

Cloudflare, Inc. (NYSE: NET)

Initiation of coverage | Price of record \$358.82 (close, 24 September 2026) | Report date 25 September 2026

Verdict	Price	Base-case value	Probability-weighted value	Level of interest
Watchlist	\$358.82	\$298	\$289 (-19.5%)	About \$260

Investment summary

Cloudflare is one of the best-run growth businesses in public markets, and it is currently priced as if nothing can go wrong. Revenue in the June quarter rose 36% to \$696.1 million, up from 27% growth five quarters earlier, and management raised the full-year revenue outlook to \$2.864-2.870 billion (about 32% growth). Dollar-based net retention climbed to 120%, large customers grew 27% to 4,698, and remaining performance obligations rose 38% to \$2.73 billion. The operating story is genuinely improving.

The share price has moved further and faster than the fundamentals. At \$358.82 the stock is up about 61% in twelve months against 32% expected revenue growth this year, which means most of the gain came from a higher multiple. Enterprise value is roughly 44 times 2026 revenue guidance, 34 times 2027 consensus revenue, and about 286 times the midpoint of 2026 non-GAAP EPS guidance of \$1.25-1.26. Free cash flow was 8% of revenue in the June quarter, and stock-based compensation ran at about 20% of revenue over the last four quarters.

The verdict is **Watchlist**. The base case, in which growth runs near 29% in 2027 and the revenue multiple eases to 30 times, is worth about \$298 per share. The probability-weighted value is about \$289, about 19.5% below the current price, while the bear case sits near \$143. The name becomes interesting at about \$260, where the stock would trade on roughly 26 times 2027 consensus revenue and around 10% below the base-case value.

Company developments. The most consequential development is the AI-first restructuring announced on 7 May 2026, which removed about 1,100 roles (roughly 20% of staff). It raises the earnings ceiling but has not yet shown up fully in guided margins, and it does not change the verdict, because at this valuation the multiple matters more than any plausible savings. A run of agent-related launches and partnerships (OpenAI Daybreak, Cursor Cloud Agents, Monetization Gateway, FedRAMP High) supports the growth narrative but carries no disclosed revenue.

Key figures

Metric	Value	Metric	Value
Market capitalisation	\$127.8bn	Shares outstanding	356.1m
Enterprise value	\$127.1bn	Diluted share guide (FY26)	~374m
Q2 2026 revenue	\$696.1m (+36%)	Q2 non-GAAP op. margin	13.8%
FY26 revenue guide	\$2,864-2,870m	FY26 non-GAAP EPS guide	\$1.25-1.26
EV / 2026 revenue	44x	EV / 2027 cons. revenue	34x
Cash and securities (30 Jun)	\$4.16bn	Total debt (30 Jun)	\$3.53bn
52-week range	\$158.83-367.43	Short interest	1.9% of shares

Market data as of 24-25 September 2026. Balance sheet as of 30 June 2026, before the August convertible issue. Company filings, market data.

Framework: what drives returns here

Cloudflare sells security, performance and developer services running on one global network that sits in front of roughly a fifth of websites. Revenue is mostly subscription with a growing usage-based component, and large customers produce 73% of it. Five variables will decide shareholder returns over the next two years:

Driver	Why it matters	How it is judged
Growth durability	The multiple assumes 30%-plus growth for years	Revenue growth, cRPO and RPO growth, large-customer adds
Net retention and deal size	Expansion is the cheapest growth	DBNR (120% in Q2), pool-of-funds contract sizes
Gross margin	Down 320bp year on year as paid and AI traffic grows	Non-GAAP gross margin against the company's 75-77% long-term target range
Operating leverage after the restructuring	Decides whether earnings catch up with the price	Non-GAAP operating margin, FCF margin, SBC as a share of revenue
Valuation and discount rate	A long-duration asset is sensitive to yields	EV/revenue against growth; the 10-year yield

Business and industry

The company groups its products into acts: application services (CDN, DDoS, web application firewall, bot management), the Cloudflare One zero-trust and SASE suite, and the Workers developer platform, which now includes storage, AI inference, sandboxes and agent tooling. The model is land and expand: a free and self-serve base of millions of users funnels into paid plans and enterprise contracts. The United States produced 51% of Q2 revenue (up 41%), EMEA 27% (up 30%) and APAC 14% (up 32%). Partners carried 31% of revenue.

