

Arista Networks, Inc. (ANET)

\$205.73 (As of 03/30/20)

Price Target (6-12 Months): **\$220.00**

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:D

Value: D

Growth: B

Momentum: D

Summary

Arista is well poised to benefit from strong demand for its data center switches and continued spending on IT infrastructure products for deployment in cloud environments. Notably, its switches and routers support the high-end cloud networking market that require fast throughput at low cost. Arista's strategy of leveraging merchant silicon from multiple suppliers has also expanded product portfolio and increased its ability to offer products at cheaper prices. However, the company expects near-term volatility to continue in the cloud business despite underlying strength of the resilient business model and diligent execution of operational plans. Intensifying competition, legal woes and stretched valuation remain other concerns for the company. The reduction in 2020 forecasts has resulted in significant share meltdown, which is worrisome.

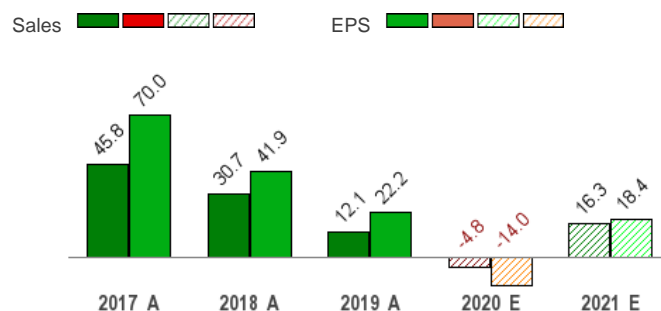
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$331.27 - \$156.63
20 Day Average Volume (sh)	1,188,989
Market Cap	\$15.7 B
YTD Price Change	1.2%
Beta	1.55
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Communication - Components
Zacks Industry Rank	Top 37% (95 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	9.6%
Last Sales Surprise	0.4%
EPS F1 Est- 4 week change	-4.8%
Expected Report Date	05/07/2020
Earnings ESP	0.0%
P/E TTM	21.1
P/E F1	24.6
PEG F1	1.3
P/S TTM	6.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	619 E	654 E	692 E	728 E	2,671 E
2020	515 E	553 E	597 E	639 E	2,296 E
2019	595 A	608 A	555 A	553 A	2,411 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$2.40 E	\$2.23 E	\$2.41 E	\$2.57 E	\$9.91 E
2020	\$2.10 E	\$1.81 E	\$1.96 E	\$2.17 E	\$8.37 E
2019	\$2.31 A	\$2.44 A	\$2.69 A	\$2.29 A	\$9.73 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 03/30/2020. The reports text is as of 03/31/2020.

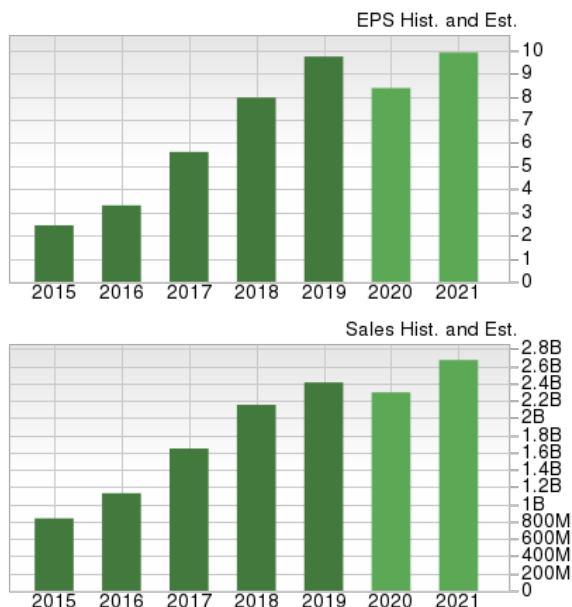
Overview

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 10.3%, 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.
- ▲ 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 benefit from continued IT investments owing to its innovative product offerings.

Reasons To Sell:

- ▼ Earnings estimate for the current year has decreased 23% over the past year to \$8.37 per share, while next-year earnings estimate is down 27.1% over the past year to \$9.91 per share. Due to muted demand in the cloud business, Arista reported lower revenues year over year in fourth-quarter 2019. This failed to impress investor sentiments and the stock is down 35.4% over the past year. The reduction in forecasts for 2020 has further resulted in significant share meltdown, which is worrisome for Arista.
- ▼ 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.
- ▼ The company expects near-term volatility to continue in the cloud business despite underlying strength of the resilient business model and diligent execution of operational plans. For first-quarter 2020, the company projects revenues in the range of \$522-\$532 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% and non-GAAP operating margin of approximately 34%. 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.

