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Nutanix, Inc. (NTNX)

Q1 2025 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, and welcome to the Nutanix First Quarter 2025 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

It is now my pleasure to introduce Vice President of Investor Relations, Rich Valera.

Richard Valera

Vice President-Investor Relations, Nutanix, Inc.

Good afternoon, and welcome to today's conference call to discuss first quarter fiscal year 2025 financial results. Joining me today are Rajiv Ramaswami, Nutanix's President and CEO; and Rukmini Sivaraman, Nutanix's CFO. After the market closed today, Nutanix issued a press release announcing first quarter fiscal year 2025 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 more detailed description of these and other risks and uncertainties, please refer to our SEC filings, including our most recent Annual Report on Form 10-K 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 predictions of future events.

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 on December 10; and the Barclays Global Technology Conference in San Francisco on December 12. We hope to see some of you at these events.

Finally, our second quarter fiscal 2025 quiet period will begin on January 18. 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're happy to report first quarter results that came in ahead of our guidance. We continue to see steady demand for our solutions, driven by businesses prioritizing their digital transformation and infrastructure modernization initiatives, and looking to optimize their total cost of ownership or TCO.

Taking a closer look at the first quarter, we exceeded all our guided metrics. We delivered quarterly revenue of $591 million and grew our ARR 18% year over year to $1.966 billion. We also saw another quarter of strong year-over-year growth in new logos and solid free cash flow generation. Our largest wins in the quarter demonstrated the appeal of the Nutanix Cloud Platform to organizations that are looking to modernize their IT footprints, including adopting hybrid multi-cloud operating models and modern applications, while also managing through disruption from industry M&A.

One of our largest wins of the quarter was a full stack expansion with a global provider of IT consulting services based in the APAC region. This existing Nutanix customer expanded with us by shifting more workloads to our Cloud Platform and adding additional components of our portfolio, enabling them to increase their automation and self-service capabilities, while also reducing that exposure to their other incumbent infrastructure provider. This expansion was also aimed at strengthening their go-to-market with Nutanix in the areas of Generative AI, modern applications and competitive migrations.

Another notable win in Q1 was a significant expansion with a North American based Fortune 100 provider of foodservices and products. This customer was looking to implement a hybrid, multi-cloud environment with the intent of running more of their workloads in the public cloud and lowering their total cost of ownership, while also reducing their exposure to our largest competitor. They chose the Nutanix Cloud Platform, including Nutanix Cloud Clusters, or NC2 running on AWS, along with Nutanix Cloud Management. This enabled them to reduce their projected TCO by nearly 50%, while also consolidating their existing data center footprint.

On the product front, we recently announced the general availability of GPT-in-a-Box 2.0, our solution for simplifying the deployment of Generative AI applications. A key component of this offering is Nutanix Enterprise AI, or NAI, which helps streamline deployment, scaling and running of inferencing endpoints for large language models. NAI can be deployed within GPT-in-a-Box on prem or at the edge, or independently on native public cloud services such as AWS EKS and Azure AKS. These new capabilities help further our vision of becoming the leading platform for running all apps and managing data anywhere.

A first quarter new logo with a government ministry in the EMEA region demonstrated early progress with the new Generative AI and modern application capabilities of our platform. This customer was looking to modernize their infrastructure and chose a full stack Nutanix solution to support development and deployment of their cloud native and Generative AI applications. They chose GPT-in-a-box 2.0 solution, including our Nutanix Kubernetes Platform and Nutanix Cloud Infrastructure as well as our Nutanix Unified Storage Edge and Nutanix Database Service offerings.

Moving on, we also continue to make progress on the partnership front, signing an expanded strategic partnership with AWS that will simplify cloud migrations and offer access to AWS services for customers looking to migrate to NC2 on AWS. As part of this collaboration, customers will gain access to promotional credits from AWS to support customer migrations and proof of concept trials as well as Nutanix licensing promotions. Customers can also gain access to promotional credits for migrating VMware Cloud on AWS workloads to NC2 on AWS through the AWS VMware Migration Accelerator Program.

Finally, we continued to receive industry recognition in Q1, being named a leader in the 2024 Gartner Magic Quadrant for distributed hybrid infrastructure alongside some of the world's leading public cloud providers, improving from our challenger position in the 2023 Magic Quadrant.

In closing, I am pleased with our solid first quarter results, our ongoing innovation on our Cloud Platform, particularly with respect to its support for Generative AI and modern applications, and on the progress we continue to make on partnerships. We remain focused on delighting our customers while driving sustainable, profitable growth.

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

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

Thank you, Rajiv. And thank you, everyone for joining us today. I will first discuss our Q1 fiscal 2025 results followed by our guidance for Q2 fiscal 2025 and an updated outlook for the full fiscal year 2025. Results in Q1 2025 came in above the high end of our range across our guided metrics. Revenue in Q1 was $591 million higher than the guided range of $565 million to $575 million, representing a year-over-year growth rate of 16%. The outperformance in revenue was driven by good renewals execution. ARR at the end of Q1 was $1.966 billion, representing year-over-year growth of 18%.

