



# Cloudflare, Inc.

NET

EQUITY RESEARCH REPORT

May 09, 2026

# NET — Cloudflare, Inc.

**Report Date:** May 9, 2026

**Analyst:** Moschovakis Capital Research

**Live Market Price:** \$196.13 USD

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## EXECUTIVE SUMMARY

Metric	Value
Recommendation	**AVOID**
Current Price	\$196.13
Fair Value (Base Case)	~\$95-110
Margin of Safety	**Negative 45-50%** (price exceeds fair value)
Target Entry (if HOLD)	<\$90 (likely will not occur)

Return Profile	Value
Dividend Yield	0.0%
Expected Dividend Growth	N/A
Expected Price Appreciation (Base)	-3% to -5% CAGR
Total Expected Return (Base)	** -3% to -5% CAGR**
Bear Case Total Return	** -15% to -20% CAGR**
Bull Case Total Return	+12% CAGR
Probability-Weighted Return	** -2% CAGR**

Risk Assessment	Value
Wealth Preservation Score	**22 / 100**
Downside Protection Score	20 / 100
Quality Score	38 / 100
Risk Level	**ELEVATED**
Probability of >50% Loss	~30-35%
Recession Profile	**VULNERABLE** (untested as standalone profitable entity)

### One-Line Thesis:

You are being asked to pay 36x sales and over 270x free cash flow for a GAAP-unprofitable software business in a sector where competition from hyperscalers is accelerating, and the math required to deliver capital preservation from this entry price does not work.

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## INVESTMENT THESIS

Cloudflare runs a high-quality business. The connectivity cloud platform, the 330+ city edge network, the developer ecosystem around Workers, and the pivot toward AI inference and agentic monetization (Pay-per-Crawl, NET Dollar) are real assets. Matthew Prince has built something durable, and the company generated \$358M of free cash flow in FY2024 against \$1.67B of revenue. The business itself is not the problem.

The problem is the price. At \$196.13, you are paying roughly \$66 billion in enterprise value for a company that has lost money on a GAAP basis every year of its public history, that trades at 36x sales versus a software industry average closer to 6-8x, and at over 270x trailing free cash flow. To earn a 7% CAGR over ten years from this entry, Cloudflare would need to roughly double in price by 2036 while compounding revenue at 20%+ for a decade and seeing margins expand into the 25-30% operating range. That outcome is plausible. It is not, however, the base case — it is closer to the bull case. A more realistic base case involves multiple compression toward sector norms even if execution remains strong, which produces flat-to-negative returns over the holding period. That is not a wealth preservation profile.

The downside case is what disqualifies this from consideration. If revenue growth decelerates from 30% toward 15% — which sell-side already projects within 24 months — and the multiple compresses toward even a generous 12x sales, the stock trades to roughly \$80-95. That is a 50%+ drawdown from the current price. With no dividend cushion, no balance sheet fortress (debt/equity 1.48x, debt/EBITDA 39x), and a GAAP loss profile that has never been tested in a real recession, the asymmetry runs against the investor at this entry. **Exit triggers if held: revenue growth deceleration below 20%, GAAP operating margin failing to turn positive by FY2027, multiple expansion above 40x sales without earnings inflection, or any sign of dollar-based net retention dropping below 110%.**

Cloudflare is a fine company. NET at \$196 is a poor instrument for capital preservation.

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## STAGE 1: SECTOR & THEME ASSESSMENT

**Sector:** Software — Cybersecurity / Edge Computing / CDN

**Sector Verdict:** CONTINUE (with caveats)

The cybersecurity and cloud infrastructure sector is not in secular decline. AI workloads, zero-trust architecture mandates, and edge compute migration provide structural tailwinds. The sector is, however, highly competitive and characterized by valuation multiples that have historically compressed sharply in risk-off cycles (2022 drawdowns of 50-80% across the cohort). It is moderately cyclical: enterprise IT spending contracts in recessions, lengthening sales cycles and pressuring net retention.

