E. Fish
Analyst, Piper Sandler & Co.

Q

Very helpful. And surprised to hear a little bit about the Cisco partnership already picking up. I mean, we're two months in, understanding it's easier with the installed base of HyperFlex to kind of sell or sell into that base. But any way to think about if there are larger periods of renewals at certain times within that base or if those renewals are accelerating, understanding you mentioned that the larger – the wins there were more on the kind of customers evaluating HyperFlex and you guys got substituted in?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. I mean, that's why I think we're happy that our joint solution with Cisco became available this last quarter. So, it's now in the field, both sellers are selling it. And those deals, the initial deals, of course, naturally, are ones where Cisco was either had already won them or were very close to winning them with HyperFlex. And now, they're simply converting those over to Nutanix going forward.

So, that's sort of the first part. But with respect to new pipeline, really, I mean, we know that our pipeline it takes 6 to 9 months to go through those deals for us, right? So, we don't expect a huge amount of Cisco this year. We expect some and we factored that into our guidance this year. And then, we expect that to continue growing next fiscal year and beyond.

James E. Fish
Analyst, Piper Sandler & Co.

Q

Good stuff. Thanks, guys.

Operator: Thank you. One moment for the next question. Our next question will be coming from Matt Hedberg of RBC Capital. Your line is open.

Matthew Hedberg
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question, guys. And I'll offer my congrats as well. Really solid quarter and guide, especially given the uncertainty of the macro environment. Rukmini, I had a question for you. You noted strong renewals in the quarter and obviously it's becoming a bigger part of the mix. On the call, you talked about some new wins as well. But I'm curious, can you just step back and maybe double-click a little bit more on the new business side of it? I know that obviously it's been more of a renewals business of late, but just where are we in the new business sort of aspect of the story?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yeah. Hi, Matt. Thank you for the question. So, if we think about Q1, I'll talk about Q1 performance versus maybe what you were alluding to, but then also maybe talk a little bit about the full year, Matt, to your point on just trends and so on. So in Q1, specifically, our overall sort of top line performance – or outperformance really was driven by a combination of good execution across our new and expansion business. And within that, we talked specifically about our US federal business, which had a really significant and nice year-over-year growth in new and expansion ACV bookings. So that was certainly something that we benefited from in Q1.

Now, for the full year, Matt, we've talked about, I think, some puts and takes that we are factoring into our outlook. One is that we are expecting some improvement in our new and expansion ACV performance compared to fiscal year 2023. We've talked about – Rajiv just touched upon like some things that we're factoring in, in terms of benefits, whether it be a little benefit from what's happening in the competitive environment, and some benefit from the fairly new fiscal partnership and so on.

So we have some things that we're optimistic and excited about. At the same time, as you started your question, Matt, like there's also uncertainty in the macro, which just means that it's harder for us to sit here and say exactly how the rest of the year is going to play out. So those are some of the things we've factored into our new and expansion performance for the year.

I will say, I think as you pointed out, right, renewals tends to be a much more predictable portion of the business just given our GRR, as you said before, is in the 90-plus-percent range and we know when those renewals are coming up for the next transaction. And so, that part continues to be predictable and continues to perform well. And so hopefully that gives you a sense of our new and expansion comparison.

Matthew Hedberg
Analyst, RBC Capital Markets LLC
Q

Super helpful. If I could ask one more. The gross margin performance has been great and, obviously, you guided to a really strong Q2 gross margin. Maybe could you double-click there also, like, what are some of the biggest factors driving that significant gross margin improvement?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yeah. So I think a couple of points there I would make, again, I'd start with sort of the Q1 and maybe the Q2 guide, Matt, and then talk more broadly on gross margin. So for Q1, we attributed our gross margin outperformance to revenue coming in slightly higher, of course, because we beat on revenue. But we also had a mix of factors that led to COGS coming in lower.

Now, there were a few things in there, Matt. Nothing that I would call out as one singular factor, but a mix of things, some of which we believe will sustain and which is why we were happy to take up our full year gross margin number. Last quarter when we gave you the first guide, we said approximately 84% and we're happy to take it up to approximately 85%.

So, I would say it's just a mix of good execution on a few different fronts, and a reminder that our COGS has a good portion of it is our support teams, right, so our customer support folks are in there. We have services cost in there. And so, across a few different dimensions, we were happy to see gross margin do better and take some of that across to the full year guide as well.

