

Arista Networks, Inc. (ANET)

\$238.05 (As of 01/24/20)

Price Target (6-12 Months): **\$250.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/23/20)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:C

Value: D

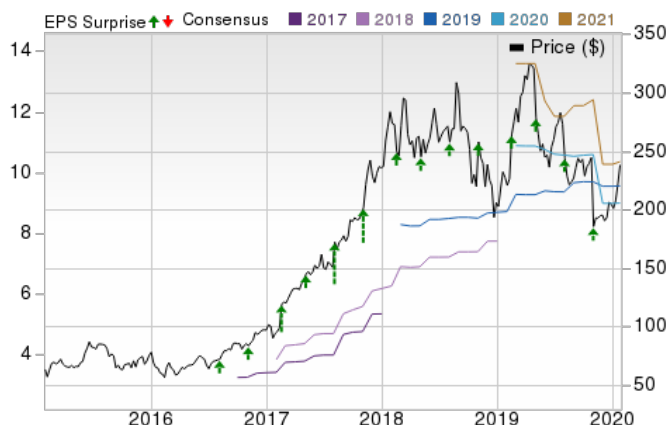
Growth: A

Momentum: D

Summary

Arista continues to benefit from the expanding cloud networking market driven by strong demand for scalable infrastructure. The company aims to sustain healthy revenue growth and cash flow in 2020 on the back of industry-leading product offerings that enable seamless integration with third-party applications for network management and automation. Its strategy of leveraging merchant silicon from multiple suppliers has expanded product portfolio and enhanced its ability to offer products at cheaper prices. However, the company failed to impress investors due to its soft outlook for the December quarter. It suffered a record plunge in cloud demand in third-quarter 2019 owing to a shift in the procurement strategy with a reduction in demand from a second cloud titan. It also faces stiff competition in the space, particularly from Cisco.

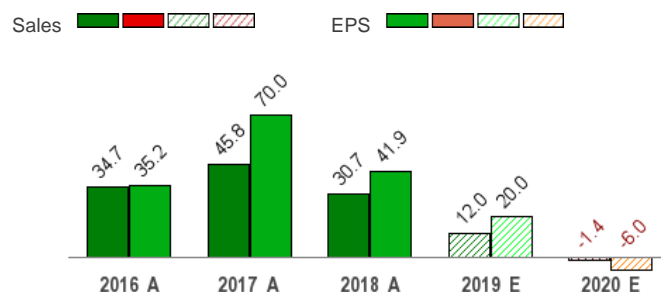
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$331.27 - \$173.31
20 Day Average Volume (sh)	562,466
Market Cap	\$18.2 B
YTD Price Change	17.0%
Beta	1.49
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Communication - Components
Zacks Industry Rank	Top 41% (104 out of 255)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	10.3%
Last Sales Surprise	-15.0%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	02/13/2020
Earnings ESP	2.7%
P/E TTM	24.6
P/E F1	26.5
PEG F1	1.4
P/S TTM	7.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	522 E	571 E	617 E	661 E	2,376 E
2019	595 A	608 A	555 A	551 E	2,409 E
2018	472 A	520 A	563 A	596 A	2,151 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.92 E	\$2.12 E	\$2.33 E	\$2.52 E	\$8.98 E
2019	\$2.31 A	\$2.44 A	\$2.69 A	\$2.09 E	\$9.55 E
2018	\$1.66 A	\$1.93 A	\$2.11 A	\$2.25 A	\$7.96 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/24/2020. The reports text is as of 01/27/2020.

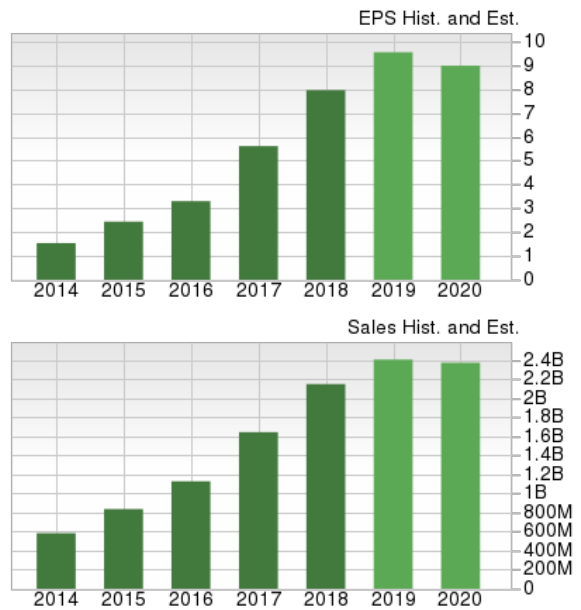
Overview

Santa Clara, CA-based Arista Networks, Inc. is engaged in providing cloud networking solutions for data centers and cloud computing environments. The company offers 10/25/40/50/100 Gigabit Ethernet switches and routers optimized for next generation data center networks.