Intensifying competition, legal woes and stretched valuation remain primary concerns. Redesigning of products and their supply chain mechanism have eroded the margins of the company.

Last Earnings Report

Arista Beats on Q4 Earnings Despite Lower Revenues

Arista reported mixed fourth-quarter 2019 results, wherein both the bottom line and the top line surpassed the respective Zacks Consensus Estimate. However, it reported lower revenues year over year due to muted demand in the cloud business.

Net Income

On a GAAP basis, net income improved to \$260.7 million or \$3.25 per share from \$170.3 million or \$2.10 per share in the year-ago quarter, primarily driven by income tax benefit.

Quarterly non-GAAP net income came in at \$183.4 million or \$2.29 per share compared with \$182.2 million or \$2.25 per share in the year-ago quarter. The bottom line beat the consensus estimate by 20 cents.

In full-year 2019, GAAP net income improved to \$859.9 million or \$10.63 per share from \$328.1 million or \$4.06 per share a year ago on higher revenues and lower operating expenses. Non-GAAP net income came in at \$786.8 million or \$9.73 per share compared with \$643.3 million or \$7.96 per share in 2018.

Revenues

Quarterly total revenues decreased 7.2% year over year to \$552.5 million and were above the midpoint of the company's guidance of \$540-\$560 million, due to volatility in the cloud business given a sudden shift in procurement strategy from a key cloud titan. This resulted in a material reduction in demand. The top line, however, surpassed the Zacks Consensus Estimate of \$551 million. In full-year 2019, total revenues increased 12.1% year over year to \$2,410.7 million.

Arista generated 75% of total revenues from the Americas and the remainder from international operations. Product revenues declined to \$447.5 million from \$503.2 million, while Service revenues rose to \$105 million from \$92.5 million on healthy renewal activities.

Other Quarterly Details

Non-GAAP gross profit decreased to \$360.2 million from \$382.1 million for respective margins of 65.2% and 64.1%. The non-GAAP gross margin was above the mid-point of management's guidance of 63-65%. This was reflective of healthy enterprise and financial verticals with a lower contribution from cloud business.

Non-GAAP operating income was down to \$205.8 million from \$222.1 million a year ago, while non-GAAP operating margin remained flat at 37.3%.

Cash Flow and Liquidity

Arista generated \$963 million of cash from operating activities in 2019 compared with \$503.1 million a year ago. As of Dec 31, 2019, the cloud networking company had \$1,111.3 million of cash and cash equivalents with \$262.6 million of non-current deferred revenue balance compared with respective tallies of \$649.9 million and \$228.6 million in the prior-year period. During the quarter, the company repurchased \$51.5 million worth shares at a weighted average price of \$189 per share.

Q1 Guidance

The company expects near-term volatility to continue in the cloud business despite underlying strength of the resilient business model and diligent execution of operational plans. For first-quarter 2020, the company projects revenues in the range of \$522-\$532 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% and non-GAAP operating margin of approximately 34%.

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 does not expect to face significant direct impact from coronavirus outbreak due to its minimal manufacturing footprint in China, although some supply chain mechanisms are likely to be hampered.

Quarter Ending **12/2019**

Report Date	Feb 13, 2020
Sales Surprise	0.35%
EPS Surprise	9.57%
Quarterly EPS	2.29
Annual EPS (TTM)	9.73

Recent News

On Mar 9, 2020, Arista announced that it has launched an optical line system in an Octal Small Form-factor Pluggable (OSFP) module. This OSFP-Line System addresses the needs of Tier II cloud and Internet service providers for high bandwidth links that are easy to operate. Currently in testing, it is likely to be available in the second half of 2020. It brings new capabilities to colocation operators, edge compute and metro Data Center Interconnect applications. The Arista OSFP-LS is a compact, low power and cost-effective solution for increasing bandwidth between data centers without the need for external optical line systems. It is easier to deploy than conventional external line systems that require their own power feed and control management software.

Valuation

Arista shares are down 35.4% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 28.3%, while those in the Zacks Computer and Technology sector are down 5.5% over the past year.

The S&P 500 Index is down 11.8% in the past year.