Matthew Hedberg
Analyst, RBC Capital Markets LLC
Q

Got it. Thanks a lot.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Thank you.

Operator: Thank you. One moment for the next question. Our next question will be coming from George Wang of Barclays. Your line is open.

George Wang
Analyst, Barclays Capital, Inc.
Q

Oh, hey, guys. Congrats on the quarter. Yeah, I have two quick ones. Firstly, just given better-than-expected free cash flow generation, just given kind of you guys started purchasing stocks, just curious kind of any high-level plan going forward how to model in terms of the share buybacks just given the better free cash flow profile.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Hi, George. Thank you for the question. So, as I mentioned in my prepared remarks, we did begin repurchasing shares in Q1 under the authorization that we had from our – that was approved by our board in August. And we did that through a 10b5-1 program that we've set up. Due to the timing of the authorization, we were only in the market for a portion of Q1. And you'll see in the financial tables that we put up with the release that we spent about $17.5 million repurchasing shares during that time. So, for a portion of Q1, we spent $17.5 million.

And the timing and amount of the future repurchases will continue to depend on a variety of factors, George, including stock prices, just conditions of the market and so on. And so, I won't get too specific in terms of outlook, but I wanted to give you at least a bit of color on what we did in Q1, acknowledging it was only for a portion of the quarter.

George Wang
Analyst, Barclays Capital, Inc.
Q

Okay. Great. Just a quick follow-up, if I can. Just can you kind of comment on the backlog? Last quarter, you talked about backlog slightly improved in absolute dollar year-over-year, and you kind of factored into the FY 2024 guide. Just curious if you have any latest update in terms of the backlog level and any sort of plus or minuses how would that factor into the latest guide.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Yeah. Happy to give you some color on that. So, we used some backlog in Q1 as is seasonally typical for Q1 and expect some backlog to be consumed over the course of this fiscal year as we've talked about before. But as is to be expected in an environment like this, where things remain fairly uncertain from a macro perspective, the range of possible outcomes is wider than usual. And as we continue to grow, the absolute dollar number of backlog will also increase over time. So, a few different factors there. But yeah, I think in Q1 we used some backlog as is typical for Q1 and we expect to use some backlog over the course of the year as well.

George Wang
Analyst, Barclays Capital, Inc.

Q

Okay. Great. I will go back to the queue.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you.

Operator: Thank you. One moment for the next question. The next question will be coming from Michael Cikos of Needham. Your line is open.

Michael Joseph Cikos
Analyst, Needham & Co. LLC

Q

Hey, guys. Thanks for getting me on the call here and congrats on the strong quarter. Wanted to cycle back to some of the comments when we're describing the revenue and the ACV billings outperformance. I know that we cited specifically US federal. Can you give us a better sense as far as what US federal is as far as size or contribution to revenue or ACV billings, understanding that there's probably seasonality with their year-end? But would just be good to get a flavor for how big of a component that is of the overall business.

And then also, if you could shed some light – I know that you cited the improved linearity during the quarter. Is that improved linearity tied back to the stronger US federal business or are those two independent items in your view?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

So, I can take a first crack at the federal piece. Rukmini, again, go for the rest. So, [ph] one of the things (34:43), look, largely we don't have verticals, but we have two exceptions, and that's in the US we have federal as a vertical and we have healthcare as another vertical.

So from that perspective, federal is a significant portion of our business. We haven't broken it out exactly in terms of the percentages. But given the fact that it is one of two verticals and we have a focused team on it, it is important for us. And of course, there's also seasonality there as Rukmini was alluding to here, I mean, this quarter typically is strong for federal. So that's kind of what we have to say about federal. Rukmini, you can comment on the linearity.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yes. So, on the linearity, Mike, what we mean there is we have some expectations of how much bookings comes in, in month one, month two, month three. And the reason that's important for free cash flow, right, is because we invoice soon after we get the booking, and we have 30- to 45-day invoice payment term. And so, what we saw in Q1 is that, compared to our expectations going in, we saw a larger proportion of those bookings come in month one and month two.