Arista uses multiple silicon architectures across its products. At the core of the company's cloud networking solutions is the Linux-based Extensible Operating System (EOS), which was architected to be fully programmable and highly modular.

EOS supports leading cloud and virtualization solutions, including VMware NSX, Microsoft System Center, OpenStack and other cloud management frameworks. The company co-authored the VXLAN protocol specification with VMware and were the first to demonstrate VXLAN integration. Moreover, it has now expanded VXLAN routing and integration.

In 2015, Arista introduced CloudVision, a network-wide approach for workload orchestration and workflow automation delivering a turnkey solution for cloud networking. The company currently serves five verticals namely – cloud titans (customers that deploy more than one million servers), cloud specialty providers, service providers, financial services and rest of enterprise.



Reasons To Buy:

- ▲ Arista topped the Zacks Consensus Estimate for earnings in each of the trailing four quarters, the beat being 10.5%, on average. It is a leader in 100-gigabit Ethernet switching share in port for the high-speed datacenter segment. The company has successfully integrated two M&A transactions — Mojo Networks for Cognitive Wi-Fi in the campus and Metamako for ultra-low latency networking — which remain additional tailwinds for business growth. Moreover, it is earning a strategic role with customers deploying transformative cloud networking. The company aims to sustain revenue growth and generate healthy cash flow in 2020, on the back of industry-leading product offerings.
- ▲ Furthermore, Arista continues benefiting from the expanding cloud networking market, owing to strong demand for scalable infrastructure. In addition to high capacity and easy availability, its cloud networking solutions promise predictable performance along with programmability that enables integration with third-party applications for network management, automation and orchestration. The company's product portfolio facilitates the implementation of high-performance, highly scalable and appropriate solutions for every environment.
- ▲ Arista's strategy of leveraging merchant silicon from multiple suppliers has expanded product portfolio and increased its ability to offer products at cheaper prices. This has also helped it to focus on developing software like EOS (Extensible Operating System) and CloudVision. While EOS is core to the company's cloud networking solutions for next-generation data centers and cloud networks, CloudVision is a network-wide approach for workload orchestration, workflow automation and real-time telemetry as a turnkey solution for cloud networking. Arista is well poised to benefit from strong demand for its data center switches. Moreover, continued spending on IT infrastructure products (server, enterprise storage and Ethernet switches) for deployment in cloud environments is likely to benefit the company. Notably, its switches and routers support the high-end cloud networking market that require fast throughput at low cost. The robust product portfolio is aiding the company to win customers on a regular basis, boosting its top line.

Arista is playing a strategic role in deploying transformative cloud networking solutions and aims to sustain a healthy revenue growth in 2020 backed by innovative product offerings.

Reasons To Sell:

- ▼ Arista had lost a quarter of its market value after the release of third-quarter 2019 results. Despite 24% rise in earnings on 16.2% revenue growth year over year, the cloud networking company failed to impress investor sentiments due to its soft outlook for the December quarter. The company suffered a record plunge in cloud demand in the third quarter owing to a shift in the procurement strategy with a reduction in demand from a second cloud titan. Consequently, the reduction in forecasts for 2020 resulted in significant share meltdown, which is worrisome for Arista. For fourth-quarter 2019, the company projects revenues of \$540-\$560 million which is about 8% lower than its prior-year quarter figure.
- ▼ Moreover, intensifying competition, legal woes and stretched valuation remain primary concerns. Redesigning of products and their supply chain mechanism has eroded margins of the company. Arista faces stiff competition in the cloud networking solutions, particularly in the 10-gigabit Ethernet and above. Cisco is the dominant player in the data center networking market due to its diverse portfolio of IP based networking products. Apart from Cisco, Arista faces significant competition from large network equipment and system vendors such as Brocade, Dell, Hewlett-Packard, Juniper Networks (in the routing platform), Extreme Networks and Mellanox.
- ▼ Continued lawsuits have been a distraction for Arista. It has been forced to bring down much of its manufacturing operations in the United States, which along with redesigning of products have led to loss of time as well as hurt gross margin. The gross margin (TTM) of the company has decreased from 67.1% in 2014 to 63.8% in 2018. Arista faces increased revenue and margin pressures due to delay in ramp up of 400G optics and port growth within Internet Content Providers slowing considerably. Higher operating expenses further continue to dent margins. The company expects 2020 to be quite turbulent, with a pause in cloud titan set of orders leading to muted growth compared with previous years.