Industry demand is strong on three fronts: security budgets keep growing, zero-trust networking is replacing legacy VPN and firewall stacks, and AI agents are producing a new category of traffic. Management reported that non-human traffic passed 50% of network requests for the first time in Q2. Competition is intense and comes from several directions: Akamai and Fastly in delivery, Zscaler and Palo Alto Networks in SASE, and the hyperscalers in compute. On the Q2 call management acknowledged losing some deals where large customers consolidated spend with a hyperscaler. Cloudflare's advantage is the breadth of one network and one control plane, a very low cost per request, and the speed at which it ships new products.

Financials

Quarter	Revenue	Growth	GAAP gross margin	GAAP net income	Company FCF
Q2 2026	\$696.1m	36%	71.8%	-\$170.0m	\$56.4m (8%)
Q1 2026	\$639.8m	34%	71.2%	-\$22.9m	\$84.1m (13%)
Q4 2025	\$614.5m	34%	73.6%	-\$12.1m	n/a
Q3 2025	\$562.0m	31%	74.0%	-\$1.3m	n/a
Q2 2025	\$512.3m	28%	74.9%	-\$50.5m	n/a
Q1 2025	\$479.1m	27%	75.9%	-\$38.5m	\$52.9m

Q4 2025 and Q3 2025 gross margins are derived from reported revenue and gross profit. FCF shown only where the company figure was confirmed. Company releases and filings.

Growth has accelerated from 27% to 36% over five quarters, and the Q3 guide of \$736-737 million (about 31%) looks conservative against a record of beating the top of guidance. The weaker points are gross margin and cash conversion. Non-GAAP gross margin fell to 73.1% from 76.3% a year earlier as heavier, lower-margin traffic grew faster than the rest. Q2 free cash flow of \$56.4 million was held back by restructuring cash costs; the trailing four quarters produced roughly \$340 million, about 14% of revenue.

Stock-based compensation totalled about \$508 million over the last four quarters, around 20% of revenue, so free cash flow net of stock pay is still negative. The GAAP loss of \$170 million in Q2 included about \$151 million of severance charges; excluding them, management said the net loss would have been about \$18 million. The balance sheet is sound: \$4.16 billion of cash and securities against \$3.53 billion of debt at 30 June, almost all of it zero-coupon convertible notes. In August the company added \$2.5 billion of 0% notes due 2031 (conversion price about \$496.94, with a capped call to about \$854), which lengthens the maturity profile at no cash cost but adds a future dilution overhang above \$497.

Company developments

Development	Status and date	What is known	What is forecast (and by whom)	Impact
AI-first restructuring	Announced 7 May 2026; mostly complete by Q3	About 1,100 roles cut (~20% of staff). Charges guided at \$140-150m, later up to \$165m; ~\$151m recorded in Q2	Savings not disclosed. Our estimate of gross run-rate savings: \$165-275m a year	High
Q2 results and raised guidance	Reported 6 Aug 2026	Revenue +36%; FY26 revenue guide raised to \$2,864-2,870m and non-GAAP op. income to \$443-445m	Management: Q3 revenue \$736-737m	Medium
\$2.5bn 0% convertible notes due 2031	Priced 11 Aug, settled 13 Aug 2026	Conversion ~\$496.94; capped call to ~\$854.12; net proceeds ~\$2.46bn	Use: general purposes, debt repayment, possible acquisitions	Medium
Agent payments: Monetization Gateway, Wallets, x402 support	Announced around Q2 results, Aug 2026	Tools for sites to charge AI agents and for agents to pay	Management: very large transaction capacity planned; no revenue guidance	Medium
OpenAI Daybreak vulnerability service	Announced 3 Sep 2026	Vulnerability Discovery and Remediation using OpenAI Daybreak models; no financial terms	None disclosed	Medium
FedRAMP High authorization	Announced 11 Aug 2026	Clears the highest US federal cloud security level	Opens larger federal deals; not sized	Medium
Cursor Cloud Agents on Cloudflare Sandboxes	Announced 2 Sep 2026	AI coding agents run in Cloudflare-hosted sandboxes	None disclosed	Low
Adaptive Intelligence bot defence; AI crawl controls	31 Aug and 15 Sep 2026	New bot detection engine; separate site controls for search, training and agents	None disclosed	Low
Signal key transparency; Kitesurf agent browser	7-12 Aug 2026	Customer win (Signal) and a browser built for AI agents	None disclosed	Low