We saw strength in landing new customers onto our platform, helped by more leverage from our OEM and channel partners from the various programs we have put in place to incentivize new logos and from a general increase in engagement from customers looking at us as an alternative in the wake of industry M&A. NRR or net dollar based retention rate at the end of Q1 was 110%. Expansion with existing customers was impacted largely by our US Federal business, for which Q1 is a seasonally strong quarter given their September 30th fiscal year end. Our US Fed business performance was lower year-over-year relative to the strong comparison from Q1 a year ago, which we believe is due to impacts from the elongated continuing resolutions resulting in lighter spending from our Fed customers.

Based on our current view, we expect our US Federal business performance to return to more normal levels in the second quarter. In Q1, we continued to see modestly elongated average sales cycles compared to historical levels, which we believe is influenced by the macroeconomic environment and continued increased scrutiny on spend. In addition, as discussed during prior earnings calls, we believe the larger opportunities in our land and expand pipeline continue to involve strategic decisions and C-suite approvals, causing them to take longer to close and to have greater variability in timing, outcome and deal structure. These factors also impact our ARR growth.

Average contract duration in Q1 was 3.1 years, flat sequentially quarter-over-quarter. Non-GAAP gross margin in Q1 was 87.5%. Non-GAAP operating margin in Q1 was 20% higher than our guided range of 14.5% to 15.5%, largely due to higher revenue and to a smaller extent due to lower expenses, including as a result of certain non-recurring payments and credits.

Non-GAAP net income in Q1 was $122 million or fully diluted EPS of $0.42 per share based on fully diluted weighted average shares outstanding of approximately 289 million shares. GAAP net income and fully diluted GAAP EPS in Q1 were $30 million and $0.10 per share respectively. Free cash flow in Q1 was $152 million, representing a free cash flow margin of 26%. Moving to the balance sheet, we ended Q1 with cash, cash equivalents and short-term investments of $1.075 billion, up from $994 million at the end of Q4.

Moving to capital allocation, we repurchased about $20 million worth of shares in Q1 and used about $79 million of cash in Q1 to retire shares related to our employees' tax liability for their quarterly RSU vesting.

Moving to Q2 2025, our guidance for Q2 is as follows. Revenue of $635 million to $645 million. Non-GAAP operating margin of 20% to 21%. Fully diluted weighted average shares outstanding of approximately 289 million shares. Moving to the full year, the updated guidance for fiscal year 2025 is as follows. Revenue of $2.435 billion to $2.465 billion, representing a year-over-year growth of 14% at the midpoint and no change from our initial guidance. Non-GAAP operating margin of approximately 16% to 17%, an increase from our previous guidance.

Free cash flow of $560 million to $610 million, representing a free cash flow margin of approximately 24% at the midpoint and an increase of [ph] $15 million (00:14:58) relative to our prior initial guidance at the midpoint.

I will now provide some commentary and assumptions regarding our updated fiscal year 2025 guidance. First, we are seeing continued land and expand opportunities and a growing pipeline for our solutions. However, as we have discussed previously, we expect continued uncertainty in the timing, outcome and deal structure from the growing mix of larger deals in the pipeline. And as I mentioned earlier, we have continued to see a modest elongation of average sales cycles relative to historical levels, which we believe is related to the uncertain spending environment and which we expect to continue. Second, the guidance assumes that renewals will continue to perform well in fiscal year 2025. Third, the full year guidance assumes that average contract duration will be flat to slightly lower compared to fiscal year 2024, as renewals continue to grow as a percentage of our billings. Fourth, the non-GAAP operating margin guidance assumes incremental, prudent investments in sales and marketing and research and development targeted towards addressing our large market opportunity. Those investments are expected to continue to ramp through the course of the fiscal year.

Finally, a note on seasonality. Based on our current view of renewals cohorts and visibility into land and expand, we expect revenue seasonality in fiscal Q3 relative to Q2 to be similar to what we saw in fiscal year 2023. In closing, we are pleased that our Q1 performance exceeded the high end of our guidance and would like to thank our employees, customers, partners, investors and stakeholders for their continued trust in us. We remain committed to continued progress aligned with our stated philosophy of sustainable, profitable growth, both through durable top line growth and expanding margins.

With that operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And due to time constraints, we ask that participants please limit themselves to one question and one follow up. And our first question comes from the line of Pinjalim Bora with JPMorgan.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Oh, great. Thanks for taking the question and congrats on the quarter, guys. Rajiv, one for you. Maybe can you talk about what are you hearing from customers around the VMS (sic) [VMC] (00:17:47) offering? Trying to understand if this new partnership with AWS might act as a catalyst to kind of convince people to move to NC2 or are you seeing any signs of that?

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

A

Okay. Pinjalim, Rajiv here. I think you meant VMC on AWS, correct? You said, VMS.

Pinjalim Bora
Analyst, JPMorgan Securities LLC

Q

Correct. VMC, correct.