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Last Earnings Report

Arista Beats Q3 Earnings Estimates on Higher Revenues

Arista reported solid third-quarter 2019 results, wherein both the bottom line and the top line increased year over year and surpassed the respective Zacks Consensus Estimate. The strong quarterly performance reflected the underlying strength of the resilient business model and diligent execution of operational plans.

Net Income

On a GAAP basis, net income improved to \$208.9 million or \$2.59 per share from \$168.5 million or loss of \$2.08 per share in the year-ago quarter, primarily driven by top-line growth.

Quarterly non-GAAP net income came in at \$217.1 million or \$2.69 per share compared with \$171.3 million or \$2.11 per share in the year-ago quarter. The bottom line beat the consensus estimate by 25 cents.

Revenues

Quarterly total revenues increased 16.2% year over year to \$654.4 million and were at the higher end of the company's guidance of \$647-\$657 million, driven by healthy overall demand and strong performance from cloud titan and enterprise verticals. In addition, Arista registered record number of new customer additions during the quarter. The top line surpassed the Zacks Consensus Estimate of \$653 million.

Arista generated 81% of total revenues from the Americas and the remainder from international operations. Product revenues jumped to \$555.1 million from \$485.5 million, and Service revenues rose to \$99.3 million from \$77.8 million on healthy renewal activities.

Other Quarterly Details

Non-GAAP gross profit improved to \$421.2 million from \$364 million for respective margins of 64.4% and 64.6%. The non-GAAP gross margin was above the mid-point of management's guidance of 63-65%. This was reflective of healthy enterprise and service contributions combined with a continued focus on cost optimization.

Non-GAAP operating income came in at \$258.2 million compared with \$209 million a year ago. Non-GAAP operating margin improved to 39.4% from 37.1%.

Cash Flow and Liquidity

Arista generated \$635.9 million of cash from operating activities in the first nine months of 2019 compared with \$207.3 million in the year-ago period. As of Sep 30, 2019, the cloud networking company had \$1,095.3 million of cash and cash equivalents with \$237.6 million of non-current deferred revenue balance. During the quarter, the company repurchased \$115 million worth shares at a weighted average price of \$224 per share.

Q4 Guidance

Arista is well positioned with its key cloud customers and is focused on expanding presence across all the verticals. For fourth-quarter 2019, the company projects revenues in the range of \$540-\$560 million. The lower revenue projection is primarily due to the volatility in demand on account of a shift in procurement strategy from a cloud titan customer, resulting in a material reduction in demand. It anticipates non-GAAP gross margin of 63-65% and non-GAAP operating margin of approximately 36%.

Moving Forward

Apart from driving cloud area networking, Arista boasts the number one market position in 100-gigabit Ethernet switching share in port for the high-speed datacenter segment. The company aims to sustain long-term revenue growth and healthy cash generation on the back of industry-leading product offerings.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	-15.02%
EPS Surprise	10.25%
Quarterly EPS	2.69
Annual EPS (TTM)	9.69

Recent News

On Nov 5, 2019, Arista communicated that it has introduced CloudEOS, delivering two new offerings that solve critical networking challenges in multi-cloud and cloud-native environments. This, in turn, enables an enterprise-class networking experience with segmentation, telemetry, monitoring, provisioning and troubleshooting from campus to data center to cloud. CloudEOS provides two main capabilities — CloudEOS Multi Cloud and CloudEOS Cloud Native. CloudEOS is available on Amazon Web Services, Microsoft Azure and Google Cloud. Arista's CloudEOS can be deployed across the enterprise edge, WAN, campus, data center, on-premises Kubernetes clusters, and multiple public and private clouds.

On Oct 9, 2019, Arista announced that it is providing network platforms for SK Telecom's — South Korea's largest wireless carrier — 5G network. The company is working with SK Telecom to deliver a 5G open architecture with programmable automation that will scale to support the Telecom's customers. By installing Arista's network switches optimized for 5G in its infrastructure, SK Telecom has been able to provide high quality 5G services to its customers. Arista is providing SK Telecom with universal spine and leaf network switches, combining routing and switching to reduce complexity and significantly improve scale without compromising performance at speeds of 100 plus Tbps.

Valuation

Arista shares are up 10.6% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer and Technology sector are up 15.4% and 33% over the past year, respectively.

The S&P 500 Index is up 23.8% in the past year.

The stock is currently trading at 26.21X forward 12-month earnings, which compares to 23.31X for the Zacks sub-industry, 22.92X for the Zacks sector and 18.93X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 54.8X and as low as 19.9X, with a 5-year median of 35.1X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$250 price target reflects 9.54X forward 12-month earnings.