And you're right, there's an outperformance in spread as well, and of course, that had the year-end, the US federal government has their fiscal year-end in September so that was likely a factor in that. And so, what that meant was that, given, again, we invoice right after we get the bookings, we collected more cash from bookings in Q1 than we had previously expected, which was a significant driver of the cash flow performance in Q1.

Michael Joseph Cikos
Analyst, Needham & Co. LLC

Q

Understood. Thank you for clearing that up. And I guess the other question that I had, this is more specific to the 2Q guidance that we had here today, Rukmini, but if I could just take a look – I'm happy to see that the revenue is coming in above where the sell-side models were, happy to see the strong gross margins, and then the operating margins also coming in ahead of where we had been. But one of the things that I'm looking at is the OpEx.

The implied OpEx from Q1 to Q2 has a pretty material tick up after being relatively flat the last couple of quarters. And I just wanted to see what is it that you guys are embedding in that, is it more maybe targeted go-to-market initiatives? Are you focused on hiring or potentially backfilling open positions? Like, how should we think about that OpEx ramp that you guys are putting now in the 2Q guide?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yes. So, a few points on Q2 OpEx related to Q1, Mike. The first one is, as we talked about when we laid out sort of our initial full year guide on the last call, we talked about the fact that we plan to continue to invest to drive growth while continuing to improve the margin profile. And that's the approach that we've taken for this year.

And you saw some of that in the last call, but also we touched on this sort of idea at Investor Day as well. And so, in general, we've started those investments, and as you can imagine, it takes time. We're continuing to hire, and so as you can imagine, that sort of leads to sort of an increase in Q2 as more of the folks come on board.

The other piece is, this is only for one month of Q2, but in the calendar year reset, and I alluded to this in my script as well, the payroll taxes and all of that reset for calendar year 2024, which means that we have one month of that in January. That also has an effect on the Q2 OpEx. That all said, of course, we were pleased, as you pointed out, to be able to raise both of our top line and bottom line guidance for the full year.

Michael Joseph Cikos
Analyst, Needham & Co. LLC

Q

That's great. Thank you for explaining that again, Rukmini. And I'll turn it over to my colleagues. Appreciate the time.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you, Mike.

Operator: Thank you. One moment while we prepare for the next question. And the next question will be coming from Erik Suppiger of JMP. Your line is open.

Erik Suppiger
Analyst, JMP Securities LLC

Q

Yes. Thanks for taking the question and congrats. Two questions. One, you said the sales cycles continue to elongate, are they still getting longer or is it just they've kind of reached a level of extended cycles? And is it consistent with last quarter? Is it actually getting longer?

And then secondly, you've had some time now to talk with customers about their ChatGPT-in-a-Box. What are the specific use cases that the customers are using, either what department are they using that for, or how are they using that in particular?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Rukmini?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you, Erik. I'll take the first one – yeah. And then, Rajiv, you can take maybe the GPT-in-a-Box question. So on sales cycles, what I said in my script, Erik, was that we're seeing some increased elongation, right, and a modest increase in average sales cycles on a year-over-year basis. I'm comparing Q1 to Q1, it has gotten longer in Q1.

But if you look at average sales cycle in Q1, it was more or less the same as the last few quarters. So it's not like it's continued to lengthen necessarily quarter-over-quarter. But year-over-year, it remains elevated. And this, again, it's hard to sort of forecast what's going to – exactly is going to happen here given all the uncertainties we've talked about. But that's what we find in Q1.

Erik Suppiger
Analyst, JMP Securities LLC

Q

Okay.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

So, Erik, on the GPT-in-a-Box – by the way, it's GPT, not ChatGPT, to be exact.

Erik Suppiger
Analyst, JMP Securities LLC

Q

Yeah. Apologies for that. Yeah.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

So, on the GPT-in-a-Box, actually there are four use cases that we typically see. And, again, I have already cautioned all this by saying it's still pretty early, a lot of people are just trying to figure out how to use Gen AI. But the four use cases right now, first, of course, is the classic customer service use case, that includes chat. That's one. The second is a whole bunch of operations having to do with document; document search, document analysis, document – the dribble of key information from unstructured data, for example. So that's a second big, I would say, use case.

The third use case is co-piloting, generally providing assistive services, for example, to software developers or our researchers in pharma, for example. That's a third use case. And the fourth use case that I would broadly classify as fraud detection or fraud prevention. And these are things that are across multiple verticals. I think these tend to cut across verticals whether it be financial services or retail or federal or whatever.