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

VMC on AWS. Correct. Okay. All right. So clearly, I think that seems to be an offering that Broadcom is not focused on as much. And it created an opportunity for us, for sure. And customers are concerned as to what might happen with that offering. For example, the [ph] GAO Cloud (00:18:24) version of that offering, government cloud version was apparently deprecated by Broadcom. So, this is one of the impetuses for the expanded partnership that we have with AWS that we are working together with them to provide easier migration for customers from VMC onto NC2 on AWS. We talked about one of the wins last quarter, actually a leading university that actually went and did exactly that. And anyway, so this is really one of the impetuses why AWS is partnering with us. They're offering migration credit. There's a Migration Accelerator Program. And we are working together to help customers who might be interested in migrating off that offering onto something else in the public cloud.

Pinjalim Bora
Analyst, JPMorgan Securities LLC
Q

Yeah, understood. One for Rukmini. Rukmini, I'm trying to understand the guidance seems like a very solid Q1 beat. You took the Q2 numbers up. But the second half seems like it's an implied guide down because you didn't take the full year number up. So, I'm trying to understand, is that just, prudence, caution around what you're seeing on the sales cycles? Were there any deals that kind of moved from the second half into the first half that changed the seasonality a bit? And lastly, do you think we're close to a trough on NRR?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Thank you, Pinjalim. Both good questions. I'll start with your revenue guidance first. So yes, we were happy with our Q1 revenue performance, but we are only one quarter into the fiscal year. And given the uncertain environment, including that related to a new administration in the US, we think it's prudent to maintain our full year top line guide until we have a better view of how the rest of the year is going to play out. And as I noted in my prepared remarks, we continue to see these modestly elongated average sales cycles compared to historical levels. And we believe that the larger opportunities in our land and expand pipeline continue to involve strategic decisions, more approvals and causing them to take longer to close and to have greater variability in deal structure, outcome and timing.

And finally, from a seasonality perspective, we've historically seen a fairly even split in revenue between the first half and second half of the fiscal year. So, our current expectations aren't that different from what we've seen historically. So, that's on the revenue top line guidance question, Pinjalim.

I think your second part of the question was around NRR. So, a few things on NRR. First, I will say that given that our GRR, while we don't disclose it, we've said in the past that it has not changed significantly relative to recent levels. So, given that, the largest driver of net new ARR is land and expand ACV, right? And your question specifically is on NRR, which does not, for example, benefit from the strength that we saw in our land. So, I want to first start by clarifying that. And we did see some divergence there between sort of the strength in our land performance.

Now, with respect to expand with existing customers, expand accounts for the majority of our land and expand, which was impacted largely by our US Fed business, which was lower year-over-year relative to the strong compare we had from Q1 a year ago, which we believe is due to the CR, the continuing resolutions from in the

US. And so, all the dynamics we talked about on large sales cycle, larger deal sizes, elongated sales cycles, all that does impact expand as well, Pinjalim. So that all did go into the NRR number.

Now, I think your question was around, is this the – is this – have we had sort of the low point for NRR? We don't guide to NRR, as you know, but we do expect that NRR would be impacted by some of these factors that we've talked about, like the sales cycles and the mix of large deals, when we expect some of that to continue, so that we believe is the case, but we don't explicitly guide to NRR.

Operator: Thank you. And our next question comes from the line of Meta Marshall with Morgan Stanley.

Meta A. Marshall
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thanks. Maybe following up on the federal piece, you noted in the script that you expected kind of fiscal Q2 to be better. I would expect you would need the administration change. So maybe you wouldn't expect kind of a federal to improve until fiscal Q3. But just wanted to kind of listen about what went into that commentary, if you could explain that more. And then maybe just a second question. Just any update on kind of timing of Dell PowerFlex kind of integration? Just anything there would be helpful. Thanks.

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

A

So Meta, on the federal question, I mean, we don't have visibility in terms of what the new administration is going to do or not do. So, we can't really talk about what could happen after the new administration comes in. So, we have a near-term view on Q2, of course, which we factored in, and that's why we feel comfortable about our federal business coming back to more normal levels in Q2, based on what we know today. And of course, we'll have to see what the new administration does after they come on board.

Now, on the Dell question specifically, so as you know, Meta, there's two parts to the Dell relationship. One is the existing hyperconverged solution that we have, which will be an appliance sale by combining our software on their service that's been in the market now this quarter and it's still early days for that. Your question on PowerFlex, we expect to have that in the market in the first half of calendar 2025 and we expect to see some revenue contribution from it in FY 2026.

Operator: Thank you. And our next question comes from the line of Jim Fish with Piper Sandler.

James E. Fish
Analyst, Piper Sandler & Co

Q

Hey, guys. I did want to build off of Meta's questions and Pinjalim's there a little bit. Can you just remind us how big this federal vertical can be for you guys here in fiscal Q1 versus kind of what you saw here and what the actual impact to net retention rate was? Like, are we talking about a point or two difference that we would have seen versus the [ph] 110 (00:24:58) or how to kind of quantify that?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

I'll take that, Jim. So, first on quantification of fed, we don't disclose that, Jim, but as you can imagine, and we've said this before, that for our Q1 is typically the seasonally strongest quarter given it's also the federal year end, which covers September 30. So, we don't disclose that number, Jim, but that is Q1 is our strongest fed quarter.