Sector valuation is elevated relative to history. Software multiples sit above 10-year medians, and Cloudflare itself trades at the high end of even this expensive cohort.

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## STAGE 2: FUNDAMENTAL GATEKEEPING

### 2.1 Solvency Check

Metric	Value	Threshold	Status
Debt/Equity	1.48x	<1.0x	<b>**FAIL**</b>
Interest Coverage	Negative (operating losses)	>5.0x	<b>**FAIL**</b>
Current Ratio	~2.0x (est.)	>1.5x	Pass
FCF Positive (last 5 years)	4 of 5 (consistently positive 2022+ of 5)		Pass
Cash position	~\$2B+	>20% of debt	Pass

The cash cushion is meaningful and FCF generation is real. However, the company has never produced GAAP operating profit, interest coverage is mathematically negative, and leverage sits above wealth-preservation thresholds.

**Solvency Assessment: MARGINAL**

### 2.2 Earnings Quality

Operating cash flow (\$380M FY2024) materially exceeds net income (-\$78.8M) — a function of stock-based compensation, which is a real economic cost being excluded from the cash flow narrative. Adjusted (non-GAAP) profitability metrics consistently exclude \$250M+ of annual SBC. This is a major earnings quality concern: the cash flow looks healthy because shareholders are absorbing dilution rather than the company paying employees in cash.

**Earnings Quality: QUESTIONABLE** (cash flow is real but flatters true economic profitability)

### 2.3 Dilution Check

Stock-based compensation runs roughly 15-18% of revenue annually. Share count has grown materially over the past five years through SBC and acquisitions. This is the single largest red flag for a wealth preservation mandate: management compensation is being paid by diluting your ownership.

**Dilution Assessment: CONCERNING / approaching DEAL-BREAKER**

### 2.4 Dividend Sustainability

Cloudflare pays no dividend and has stated no intention to do so. For a wealth preservation framework, this removes the income cushion entirely. Total return must come exclusively from price appreciation, which at this valuation requires multiple expansion or extraordinary fundamental growth.

**Dividend Sustainability: N/A — no income return**

### 2.5 Capital Efficiency (ROIC)

GAAP operating losses produce negative ROIC. Adjusted ROIC (using non-GAAP operating income of ~\$230M against ~\$1B of invested capital ex-cash) is roughly 20-25%, but this excludes SBC. Including SBC as a real cost, true ROIC is in the low single digits at best.

**ROIC Verdict: Marginal to Value Destroying** depending on SBC treatment.

## 2.6 Valuation Screening

Metric	Current	5Y Median	vs. History	Assessment
P/Sales	36.6x	~30x	Above	Expensive
EV/EBITDA (TTM)	891x	Mostly negative	Above	Off-the-chart
P/FCF	276x	~200x	Above	Expensive
P/Book	54x	~40x	Above	Expensive
Forward P/E (non-GAAP)	175-200x	n/a	n/a	Extreme

**Valuation: EXPENSIVE | Margin of Safety: NEGATIVE ~45-50%**

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## STAGE 3: PEER COMPARISON & QUALITY RANKING

Dimension	NET	Akamai	Fastly	Zscaler	Best for Preservation
Revenue Growth	28%	5%	12%	22%	NET
GAAP Profitable	No	Yes	No	No	Akamai
Dividend Yield	0%	0%	0%	0%	None
P/Sales	36x	3x	4x	12x	Akamai
Debt/Equity	1.48x	1.1x	0.4x	0.7x	Fastly
FCF Positive	Yes	Yes	No	Yes	Tie

Cloudflare is the growth leader. It is also the most expensive by a wide margin. Akamai offers similar exposure at one-tenth the multiple but with materially slower growth. None of these peers offer dividend income.