High-impact development: the AI-first restructuring

What is known. On 7 May 2026, alongside Q1 results, the company announced an "agentic AI-first operating model" and cut about 1,100 roles, roughly 20% of headcount. It guided restructuring charges of \$140-150 million (\$105-110 million cash, the rest stock-based) and later raised the ceiling to \$165 million (about \$130 million cash). Management said internal AI usage had risen more than 600% in three months and framed the change as a new operating model rather than cost cutting. The shares fell more than 20% in the days that followed, then recovered on the Q2 print.

Why it matters here. Headcount is the largest cost line in a software business whose non-GAAP operating expenses run near 60% of revenue. A 20% reduction touches every function, from sales to engineering, so the outcome decides both the margin path and whether product velocity, the company's main competitive weapon, holds up.

What success and failure look like. Success is a non-GAAP operating margin that steps up visibly from 13.8% in Q2 (the Q3 guide implies about 17.6%) while revenue growth stays near 30% and the pace of launches does not slow. Failure is slower growth, weaker sales productivity or rising churn in quarters where margins improve only because costs were cut. The first hard readings arrive with Q3 results (not yet scheduled; late October or early November is the usual pattern) and the FY27 outlook in February.

Economics. The company has not disclosed the savings. Our estimate assumes a fully loaded cost of \$150,000-250,000 per role, which gives gross run-rate savings of \$165-275 million a year. The guidance does not show savings of that size: between May and August the full-year non-GAAP operating income guide rose by only about \$24 million at the midpoint, while the revenue guide rose by about \$58 million. The likely explanation is reinvestment in AI products, network capacity

(capex guided at 14-15% of revenue) and gross margin pressure. Consensus 2027 non-GAAP operating income of about \$666 million (an 18% margin on \$3.70 billion of revenue) already assumes most of the improvement.

Precedent and competitors. Large software cuts at growing companies usually lift margins within two to four quarters, but the cases that hurt are the ones where the sales force was cut too deeply. Cloudflare's own record of beating guidance every quarter is the best evidence that execution has held so far.

Case (our estimate)	Assumption	2027 non-GAAP op. income vs consensus	EPS effect	Value effect per share
Success	About \$100m more of savings retained	+\$100m (+15%)	+\$0.21	+\$13 at 50x; +\$51 at today's ~190x
Base	Savings mostly reinvested, as guidance implies	In line	None	None; already in consensus
Failure	Growth 2-3 points lower from lost capacity	Revenue -\$70-110m; margin roughly flat	-\$0.10 to -0.20	-\$25 to -40 via a lower multiple

Inputs: consensus 2027 revenue \$3.70bn and non-GAAP operating income \$666m; 374m diluted shares; 20% tax rate (management's Q3 guide). All figures are our calculation.

What the price assumes. The market already rewarded the change once, through the Q2 rally, and consensus has absorbed it. At about 190 times 2027 consensus operating income, even the success case adds less value than a modest change in the revenue multiple would remove. The verdict is Watchlist with or without the item; it moves the bull case, not the base case. **Still unknown:** the actual savings, how much is being reinvested, and sales capacity after the cut. The Q3 margin print and the 2027 outlook will settle most of it.

Growth drivers

Driver	Status	Likelihood	Impact
Workers developer platform turning into material revenue (nearly 2m developers added in Q2)	Management: now a meaningful contributor; not broken out	High	High
Large-customer expansion and pool-of-funds contracts (\$4-32m disclosed deals)	Shipped; record adds in Q2	High	High
Zero-trust and SASE wins helped by agent-security controls	Shipped; FedRAMP High since 11 Aug	Medium	Medium
Charging AI agents for content and APIs (Monetization Gateway, Wallets)	Announced Aug 2026; revenue not disclosed	Low to medium	Medium, longer term
Margin expansion after restructuring	Q3 guide implies ~17.6% op. margin	Medium	Medium

Management

Co-founders Matthew Prince (CEO) and Michelle Zatlyn (President) still run the company, with Thomas Seifert as CFO. Guidance accuracy is strong: in May the company guided Q2 revenue at \$664-665 million and delivered \$696.1 million, and it guided Q2 non-GAAP operating income at \$90-91 million and delivered \$96.1 million. That is a pattern of conservative guidance and consistent beats. Capital allocation leans on cheap convertible debt rather than buybacks. Insiders sell steadily under trading plans; recent Form 4 filings show sales by the CFO, the President and a director in September. Nothing in them looks unusual, but there has been no insider buying.