And similarly, right, we're not to break out NRR impact by fed or by any other set of segmentation at this point. But we did see the fact that overall fed and expand specifically was lower than last year, was a challenge for us in Q1 relative to what we saw last Q1, which was a strong compare.

James E. Fish
Analyst, Piper Sandler & Co

Q

Got it. And Rajiv, maybe for you, I think we're all kind of anxious here about when we could see more standalone known AHV into other storage arrays. Obviously, you just talked about the calendar first half of 2025 seeing Dell PowerFlex. But how should we start thinking about Nutanix's relationships of getting standalone AHV integration into some of the other providers out there? And, why we wouldn't start to see that AHV attach go from 74% today to, faster to 100%. Thanks, guys.

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

A

Yeah, I think those are two different questions there, Jim. I think on the first question, clearly, the only one that we've announced so far has been the Dell PowerFlex relationship. As you can imagine, we do have plans to expand that selectively to other storage arrays over time. I'm not going to preannounce anything right now, but you can assume that we are working on that in a very careful way. At the same time, we also want to make sure that whatever we do is actually, focusing on expanding the market opportunity for us and doesn't cannibalize the existing HCI opportunity. So, we are focused specifically on working with storage array vendors that are, workloads that would not necessarily be easier to capture with HCI because the workload we can capture with our own HCI platform, we would like to do that with the full stack. And over time, even for those that we do go in, our goal is to sell the full stack over time. So, stay tuned. I mean, we of course, we'll continue to explore other options in the market when it comes to other storage arrays. And you can, we don't have anything more to say at this point, but the idea is to start with Dell and then over time expand to others.

With respect to your question on AHV penetration, again I think our philosophy has always been we support multiple hypervisors and there's been a natural cadence to by which the AHV adoption has continued to grow, and we are still at where it is. I don't necessarily need it to be 100%, frankly, but our goal is to increase the AHV footprint because we also want to be able to insert into VMware accounts where our platform is running on top of ESX, the VMware hypervisor, and we continue to support that going forward as well. But we would of course like to see more and more customers start to migrate over to our AHV footprint and having of course third party support, third party storage support will only help amplify that.

Operator: Thank you. And our next question comes from the line of Jason Ader with William Blair.

Jason Ader
Analyst, William Blair & Co. LLC

Q

Yeah, thank you. Hey, guys. So, when I look at the second half and you gave basically guidance revenue per quarter for the second half. But then looking at the operating margin for the year, you raised that only slightly after having pretty significant outperformance in Q1 and also guiding to, pretty robust operating margin in Q2. So that implies the second half is going to be kind of way down on the operating margin. And I know you said you're going to be ramping expenses. But just want to make sure that there's nothing kind of idiosyncratic to the second half that we're not thinking about. And then can you talk about where that ramp up in spending is going to come from? You said sales and marketing and R&D, but could you be more specific within those buckets?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Hi, Jason. First on operating margin, so you're correct. So first, I start with revenue. What we said was, I think in response to an earlier question that our implied revenue split first half to second half is roughly even based on the guide, and that's similar to our historical patterns. While we expect operating expenses, on the other hand, to grow over the course of the year, much like it did last fiscal year. So, to your point, you're correct that we will expect to see lower operating margins in the second half of the year in fiscal year 2025. However, overall, we still expect to see year-over-year improvement in operating margin for the full fiscal year relative to fiscal year 2024.

And then to the second part of your question on where are we spending those dollars? So first, in R&D, we have talked about investing, for example, in these AHV standalone to support the standalone storage array. So that's one area of R&D investment. Some other examples include we have ramped up our offerings around cloud natives or containerized applications. That's another area, Generative AI plus our core Enterprise platform, right, to the platform and making sure that it continues to evolve. So even within our core platform, there are innovations that we continue to drive. So, that's on the R&D side some examples of where we're investing.

On the sales and marketing side, we have talked about some investments we've made, some we made last year and some will continue into this year. For example, around product specialist sellers, folks are focused on selling our entire portfolio and helping our main field sellers go do that. We have increased some investments around the channel. As another example, some inside sales folks who can be focused on driving both expansion and land around the more mid-market peer. So, those are some examples of areas that we're investing in, both sales and marketing and in R&D.

Jason Ader
Analyst, William Blair & Co. LLC
Q

Okay, great. Thank you.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Thank you.