Erik Suppiger
Analyst, JMP Securities LLC

Q

Last question is, you talked about the classic customer service, is that the majority of the use cases at this point or is it spread across those different four options?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

I would say it's spread across. The customer service one, for example, happens to be one that we, ourselves, internally trying right now within Nutanix. But I would say it's very broad-based across all of those four and it's still very early, I would say, to say, hey, we can actually say, this presents one use case versus the other, it's just – we are in the forming stages here.

Erik Suppiger
Analyst, JMP Securities LLC

Q

Okay. Thank you.

Operator: Thank you. One moment. Our next question will be coming from Meta Marshall of Morgan Stanley. Your line is open.

Karan Juvekar
Analyst, Morgan Stanley & Co. LLC

Q

Hi. Thank you. This is Karan on for Meta. So, just first question, I understand it's sort of a challenged environment today, but I guess just in terms of customer conversations or what you're hearing from customers in terms of 2024 budgets, I guess what do you hear from customers on those budgets? And are you seeing a pickup in any RFP activity?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

I wouldn't say there's anything specific we are seeing in our conversations with customers. I think – certainly, look, I would say they're still investing in their digital efforts, in their modernization efforts. Every customer call I have this conversation on how they can be using AI inside their companies. So, from a budget perspective, I would say in general, I think IT spending will probably grow faster than GDP growth.

And within that, I would say software modernization spending will probably grow faster than that. But we haven't seen any specific trend other than the fact that there are customers that are still [indiscernible] (43:22) at least, they're willing to spend the money, they want to make sure there's a solid business case and there's good TCO and ROI for everything that they do. And there's certainly more inspection, which is what is causing the elongation in the cycle, right? They want to make sure that maybe an additional level of approvals, for example, before they sign off on projects, but they're still moving forward with projects.

Karan Juvekar
Analyst, Morgan Stanley & Co. LLC

Q

Okay. That's helpful. And then a quick follow-up. Sort of at the Analyst Day, you mentioned some of the VMware share gains would likely take place, which is a little bit of share with each customer over time. I guess as you start to see these opportunities take place, are these shares maybe – are the share-taking greater than expected or is it just more opportunities or more [ph] at bats (44:06)? Or I guess just any color around sort of the opportunities you're seeing in share gains there.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. I think we commented on the overall situation from a VMware-Broadcom perspective. Again, I think we are still at a point where we have a significant and growing pipeline of opportunities that we are engaged in with prospects. But it's hard to predict what portion of those we'll win, how much will they, for example, bring us in as a second vendor or the sole vendor or just use us as a negotiating lever to get a better deal from VMware.

So, there's a lot of uncertainties and lack of predictability there for the long term. So, we've focused on the timing, for example, for when this might happen. So, that's why we have – we've modeled in some level of share gains here into our forecast for the year and it's incorporated into the guidance. But it's going to be – I would again emphasize that it's going to be a multiyear thing for us here, and it's going to be a bit timing and the exact share gains are going to be a little unpredictable.

Karan Juvekar
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. That's helpful. Thank you.

Operator: Thank you. One moment for the next question. Our next question will be coming from Ben Bollin of Cleveland Research. Your line is open.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Thank you. Good afternoon everyone. Rajiv, I wanted to ask about the Global 2000 financials awards. Could you share a little bit about what that process was like? How long was the evaluation, the pilot? And how did the ACV ramp for that deal? Does it build over time as they get more data centers? Does it commence at a full run rate? Just any color on that. And then I have a follow-up.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. So, this particular bank in Asia Pacific, the G2K bank, has been a customer for a while for us. And what they've been doing, of course, was a classic. They've been migrating from traditional legacy, three-tier infrastructure over to HCI. And for many years – I mean, they've been a customer for a while now, and for many years it was a dual vendor situation, with us and VMware. And so, they've been going on both parts. They had us, they had this, and this was a classic time where we were coming due for a renewal and they were also looking to expand, significantly increase their presence. They are growing, and they had multiple data centers that they were going to go modernize. So for them, this was a time for them to – for us to do an expansion along with the renewal, a substantial expansion.