Risks

Risk	Type	Probability	Severity
Multiple compression if growth slows toward the Q3 guide of ~31%	Valuation	Medium	High
Gross margin keeps sliding as AI and paid traffic grow	Company	Medium	Medium
Hyperscalers win consolidated deals; AI labs build their own agent infrastructure	Competitive	Medium	Medium

Risk	Type	Probability	Severity
A major outage (as in November 2025) damages trust	Operational	Low to medium	Medium
Restructuring slows sales capacity or product velocity	Company	Low to medium	Medium
Rising long-term yields reprice long-duration growth stocks	Macro	Medium	High
Dilution from SBC (~20% of revenue) and convertibles above \$497	Financial	High	Low to medium

Valuation

Earnings multiples are not useful yet: GAAP earnings are negative and non-GAAP EPS excludes stock pay worth about 20% of revenue. The right tools are EV/revenue against growth and a reverse check on cash flow. On those, the stock is expensive. Enterprise value of \$127 billion is 44 times 2026 revenue guidance and 34 times 2027 consensus. It is about 230 times 2027 consensus free cash flow of \$552 million. That is several times the revenue multiple of any listed security or edge-network peer.

A simple reverse test shows how much is priced in. If revenue compounds at 30% a year to 2031, it reaches about \$10.6 billion. At a 30% free cash flow margin and 40 times free cash flow, the business would be worth about \$127 billion in 2031, which is roughly today's enterprise value. In other words, the current price already pays for five more years of 30% growth and a mature margin, and leaves no return for the wait. (Our calculation.)

Macro drivers. Two macro variables matter. The first is the long-term discount rate, because almost all of the value sits many years out. The 10-year Treasury yield closed at 5.18% on 24 September, its highest level since 2007, after the Federal Reserve raised rates by 25bp to 3.75-4.00% on 16 September; August core CPI ran 0.3% for the month. The stock has rallied through that, which says sentiment is carrying the price. The second is enterprise IT and security spending. Demand looks healthy: jobless claims were near 197,000 in the latest week, and business activity surveys point to expansion. On the demand line the business is less rate-sensitive than its multiple.

The conclusion is that Cloudflare is overvalued on any reasonable base case. It is a high-quality compounder priced for a bull case.

Sentiment

The sell side is positive but split: of 34 analysts, 23 rate the stock a buy or strong buy, 9 a hold and 2 a sell. The average target of about \$337 and the median of \$355 both sit below the current price, with targets ranging from \$160 to \$400. Since the Q2 print, Mizuho (\$375), Citi (\$400), Stifel (\$370) and Truist (\$350) have reiterated buy ratings; J.P. Morgan started at neutral with a \$350 target; Bernstein stayed at market perform. Short interest is low at about 1.9% of shares. The news flow is strongly positive and centred on AI: the stock rose about 10% on 9 September after the OpenAI Daybreak launch and about 9% on 21 September on renewed attention to AI agents. Moves of that size on launches with no disclosed financial terms are a sign of momentum buying rather than new information on earnings.

Technicals

Indicator	Value	Reading
20-day SMA / EMA	\$315.33 / \$322.91	Price 13.8% above the SMA
50-day SMA / EMA	\$298.20 / \$299.67	Price 20.3% above the SMA
100-day SMA	\$266.66	Price 34.6% above
200-day SMA / EMA	\$230.87 / \$249.79	Price 55.4% above the SMA
RSI(14)	67.1	Strong, just below overbought
MACD (12,26,9)	16.75 vs signal 12.01	Positive, histogram +4.74
ATR(14)	\$17.68	4.9% of price a day
Volume 20-day vs 50-day	3.3m vs 3.5m	Participation fading slightly
52-week range	\$158.83-367.43	Trading near the high

Computed from completed daily sessions to 24 September 2026. Distances measured against the price of record.