Operator: Thank you. And our next question comes from the line of Wamsi Mohan with Bank of America.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.
Q

Hi, and thanks for taking my questions. It's Ruplu filling in for Wamsi today. Rukmini, the renewals business has been strong. How should we think about the growth in available to renewal pool in fiscal 2025 versus fiscal 2024? And is there any danger that renewals kind of fall off a cliff in fiscal 2026? Or is there a large enough cohort of customers who are going to renew in fiscal 2026 that strong growth in renewals continues and it grows as a mix of the business. So, just your thoughts on available to renewal pool and how you see that business continuing to grow?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.
A

Thank you, Ruplu. So, you're correct that we did talk about renewals doing well for Q1. In terms of ATR for full year fiscal year 2025, I think we referred to this in our last earnings call when we gave you all the initial guide for fiscal year 2025. The available to renew pool or ATR is expected to grow nicely in 2025 year-over-year 2024 and will continue to grow quite nicely over the next few years, Ruplu. So, I'm not going to give you a quantification for fiscal year 2026 at this point. We're still only one quarter into 2025. But yes, we expect that growth in available to renew for our renewals cohorts to continue for the next couple of years.

Ruplu Bhattacharya
Analyst, BofA Securities, Inc.

Q

Okay. Thanks for that. And maybe for my follow up, I'll ask you another question. Free cash flow in fiscal 1Q was very strong. It was $152 million, which I don't think over the last three or four years you've had such a strong 1Q. Were there any one time items? I know last quarter you had said that you might get from a partner. I think you had said $30 million benefit for the full year in terms of free cash flow. So, any guidance on how we should think about the progression of free cash flow first half versus second half in this year?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you, Ruplu. We were happy with our free cash flow performance in Q1 as you allude to. So, nothing significant I would call out as one time. So you're right, those partner payments we did call out for fiscal year 2025 and those will continue to come in. They might be a little, inconsistent in terms of quarter to quarters, but we're not breaking that out quarterly, Ruplu. There wasn't any one thing I would call out. You know, for example, in Q4, in our July quarter, we did call out, there was one significant deal that we collected in that quarter. For example, there was nothing like that, that I would call out for Q1.

And more generally, I think when you think about just I think rest of the year, part of your question is $152 million was a strong Q1 and our full year guide at the, it's $560 million to $610 million. And so, I just remind you that one expenses are going up, expected to go up through the rest of the year. So keep that in mind, right. Those expenses will ramp over the course of the year, much like they did last fiscal year. So factor that in. And, we do collect multiple years of cash from our customers, typically upfront. And so, that does mean that depending on duration or depending on some larger deals, there can be some variation quarter-to-quarter in that number, which is why we continue to guide for free cash flow really on an annual basis only.

Operator: Thank you. And our next question comes from the line of Mike Cikos with Needham.

Mike Cikos
Analyst, Needham & Co. LLC

Q

Hey guys, thanks for taking the question here. I'm going to ask a boring one on guidance and build on some of the line of questioning that Mr. Ader was going after on the operating margin and operating profit. But I just wanted to get a better understanding. Congratulations on the 20% operating margin we're seeing here in Q1. Is the view for full year in any way informed or are we potentially behind on hiring versus where we expected to be exiting Q1 or are you potentially increasing your view of additional investments in sales and marketing and R&D? Because I know that's something that we've played on the previous quarter. Just wanted to wrestle those two items.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you, Mike. Always welcome the boring questions on the guide. So, thank you for that. Not at all boring, actually. It's very practical. So, when we think of spend and our planning cycles, Mike, so we're coming out of our planning cycle. And so, as we deploy this, again similar to last fiscal year, some of this will be ramping over the course of the year. So that is, it has been the plan. And so, you'll continue to see that this year relative to last year, right. So, there's nothing unusual or different necessarily that I would call out other than, of course, as we hire people in Q1 or Q2, they might be there for partially for that quarter, but then for the next quarter, they're there for a full quarter, right. So, there's that almost normalization that happens over the course of the year. And so, that's what's baked into the OP margin guide for the full year relative to what you saw in Q1.

Mike Cikos
Analyst, Needham & Co. LLC

Q

Got it. Thank you for that. And then just one other, if I could, I know that we're and I appreciate the commentary here as well. As far as the Q2 versus 3Q seasonality on revenue. But just wanted to make sure I'm thinking about this properly. Even if I go back beyond last year, two years ago, we tend to see, call it 7% or 8%, 7% feels about right, as far as the sequential decline in revenue from Q2 to Q3. And I just – and I appreciate your qualitative comments. But if you could further elaborate on that, what is driving that seasonal component? Is it really tied to year end in Q2? And then maybe the sales incentive comp for your sales force in Q4. Is that is that what we should be thinking about that Q2 to Q3 sequential movement that we're talking to?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

You're exactly right, Mike. So historically, if you look at our performance, Q2 and Q4 tend to be seasonally stronger quarters from a top line perspective, exactly for the reasons you outlined, because Q2 has the December year end and Q4 has our end of fiscal year and therefore some sales incentives tied to a strong finish there. What has happened also is as we now have the renewal cohorts layering in, they tend to follow similarly the land and expand performance in the past, but they're just reflective of deals that were signed and when those renewals come due. So, now, we have the impact of historical land and expand, but the renewals cohorts are also following that back. So, we just wanted to remind folks of that going into Q3 and give you a sense of qualitatively what to expect relative to the Q2 guide.