The table below shows summary valuation data for ANET

Valuation Multiples - ANET					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	26.21	23.31	22.92	18.93
	5-Year High	54.78	32.75	22.92	19.34
	5-Year Low	19.89	14.43	16.87	15.17
	5-Year Median	35.14	20.92	19.24	17.44
P/B TTM	Current	6.85	3.33	5.6	4.5
	5-Year High	13.55	3.5	5.63	4.55
	5-Year Low	4.56	1.03	3.13	2.85
	5-Year Median	7.83	2.36	4.22	3.62
P/S F12M	Current	7.58	2	3.73	3.52
	5-Year High	10.63	2.93	3.73	3.52
	5-Year Low	3.3	1.73	2.3	2.54
	5-Year Median	6.36	2.13	3.01	3

As of 01/24/2020

Industry Analysis Zacks Industry Rank: Top 41% (104 out of 255)



Top Peers

Acacia Communications, Inc. (ACIA)	Neutral
ADTRAN, Inc. (ADTN)	Neutral
Ciena Corporation (CIEN)	Neutral
EXFO Inc (EXFO)	Neutral
Harmonic Inc. (HLIT)	Neutral
Juniper Networks, Inc. (JNPR)	Neutral
Zayo Group Holdings, Inc. (ZAYO)	Neutral
CommScope Holding Company, Inc. (COMM)	Underperform

Industry Comparison Industry: Communication - Components				Industry Peers		
	ANET Neutral	X Industry	S&P 500	ADTN Neutral	COMM Underperform	ZAYO Neutral
VGM Score	C	-	-	C	A	D
Market Cap	18.19 B	178.99 M	24.13 B	473.00 M	2.75 B	8.24 B
# of Analysts	11	4	13	2	6	4
Dividend Yield	0.00%	0.00%	1.78%	3.64%	0.00%	0.00%
Value Score	D	-	-	C	A	D
Cash/Price	0.14	0.12	0.04	0.25	0.21	0.03
EV/EBITDA	50.12	10.98	14.02	-20.46	15.89	14.31
PEG Ratio	1.39	2.00	2.03	11.64	0.53	14.29
Price/Book (P/B)	6.85	2.46	3.30	1.20	2.27	5.99
Price/Cash Flow (P/CF)	30.15	16.11	13.52	NA	3.54	12.98
P/E (F1)	26.51	26.69	18.92	58.18	6.45	52.50
Price/Sales (P/S)	7.72	1.62	2.65	0.85	0.39	3.20
Earnings Yield	3.77%	3.56%	5.28%	1.72%	15.47%	1.90%
Debt/Equity	0.03	0.03	0.72	0.00	8.34	4.56
Cash Flow (\$/share)	7.90	0.35	6.94	-0.14	4.00	2.68
Growth Score	A	-	-	D	C	C
Hist. EPS Growth (3-5 yrs)	53.22%	6.86%	10.60%	-10.22%	0.99%	60.85%
Proj. EPS Growth (F1/F0)	-5.92%	4.76%	7.59%	183.33%	7.92%	6.85%
Curr. Cash Flow Growth	52.91%	2.09%	13.90%	-111.13%	-0.93%	-16.96%
Hist. Cash Flow Growth (3-5 yrs)	65.05%	9.29%	9.00%	NA	8.68%	44.27%
Current Ratio	5.91	2.34	1.22	2.73	1.86	0.61
Debt/Capital	3.18%	3.04%	42.99%	0.00%	90.16%	82.03%
Net Margin	32.68%	2.03%	11.35%	-8.79%	-7.26%	5.66%
Return on Equity	28.94%	6.36%	17.10%	-0.57%	27.25%	11.34%
Sales/Assets	0.70	0.78	0.55	0.89	0.59	0.27
Proj. Sales Growth (F1/F0)	-1.38%	3.22%	4.03%	-6.79%	11.54%	0.84%
Momentum Score	D	-	-	B	B	F
Daily Price Chg	3.47%	0.00%	-1.01%	-1.69%	-2.21%	-0.06%
1 Week Price Chg	6.95%	2.49%	2.29%	5.10%	8.52%	0.23%
4 Week Price Chg	15.78%	0.00%	1.02%	0.92%	0.93%	0.64%
12 Week Price Chg	-2.67%	-0.25%	6.85%	12.26%	26.43%	1.87%
52 Week Price Chg	5.12%	0.60%	20.39%	-27.06%	-25.43%	29.25%
20 Day Average Volume	562,466	50,330	1,536,379	171,006	2,423,146	2,690,154
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	-0.40%	-3.99%
(F1) EPS Est 12 week change	-17.44%	-11.10%	-0.23%	-62.50%	-14.92%	-10.95%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	-3.28%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	D
Growth Score	A
Momentum Score	D
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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