And like we've said with other G2K customers, generally once we get in the door, they're pretty happy with us, and they do expand with us over time. In fact, we've given you some data at Investor Day in terms of how much the expansion was like. I think it was 25 or 26 banks over life. So this particular bank was similar, right? They liked us. They were comfortable with us. And then now they had this additional trigger that they were concerned about what would happen on the other side. So when they did do the expansion with us, they went with us as a sole vendor. So that's sort of how it played out for us.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Okay.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

If I can add to that, Ben, I think you had a question on ACV ramp. And just to clarify, right, our contracts typically, they're so evenly spread out, there isn't a ramp within the year. So, like this transaction, and typically most of our transactions, it would be a total TCV amount divided by the contract duration, that's how we calculate the ACV of any given transaction.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Okay. That's great. The other item, Rajiv, I'm curious, you talked about the MSP award, can you share any thoughts about your strategy around go-to-market efforts? Do you have some programs specifically geared to pursue more of these partners that are potentially alienated by this deal? That's it for me. Thank you.

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yes. I think that's a, again, that's a both an MSP-specific thing here and a broader thing here as well in your question, Ben. So, on the MSP specific, I mean, for us independent of this transaction, this was an area that we want to do more in because traditionally we have not had a big route to market through MSP. So, for the past couple of years, we've been building up our MSP presence and recruiting more of these MSPs to come onboard as partners. And that continues, and this particular deal in the first quarter was a good example of an expansion opportunity where they had done something small with us, and now this time they did a significant expansion with us.

So, I do think that with the transaction happening, it's not only the customers of VMware that are going to be concerned, but there's also their partners. And that includes the MSP partners. So we're talking to the MSP partners just like we would with other customers and trying to recruit more of them onto the Nutanix platform. And so, this is still, I would say, we are young when it comes to the MSP route to market. And so there's potentially lot more MSPs that we do need to recruit over time and get onboard as our partners. And we have a team at Nutanix that's focused on recruiting these partners and enabling them.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Thanks, Rajiv.

Operator: Thank you. One moment for the next question. The next question is coming from Ruplu Bhattacharya from Bank of America. Your line is open.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Hi. Thank you. It's actually Wamsi here at the Bank of America. I guess, Rukmini, if you could address seasonality. Your Q2 revenue guidance at the midpoint is calling for a 8% growth, that is the lowest that we've seen over the last four or five years, but you're calling for Q3 seasonality to be down similar to fiscal 2023, which is down the highest in the last several years. And I'm just wondering, are you seeing something around the macro that's causing you to view the seasonality this way, which is actually a little bit biased lower towards Q3 than historical, a little bit lower also in Q2 to the upside? Just wondering if you could share any color there.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Hi, Wamsi. Thanks for the question. So, a few things I would say. One, on the Q1 to Q2 dynamic, we talked about Q1, of course, came in at a bit higher than our expectations given the beat across revenue and ACV billings, Wamsi. So I think relative to that, Q2 I think, to your point, still going to look based on our guidance, right, higher than Q1 as we seasonally see it. I wouldn't read too much into that dynamic. And then the reason we sort of gave the color on Q3 is to just note what we're seeing right now based on pipeline and all the various factors we've talked about already as it relates to things that are driving the top line.

And I'll just remind folks again, as we said in the prepared remarks as well, that the full year ACV billings is at about a 5% or 6% discount to the sum of the four quarters given the annualization that we do each quarter for contracts less than one year. So overall, I'd say, Wamsi, I think I wouldn't read too much into the seasonality point other than what we're seeing in our pipeline, wants to give folks an update on that. And overall, we're happy to be able to raise our 2024 ACV billings guidance, right, following a solid first quarter. But we've also factored in some caution overall regarding how the rest of the year plays out given some of this macro uncertainty.

Wamsi Mohan
Analyst, BofA Securities, Inc.

Q

Okay. Okay. Thank you. Appreciate the color. And just on free cash flow, the clarification. When you think about what you would have normally called a normal looking linearity in the quarter, what would you say is the delta of overachievement in fiscal 1Q and is that overachievement primarily what's driving the full year free cash flow increase, or are you expecting sort of – is that free cash flow way beyond sort of the 1Q overachievement? Thank you so much.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Yeah. Great question, Wamsi. So, your two thoughts, so one on Q1, we, of course, don't guide to quarterly free cash flow so I'm not able to sort of give you specifically how much we overachieved our own expectations for Q1 free cash flow, but we did overachieve it. And I will say that, in addition to the billings number coming higher, right, given we had a beat on ACV billings as well for Q1, so that helped. But the linearity was a significant factor in Q1. Okay? So that did have a significant impact on the outperformance of free cash flow in Q1.