The trend is strongly up on every time frame, and the averages are stacked in bullish order. The stock is, however, 55% above its 200-day average, which is stretched. First support is the 50-day average near \$298, then the August post-earnings gap between about \$284 and \$310. Resistance is the record high of \$367.43 set on 24 September. The technical picture argues against chasing rather than against the business.

Scorecard

Scored 1-10, where 10 is always best, including Risk.

Factor	Score	Weight	Rationale
Business Quality		9/10 15%	Global network, broad product set, usage upside
Financial Strength		7/10 15%	Net cash, 0% converts; SBC heavy, GAAP losses
Competitive Advantage		8/10 15%	Scale, cost per request, shipping speed
Management		8/10 10%	Founder-led; consistent beats against guidance
Growth Potential		9/10 15%	36% growth, accelerating; DBNR 120%
Valuation		2/10 15%	44x 2026 revenue; prices in years of growth
Risk (10 = lowest risk)		4/10 10%	High multiple, beta ~1.7, margin drift
Technical Setup		7/10 5%	Uptrend intact but extended
Investment Score	68 / 100	100%	Weighted sum of the factor scores

The restructuring moved two factors: it supports Financial Strength through a lower cost base and adds to Risk through execution uncertainty. The other developments feed Growth Potential. The Risk score of 4 reflects a business whose operating risks are moderate but whose valuation and volatility make it a high-risk holding, which matches the Risks section.

Scenario analysis

Scenario	Probability	2027 revenue	EV / 2027 revenue	Fair value	vs price
Bull: growth ~35%, agent monetisation shows, restructuring savings retained	25%	\$3.87bn	40x	\$416	+16%
Base: growth ~29% (near consensus), savings mostly reinvested	50%	\$3.70bn	30x	\$298	-17%
Bear: growth ~23%, gross margin keeps falling, multiple normalises	25%	\$3.53bn	15x	\$143	-60%
Probability-weighted	100%			\$289	-19.5%

Fair value = (2027 revenue x multiple + \$0.63bn net cash) / 374m diluted shares. 2026 base revenue \$2.867bn (guide midpoint). Our calculation.

The skew is unfavourable. The bull case, which needs growth to hold near 35% and the market to keep paying 40 times revenue, adds about 16%. The bear case, which is simply growth easing toward 23% and a multiple that is still high for software, would take the price down by more than half.

Recommendation

Watchlist. The business deserves coverage and would deserve a position at the right price. It does not deserve one at \$358.82. The level of interest is **about \$260**, roughly 26 times 2027 consensus revenue and about 10% below the base-case value of \$298. Technically, the \$284-310 gap and the 50-day average near \$298 are the first places the stock could find support on a pullback, but neither offers enough margin of safety on its own. The view would also improve without a lower price if the next two quarters show the restructuring savings coming through in margins while growth holds above 30%.

What would change the view	Direction	Timing
Price near \$260 (about 26x 2027 consensus revenue)	Upgrade to Buy	Any time
Q3 revenue well above the \$736-737m guide with non-GAAP gross margin at or above Q2's 73.1%	More positive	Q3 results, expected late Oct or early Nov (date not yet announced)
Disclosed paid revenue from agent payments or the Monetization Gateway	More positive	Next 2-4 quarters
Operating margin fails to rise after the restructuring while growth slows	More negative	Q3 and Q4 2026 results
DBNR falls back below 115% or large-customer adds slow	More negative	Quarterly
A further sustained rise in long-term yields while the multiple stays near record levels	More negative	Ongoing

Final verdict

Would a disciplined investor put new money into Cloudflare today? Not at this price. The company is executing about as well as a growth company can: accelerating revenue, record customer additions, rising retention and a credible plan for AI agent traffic. The single biggest concern is valuation. At 44 times this year's revenue the stock needs years of 30%-plus growth just to justify where it trades, while gross margin is falling and stock pay still exceeds free cash flow. The restructuring, the most important company development this year, lifts the bull case but does not change that arithmetic. What would change the answer is a price near \$260 or clear evidence that margins are expanding without any cost to growth.

Sources

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- US macro data: BLS, Federal Reserve and US Treasury releases as of 24 Sep 2026
- Technical indicators computed from daily price history to 24 Sep 2026

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