Operator: Thank you. And our next question comes from the line of Ben Bollin with Cleveland Research Company.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

Good afternoon, everyone. Thanks for taking the question. Rajiv, I wanted to get your perspective, bigger picture on enterprise refresh behavior, in particular around how you see customers evolving around three tier versus HCI. And any thoughts on the pace and rate of enterprise on prem AI deployments?

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

A

Yeah, I take those two questions separately. I don't think, Ben, that much has changed with respect to three tier versus HCI. We still continue to validate the proposition of 40% to 50% lower TCO, if you replace a three tier with the HCI, and it also provides you the platform to really expand into becoming a hybrid cloud, which is what companies want. And so, over time, I do expect to continue to see HCI again into this legacy three-tier offering. So that part hasn't really changed. The dynamics really haven't changed. Of course, that's usually tied to a hardware refresh cycle because that's when you refresh your storage arrays and instead of refreshing storage arrays is what we tell customers, why don't you just buy simple servers and put HCI on it. So, no change really on that front.

On enterprise AI, what we see again is that the bulk of the spend so far has been not really on the enterprise, but in these the large hyperscalers as they build out these massive clusters to train these large language models, with the huge investments from a small handful of very large providers. So we feel that for sure.

Now, within the enterprise, most enterprises that I would say in the early stages of deploying Generative AI largely for RAG, retrieval augmented generation, and fine tuning and inferencing. They're not going to train these models. They're going to use models that are pre-existing and then use them to drive inferencing, but more cost effective, smaller clusters. We think that that segment of the market is in its early stages. We have seen the first set of applications come about. Even this quarter, as you know, we talked about the government customer in EMEA that's starting to use our GPT 2.0 offering.

I would say most enterprises are in the early stages of adoption, including ourselves, that we are targeting see things like a 25% productivity gain for our developers on improvements in how we manage legal contacts, so, companies looking at fraud detection, these are the kind of use cases that we are starting to see emerge. But I would say it's in the early days. Most enterprises are only now getting into the act of trying to build these applications. And I do think that this space is going to continue to grow over the next few years, but it's still largely incubation at this point in the enterprise.

Ben Bollin
Analyst, Cleveland Research Co. LLC

Q

That's great. And Rukmini, if I could, in the past, you had provided some perspective on the growth of $1 million plus deals in your pipeline relative to the remainder of the business. Curious, if you have any updates on that metric exiting the quarter? Thanks.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you, Ben. I will say we are continuing to see nice growth in our pipeline, including for the larger deals that we've talked about before, Ben. We're not updating those metrics specifically on a quarterly basis, but yes, we are seeing continued interest and engagement and growth in pipeline from those $1 million-plus cohorts and more generally.

Operator: Thank you. And our next question comes from the line of Simon Leopold with Raymond James.

Victor Chiu
Analyst, Raymond James & Associates, Inc.

Q

Hi, guys. This is Victor Chiu in for Simon Leopold. I wanted to drill into your commentary around the increased customer engagement from VMware base. And maybe help us understand if this was an incremental acceleration relative to what you were previously observing. And if so, maybe help us understand what's driving that and if you expect that to continue.

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

A

So, Victor, the market continues to be dynamic, but it's – from our perspective, it's still largely unchanged in terms of our opportunity, multiyear opportunity to gain share. So, we don't see – we haven't seen a significant change in that this quarter compared to the last several quarters really. And we haven't seen any real meaningful changes in our win/loss rates either on these opportunities. I'll say what we've already said before, right? A lot of these deals they are tied to VMware customers, their ELA renewal cycles. They're tied to when the installed base is coming up for a hardware refresh, although we're also expanding our ability to capture, to have our solutions work on existing hardware, like for example, the [indiscernible] (00:43:21) that we're doing with Dell or like continuing to be able to deploy our software on already existing VMware HCI customers. And of course, it's a dynamic market in the sense that sometimes we will see aggressive behavior from Broadcom as well as key growth customers, especially very large ones. So, really, I would say net-net, nothing much has changed.

Victor Chiu
Analyst, Raymond James & Associates, Inc.

Q

Okay. And if an organization decides that they wanted to move away from VMware, kind of on average, how long is that transition typically, kind of what are the steps involved that require for a customer to do something like that?

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

A

Yeah. Correct. It depends on the scale and complexity of their deployment. So if they are, for example, I give you the two bookends. So, on the smart – on the easy side, if they are just largely just say VSphere customer and they are willing to replace their hardware, it's a very easy migration. We can migrate that within a month or two off and at relatively small scale. A lot of that is automated as well. Same goes for public cloud to the public cloud. I think there was a question earlier about VMware Cloud on AWS. Those offerings actually very easy to migrate. Again, within a month, we can have those customer off and on to Nutanix offering.

But at the other end of the spectrum, these large customer that use multiple VMware product with [indiscernible] (00:44:44) and there it can be many years, it can be three years to do a migration just because they can't migrate all of it at once. There is no requirement for a professional service engagement to convert over some of their more complex custom scripts that they have written and custom investments they've made on top of the VMware portfolio. So, those migrations tend to be more complex, require professional services and take a few years. So, there's an entire spectrum across those.