And I think the second part of your question is around the full-year free cash flow guidance. And what I'd say there is that, in addition to benefiting from the raised top line guide and, of course, as you know billings have a very high correlation with free cash flow, right, so the fact that we were able to raise our full year billings number, so that's one factor. But we're also expecting to see some benefit from somewhat better working capital management within the year than previously expected, including some improved linearity, so that was helping us to raise the full year free cash flow guide as well.

Wamsi Mohan
Analyst, BofA Securities, Inc.
Q

Okay. Great. Thank you so much. Congrats on the quarter.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Thank you, Wamsi.

Operator: Thank you. One moment for the next question. And the next question is coming from Simon Leopold of Raymond James. Your line is open.

Victor Chiu
Analyst, Raymond James & Associates, Inc.
Q

Hey, guys. This is Victor Chiu in for Simon Leopold. Regarding the share shifts in competitive dynamics with VMware, are there instances where customers use both VMware and Nutanix?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Oh, a lot of customers use both VMware and Nutanix. And again, I think just to clarify how they use, sometimes they use us as just – they have a dual vendor strategy, they'll do some with VMware, some with Nutanix. There's also – we work together with Nutanix's – I mean, Nutanix works together with VMware hypervisor ESXi. So we have a lot of customers who are deploying Nutanix on top of VMware hypervisor ESXi.

And over the years, many of these have also migrated from ESXi to our own vision hypervisor that's included in the platform. In fact, again, I would say, over the years, we came out with our own hypervisor back in 2015, and today, if you look at our workload across the entire spectrum of customers, about 65% of those workloads have migrated and they're now on just a Nutanix hypervisor. Most of those were on the VMware ESXi hypervisor. But we have committed to continue to interoperate very nicely with VMware, and for customers to have the choice. They have – it's all about providing freedom of choice for customers. So, we incorporate with them. We can replace them fully. It's up to the customer.

Victor Chiu
Analyst, Raymond James & Associates, Inc.
Q

Okay. Okay. And are you having discussions with customers? Is your visibility kind of what – into what their plans are, going forward kind of built into your assumptions, kind of the share shifts that come along with that, is that kind of built into your assumptions?

Rajiv Ramaswami
President, Chief Executive Officer & Director, Nutanix, Inc.
A

Yes.

Victor Chiu

Analyst, Raymond James & Associates, Inc.

Q

Or is there some dry powder that potentially happens with the shift?

Rajiv Ramaswami

President, Chief Executive Officer & Director, Nutanix, Inc.

A

Yeah. Like we said, it's hard to predict the timing and how big these things are going to be, right? And so, we have factored in some of this into our guide for the full year, and we'll have to see how things materialize. There's a lot of engagement but what happens to these engagements from, do we win them fully, do we win partially, or do we win nothing and just become a leverage point for them to get a better deal on the other side, it's hard to predict ahead of time. So, we have to see how it plays out. And it's hard to predict both timing and the degree to which they'll play out for each customer.

Victor Chiu

Analyst, Raymond James & Associates, Inc.

Q

Okay. Okay. That's very helpful. Let me see here. Okay. Yeah. That's helpful. I'll jump back in queue and – yeah. That's very helpful. Thank you.

Operator: Thank you. This concludes the Q&A session. I would like to turn the call back over to management for closing remarks. Please go ahead.

Rajiv Ramaswami

President, Chief Executive Officer & Director, Nutanix, Inc.

I don't think we have any closing remarks, do we?

Richard Valera

Vice President-Investor Relations, Nutanix, Inc.

No, I think we can conclude the call now. Thank you.

Rajiv Ramaswami

President, Chief Executive Officer & Director, Nutanix, Inc.

Thank you all.

Rukmini Sivaraman

Chief Financial Officer, Nutanix, Inc.

Thanks everyone.

Rajiv Ramaswami

President, Chief Executive Officer & Director, Nutanix, Inc.

Thank you.

Operator: Thank you all for joining the conference call tonight. You may all disconnect.