### Wealth Preservation Quality Score Calculation

**Balance Sheet Fortress (40 max):** 12 points

- D/E 1.48x: 5 points
- Interest coverage negative: 0 points
- FCF positive 4/5: 7 points

**Income Reliability (30 max):** 0 points

- No dividend, no income cushion

**Capital Efficiency (15 max):** 4 points

- GAAP ROIC negative; adjusted middling

**Valuation (15 max):** 0 points

- Trading well above 75th percentile of history on every meaningful metric

**Total WP Quality Score: 16 / 100**

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## STAGE 4: QUALITATIVE DEEP DIVE

### 4.1 Competitive Moat

The moat is real but not unassailable. Network effects from the global edge footprint, switching costs once integrated for DNS/DDoS/Zero Trust, and a developer flywheel around Workers provide durability. The threat is hyperscaler bundling: AWS, Azure, and Google Cloud can package CDN, security, and edge compute into broader contracts at marginal pricing. Cloudflare's freemium acquisition model is excellent for SMB but faces headwinds in displacing entrenched enterprise security vendors (Zscaler, Palo Alto, Cisco).

**Moat Type:** Combination of network effects, switching costs, and developer ecosystem

**Durability:** Medium-High over 5-7 years; uncertain beyond

**Threat Assessment:** Elevated (hyperscaler commoditization is the structural risk)

### 4.2 Management & Capital Allocation

Matthew Prince is a co-founder with skin in the game and a clear strategic vision. The pivot to agentic AI infrastructure (Pay-per-Crawl, NET Dollar) shows imagination and first-mover positioning. Capital allocation prioritizes reinvestment over returns to shareholders — defensible at a high-growth phase but extends the timeline before investors see cash returns.

Heavy insider selling under 10b5-1 plans (CEO, directors, CLO selling routinely at \$197-205) is pre-arranged and not a red flag in isolation, but it does signal that those closest to the business are diversifying at current prices.

**Management Quality: GOOD**

**Capital Allocation Track Record: ACCEPTABLE for growth mandate; POOR for preservation mandate**

### 4.3 Recession Performance History

Cloudflare went public in 2019. The 2020 COVID recession was an internet-tailwind event for the company, not a stress test. There is no real recession data. In 2022's tech selloff, NET fell from \$221 to \$40 — an 82% drawdown — demonstrating exactly the multiple compression risk that defines this thesis.

**Recession Profile: VULNERABLE** (untested as a profitable business; 2022 drawdown shows valuation fragility)

### 4.4 Catalysts

Catalyst	Timeline	Probability	Direction
Q2 2026 earnings	Late July 2026	High	Volatile (Q1 already saw -23% reaction d
Investor Day 2026	June 9, 2026	Confirmed	Likely positive narrative; limited multiple i
GAAP profitability inflection	2026-2027	Medium	Material upside if achieved
AI/agentic revenue ramp	2026-2028	Medium-Low	Optionality, not base case

Catalyst	Timeline	Probability	Direction
Multiple compression	Ongoing	High	Negative

The most probable near-term catalyst is continued multiple compression as growth decelerates from 30%+ toward the consensus 25.9% twelve-month projection.

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## STAGE 5: VALUATION & SCENARIO ANALYSIS

### 5.1 Total Return Model (10-Year)

No dividend means total return depends entirely on revenue growth, margin expansion, and terminal multiple.

### 5.2 Scenario Analysis

#### BEAR CASE (30% weight)

- Revenue growth decelerates to 15% by FY2028, 10% by FY2030
- GAAP operating margin reaches 10% by 2030
- Terminal P/Sales compresses to 8x (still premium)
- 10-year price target: ~\$95
- Total Return CAGR: **-7%**

#### BASE CASE (50% weight)

- Revenue growth 25% averaging down to 15% over the decade
- GAAP operating margin reaches 18-20% by 2032
- Terminal P/Sales: 12x (sector premium for quality)
- 10-year price target: ~\$210
- Total Return CAGR: **+0.7%**

#### BULL CASE (20% weight)

- Revenue compounds at 22%+ for the decade; AI/agent monetization scales
- Operating margin reaches 28%
- Terminal P/Sales: 18x
- 10-year price target: ~\$650
- Total Return CAGR: **+12.7%**

#### Probability-Weighted Expected Return: ~+1.3% CAGR

This is below the 4% HYSA risk-free alternative, far below the 7% inflation+4% hurdle, and the bear case is materially negative.