Victor Chiu
Analyst, Raymond James & Associates, Inc.

Q

Do you have maybe kind of a general ballpark kind of estimation of what percentage is the easy, kind of, "low-hanging fruit" and what [indiscernible] (00:45:23) hard?

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

A

Yeah. I would say – yeah, I would say if you look at with the exception of I think if you go to a large tier one big global account, those are the ones that are difficult, right? The vast majority, the smaller customers are going to be more on the easy side.

Operator: Thank you. Our next question comes from the line of Matt Hedberg with RBC Capital Markets.

Matthew Hedberg
Analyst, RBC Capital Markets LLC

Q

Great. Thanks for taking my question, guys. Hey, I just wanted to ask, obviously, it sounds like the federal business had some headwinds. Maybe just a simple question, but Rajiv, did the enterprise business – do you think it deteriorated from a demand perspective versus last quarter, just because it seems like good results, but just trying to put a finer point on sort of like your thought on enterprise spending today versus maybe 90 days ago?

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

Yeah, Matt, I – clearly, we saw this softness in Fed, for sure. We saw it. That was very clear cut. The broader enterprise, we've actually again been doing quite well at landing new logos and people migrating. But of course, some of that is perhaps due to just what's happening with the Broadcom situation. So, we haven't seen a decline in enterprise spend or less willingness to spend. What we have seen and we've been talking about this for multiple quarters, Matt, is a lot more inspection going on on the spend, and a lot more approvals are being required higher on the food chain, looking at TCO more carefully, which of course plays to our benefit somewhat because, what we talk about in this environment is how we can reduce TCO. So, that dynamic has been going on now for several quarters. We haven't seen much of a change. So net-net, I would have to say with respect to broader enterprise demand, we haven't seen a change this quarter compared to the prior quarters.

Matthew Hedberg
Analyst, RBC Capital Markets LLC
Q

Got it. That's very clear. Thanks. And then, maybe another sort of, I guess, macro question for Rukmini. Obviously, it's not your year-end, but do you typically see a December budget flush from enterprise customers? I can't imagine you're baking that into guidance. But just kind of curious on historically, do you see customers, kind of spend it or lose it mentality when it comes to December, your calendar year-end?

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

I mean, certainly sometimes, right? I mean, if they may have a budget that's made up before this year, we've seen that in the past. We probably will see some of that this year as well, right? And I think they do have – I mean, if your company is on that calendar cycle, yeah, you probably will have some budget to spend. But again, I would not say I mean, we factored whatever we can see into our guide for Q2. So nothing really different this year compared to prior years. And so typically we see a seasonal increase in Q2 compared to Q1 and that's driven in part by the fact that what you alluded to, Matt, with people spending at the end of the year.

Operator: Thank you. And our next question comes from the line of George Wang with Barclays.

George Wang
Analyst, Barclays Capital, Inc.
Q

Hey, guys, thanks for taking my question. I just have two quick ones. Firstly, can you kind of double click on [indiscernible] (00:48:28) for the channel incentives in place? Kind of, what has changed versus the three months ago in terms of providing the promo and the incentives to the channel, especially against the backdrop of, well, maybe overlapping Nutanix with VMware contracts?

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

Yeah. I mean, this is a few months ago that we made the changes. I think no recent changes by the way on the channel side. We made that going a while ago. But what we did, we did a couple of things there, George. The first thing we did was the – we took a subset of our customer base, our target prospects, and then handed them off entirely to the channel to go drive. And so, we don't have our reps on those accounts. We leave it to the channel and we provided more incentive to those channel partners to bring us business. So, we have incentives in place for our channel partners to bring new logos to us in terms of rewards, that they will get more rewards when they bring new logos to us.

We've seen – we're also committed to the channel in the sense that all our deals go through the channel partners. So, we're not trying to work around them or shove them out of any of the deals. And so, we've seen a certainly, as a result all of that, a significant increase in channel partner engagement with us over the last year or two. Some of it is, of course, just what they're seeing with Broadcom, more channel partners coming to us, some of it is our own incentives that we're offering for them. And we also have incentive for the end customer as well, right? So for example, to help them [indiscernible] (00:49:57) migrations. We can offer them free licenses for a period of time to help them, while they're spending money on VMware, to get going on our products until they're ready to go, migrate fully over, et cetera.

George Wang
Analyst, Barclays Capital, Inc.

Q

Okay. Just a follow-up, if I can. Just in terms of repatriation, just as kind of been a theme which benefits Nutanix, just curious if anything has changed on the repatriation, any additional data points versus last quarter?