The stock is currently trading at 23.51X forward 12-month earnings, which compares to 19.85X for the Zacks sub-industry, 19X for the Zacks sector and 15.48X 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 34.3X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$220 price target reflects 9.36X 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	23.51	19.85	19	15.48
	5-Year High	54.78	32.75	22.02	19.34
	5-Year Low	19.89	14.43	16.85	15.18
	5-Year Median	34.26	21.08	19.3	17.44
P/B TTM	Current	5.43	2.55	3.98	3.42
	5-Year High	13.55	3.5	5.35	4.55
	5-Year Low	4.15	1.03	3.13	2.85
	5-Year Median	7.75	2.39	4.26	3.63
P/S F12M	Current	6.42	1.58	3.06	2.75
	5-Year High	10.63	2.93	3.59	3.43
	5-Year Low	3.3	1.58	2.3	2.54
	5-Year Median	6.41	2.09	3.06	3

As of 03/30/2020

Industry Analysis Zacks Industry Rank: Top 37% (95 out of 254)



Top Peers

Turtle Beach Corporation (HEAR)	Neutral
Harmonic Inc. (HLIT)	Neutral
Spirent Communications PLC (SPMY)	Neutral
Viavi Solutions Inc. (VIAV)	Neutral
Acacia Communications, Inc. (ACIA)	Underperform
Knowles Corporation (KN)	Underperform
Plantronics, Inc. (PLT)	Underperform
TESSCO Technologies Incorporated (TESS)	Underperform

Industry Comparison Industry: Communication - Components				Industry Peers		
	ANET Neutral	X Industry	S&P 500	KN Underperform	PLT Underperform	VIAV Neutral
VGM Score	D	-	-	B	B	B
Market Cap	15.73 B	135.94 M	18.21 B	1.31 B	444.40 M	2.62 B
# of Analysts	12	2	13	5		5
Dividend Yield	0.00%	0.00%	2.3%	0.00%	5.39%	0.00%
Value Score	D	-	-	C	A	B
Cash/Price	0.19	0.17	0.06	0.06	0.41	0.22
EV/EBITDA	14.74	7.49	11.22	9.83	18.33	12.71
PEG Ratio	1.31	1.72	1.74	1.18	NA	NA
Price/Book (P/B)	5.43	1.78	2.41	1.00	0.76	3.43
Price/Cash Flow (P/CF)	21.56	10.08	9.70	8.97	1.22	10.26
P/E (F1)	24.54	21.51	15.12	11.77	4.21	15.84
Price/Sales (P/S)	6.81	1.21	1.96	1.53	0.25	2.24
Earnings Yield	4.07%	3.13%	6.55%	8.49%	23.72%	6.33%
Debt/Equity	0.03	0.03	0.70	0.14	2.76	0.77
Cash Flow (\$/share)	9.54	0.36	7.01	1.58	9.12	1.11
Growth Score	B	-	-	B	F	B
Hist. EPS Growth (3-5 yrs)	51.02%	8.34%	10.89%	12.30%	10.76%	20.02%
Proj. EPS Growth (F1/F0)	-13.98%	-9.87%	1.80%	12.15%	-48.34%	5.59%
Curr. Cash Flow Growth	22.40%	6.97%	5.93%	8.28%	219.80%	29.45%
Hist. Cash Flow Growth (3-5 yrs)	57.99%	14.62%	8.55%	-9.73%	24.06%	1.45%
Current Ratio	5.81	2.34	1.23	2.56	1.42	3.65
Debt/Capital	2.79%	2.65%	42.57%	12.37%	73.37%	43.56%
Net Margin	37.20%	1.66%	11.64%	5.74%	-9.69%	3.64%
Return on Equity	27.00%	6.86%	16.74%	6.38%	19.10%	17.57%
Sales/Assets	0.63	0.73	0.54	0.53	0.57	0.64
Proj. Sales Growth (F1/F0)	-0.65%	0.00%	2.08%	2.25%	-1.08%	4.46%
Momentum Score	D	-	-	A	A	C
Daily Price Chg	7.55%	0.56%	2.63%	-1.67%	5.60%	2.80%
1 Week Price Chg	16.30%	5.97%	12.32%	20.25%	25.18%	13.90%
4 Week Price Chg	4.65%	-13.74%	-18.22%	-15.49%	-20.84%	-16.09%
12 Week Price Chg	1.41%	-18.70%	-23.36%	-34.28%	-59.85%	-24.10%
52 Week Price Chg	-35.38%	-32.15%	-17.22%	-20.48%	-76.62%	-9.26%
20 Day Average Volume	1,188,989	54,435	4,211,236	1,125,144	1,552,737	3,332,661
(F1) EPS Est 1 week change	0.00%	0.00%	-0.19%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-4.80%	0.00%	-3.07%	0.00%	0.00%	0.00%
(F1) EPS Est 12 week change	-7.22%	-20.00%	-4.15%	-6.67%	-22.73%	2.98%
(Q1) EPS Est Mthly Chg	-5.43%	0.00%	-2.28%	0.00%	0.00%	0.00%

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	B
Momentum Score	D
VGM Score	D

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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