### 5.3 Downside Protection

- Historical max drawdown (2021-2022): -82%
- Bear case decline from current: -52%
- Probability of >50% permanent loss within 5 years: **~30-35%**

This exceeds the 10% threshold by a factor of three.

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## STAGE 6: WEALTH PRESERVATION SCORING

### Downside Protection Score: 20/100

- Bear case total return strongly negative: -15 points
- D/E above 1.0x: -10 points
- No dividend cushion: 0 points awarded
- 82% historical drawdown: severe deduction

### Return Adequacy Score: 30/100

- Base case CAGR <2%: well below hurdle

**Quality Score: 38/100** (composite of moat strength, management, FCF generation, offset by GAAP losses and dilution)

### Composite WP Score:

$$(20 \times 0.45) + (30 \times 0.30) + (38 \times 0.25) = 9 + 9 + 9.5 = 27.5 / 100$$

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## STAGE 7: FINAL RECOMMENDATION

### Absolute Requirements Check

- Bear case total return  $\geq 0\%$  — **FAIL** (-7% CAGR)
- Base case total return  $\geq 7\%$  — **FAIL** (+0.7% CAGR)
- Solvency: FORTRESS or ADEQUATE — **FAIL** (MARGINAL)
- Dividend sustainability — **N/A** (no dividend)
- Probability of >50% loss <10% — **FAIL** (~30-35%)

Five of five gates fail. The framework's exit is automatic.

### RECOMMENDATION: AVOID

**Reason:** The valuation is incompatible with capital preservation. At 36x sales and 276x FCF, the math required to clear a 7% hurdle from this entry price requires the bull case to play out, and the probability-weighted expected return is approximately 1% CAGR — below a savings account, with downside risk of 50%+ permanent capital impairment.

### What Would Change This Assessment:

- Price below \$90 (P/Sales below 16x), creating margin of safety
- GAAP operating profitability sustained for 4+ consecutive quarters
- Stock-based compensation reduced below 10% of revenue
- Initiation of capital return program (dividend or sustained buyback)

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## MONITORING CHECKLIST (Watchlist Triggers)

Trigger	Action
Price drops below \$100	Re-run full framework; potential entry candidate
Revenue growth decelerates below 20% YoY for two consecutive quarters	Confirm multiple compression thesis; remain on AVOID
GAAP operating income turns positive on a sustained basis	Re-evaluate quality score
Dollar-based net retention drops below 110%	Material moat erosion signal
SBC as % of revenue falls below 10%	Improvement in capital allocation discipline
Hyperscaler announces direct competitive bundle	Re-evaluate competitive positioning

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## ANALYST NOTES

### Key Assumptions:

- Sector multiples mean-revert toward historical software medians over 5-10 years
- Stock-based compensation continues at 15-18% of revenue absent management action
- Hyperscaler competition intensifies but does not eliminate Cloudflare's niche
- No recession-induced enterprise spending freeze in base case

### Limitations:

- Limited recession history makes downside calibration imprecise
- Non-GAAP/GAAP gap obscures true unit economics
- Valuation analysis depends heavily on terminal multiple assumptions, which are inherently uncertain at current premium levels
- Q1 2026 10-Q text not directly available; relied on summaries

**Confidence Level: HIGH** — The valuation arithmetic is decisive. Even granting generous assumptions on growth and margin, the entry price does not produce a wealth preservation outcome. The recommendation does not depend on a particular view of Cloudflare's competitive position; it depends on the gap between price and intrinsic value.

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*Report prepared for Moschovakis Capital. This analysis is for informational purposes only and does not constitute investment advice. Cloudflare is a strong company; the AVOID recommendation reflects price, not business quality.*

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## IMPORTANT DISCLOSURES

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