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

A

Yeah. In terms of cloud repatriation, I would say we haven't seen like a massive repatriation of workloads coming back from the public cloud. We see some of that here and there, right. I would characterize that nothing has changed compared to past quarter. But I think what we see is, again, nothing has changed. People are much more careful about what they go put in the cloud. So keep in mind that the vast majority of enterprise workloads are still on prem, not in the public cloud. And now, CIOs are being more circumspect about what they use the public cloud for. For example, there is a realization that if you have steady state workloads, those workloads can be run more efficiently on prem than in the public cloud. And so, CIOs, therefore, saying, well, I'm going to keep that workload on prem. I'm not going to move that to the public cloud. So, that's what we're seeing.

Operator: Thank you. And our next question comes from the line of Nehal Chokshi with Northland Capital Markets.

Nehal Chokshi
Analyst, Northland Securities, Inc.

Q

Yes, thank you. And congrats on the really strong new logo up 50% year over year. That's really impressive. I'm trying to put through why is ARR decelerating, given the strong demand land that you're seeing? And then, if I look at the incremental ARR i.e. to change quarter over quarter for October quarter relative to the year ago quarter, that was down a lot as well. So thoughts on why are there such a weak incremental air ARR characteristics, especially given the backdrop that you're having such strong wind metrics?

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Hi, Nehal. Thank you. So, a few things to – I'll start with on your point about net new ARR. So, one of the biggest drivers of net new ARR, which is simply, as you pointed out, the difference between our ARR in this quarter versus the prior quarter is land and expand ACV, and given that our GRR has not changed significantly relative to recent historical levels. And so, when you think about land and expand, we did see some divergence, as you point out, in the performance of the land versus the expand portion of our business. So, we saw strength in the new customers and we've talked about why that is and so really happy with that performance.

Expansion, with existing customers, which actually accounts for the majority of the land and expand, was impacted largely by our US federal business, Nehal. And we've talked about why we believe that to be the case. And so – and overall, by the way, right, we've talked about these larger opportunities in our land and expand pipeline, which are taking longer to close and have greater variability in timing, outcome and deal structure. So all of those factors also do impact our ARR growth. So that's how to think about just the ARR and net new ARR.

Nehal Chokshi
Analyst, Northland Securities, Inc.

Q

Great. Thank you.

Rukmini Sivaraman
Chief Financial Officer, Nutanix, Inc.

A

Thank you, Nehal.

Operator: Thank you. And our next question comes from the line of Michael Tsvetanov with Wells Fargo.

Michael Tsvetanov
Analyst, Wells Fargo Securities LLC

Q

Hi, guys. Thanks for letting me ask the question. Asking on behalf of Aaron. I just want to ask about GPT 2.0 – GPT-in-a-Box 2.0 solution. I'm just curious as you think about, I guess, the positioning of that in the marketplace relative to kind of a full stack or three tier architecture with NVIDIA's AI enterprise software suite, how do these differ in terms of where they sit in the market? And I guess, do you see opportunity to maybe move upmarket as these solutions mature going forward?

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

A

Yeah. I mean, some of that is also a difference between training and inferencing. We are largely with GPT-in-a-Box focused on inferencing, focusing on smaller clusters, not massive compute farms to train models, smaller cluster that enterprises can use to deploy more cost effective AI inferencing applications. I'll give you one example. We, for example, one of our first use case for the Nutanix internally was a customer service use case, where incoming service requests from a customer, support ticket. The support engineer actually has a natural language integrated search interface though which they entered the query. And then, we looked through all our knowledge basis to try and accelerate our ability to answer the issue.

And that AI application is running on just a small cluster, okay, using an open source language model. And that's the kind of [indiscernible] (00:55:08) running on GPT-in-a-Box internally. And that's the kind of use case that we're enabling for the enterprise, where you have a secured data you want to do inferencing on it using existing models that are already pre-trained, but fine-tuned with your use cases. So, that's a cost optimized solution. And by the way, we are partnered with NVIDIA on that because we work together with NVIDIA, the intrinsic solution as well as, of course, using their GTUs to do all of the hard work needed here. So again, I just think we want to distinguish between inferencing on small clusters, which is mostly what we do, while sustaining a very large cluster.

Michael Tsvetanov
Analyst, Wells Fargo Securities LLC

Q

Okay, that's helpful. And if I can sneak one more in just as we think about an improving sort of traditional server and demand environment and we think about refresh cycles, obviously that presents an insertion opportunity for you guys within three tier architectures. So I'm curious, with the new partnerships with Dell and Cisco, have you seen win rates at all changing or do you anticipate those improving given your kind of broader ability to enter those deals?

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

A

Yeah, that's what I think having Cisco and Dell selling our products is, of course, positive for us. And, Cisco has been a good contributor to our new logos this quarter as well as last quarter. Dell is still, I think, very early days for us. And that's independent of the server refresh cycle or not, right? Second, I would say with respect to refresh cycles, yes, server refreshes will help, but also storage refreshers are important, right, because that's when we get the opportunity to displace those three tier architectures with HCI footprint. So both matter. I think having Dell and Cisco as strength in the market, of course, significantly and at the same time, these refresh cycles more so I would say storage refresh than server refresh but help us insert HCI into existing feature deployments.

Operator: Thank you. And thank you for participating. This does conclude today's program and you may now disconnect.