

Arrow Electronics (ARW)

\$60.65 (As of 03/09/20)

Price Target (6-12 Months): **\$52.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform
(Since: 02/16/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:A

Value: B

Growth: A

Momentum: A

Summary

Arrow's fourth-quarter results were negatively impacted by weak demand for components due to ongoing geopolitical tensions. Foreign-exchange headwinds also affected the quarterly results. Additionally, demand from smaller customers was weaker than expected. Moreover, U.S. tariffs are impeding the company's top-line growth. Also, consumption of Arrow's European exports continues to decline. Higher levels of customer inventory are also affecting revenues from the Americas. Shares have underperformed the industry in the past year. Nonetheless, Arrow benefited from a strong uptrend in design activity across all regions during the fourth quarter. Notably, a sequential improvement in backlog was also a positive. Strong momentum in infrastructure software, next-generation hardware and hybrid cloud architectures is encouraging as well.

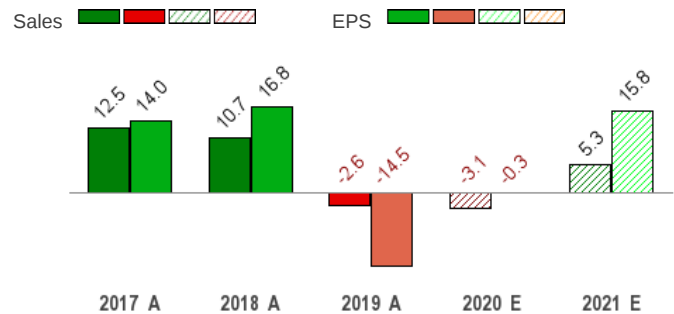
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$86.62 - \$59.90
20 Day Average Volume (sh)	647,797
Market Cap	\$4.9 B
YTD Price Change	-28.4%
Beta	1.34
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Electronics - Parts Distribution
Zacks Industry Rank	Top 43% (108 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.4%
Last Sales Surprise	0.2%
EPS F1 Est- 4 week change	-2.8%
Expected Report Date	05/07/2020
Earnings ESP	-0.8%
P/E TTM	8.1
P/E F1	8.1
PEG F1	3.0
P/S TTM	0.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	6,869 E	7,293 E	7,465 E	7,958 E	29,522 E
2020	6,411 E	6,811 E	7,049 E	7,758 E	28,029 E
2019	7,156 A	7,345 A	7,078 A	7,338 A	28,917 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.81 E	\$2.09 E	\$2.14 E	\$2.90 E	\$8.72 E
2020	\$1.34 E	\$1.66 E	\$1.86 E	\$2.63 E	\$7.53 E
2019	\$1.84 A	\$1.60 A	\$1.86 A	\$2.20 A	\$7.55 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 03/09/2020. The reports text is as of 03/10/2020.

Overview

New York-based Arrow Electronics Inc. is one of the world's largest distributors of electronic components and enterprise computing products. Arrow provides one of the broadest product ranges in the electronic components and enterprise computing solutions distribution industries. Along with these, the company provides a wide range of value-added services to help customers reduce their marketing time, lower the total cost of ownership, introduce innovative products through demand creation opportunities and enhance their overall competitiveness.

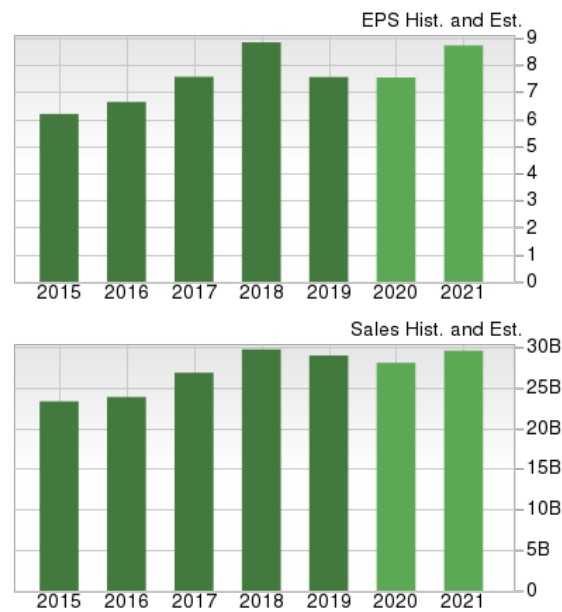
The company serves over 150,000 customers — original equipment manufacturers (OEMs), contract manufacturers (CMs) and commercial customers — through 300 sales facilities and 45 distribution centers in over 80 countries. The company's customer base comprises OEMs, CMs, value-added resellers (VARs) and other commercial users. The company's products primarily target the industrial sector (companies manufacturing machine tools, factory automation equipment or robotics equipment).

Arrow's offerings can be broadly divided into two categories:

1) Global Components (71% of 2018 revenues): Arrow distributes electronic components to OEMs and CMs through its global components business segment. This segment deals in semiconductor products and related services; passive, electro-mechanical and interconnect products such as capacitors, resistors, potentiometers, power supplies, relays, switches and connectors; and computing and memory. Within this segment, semiconductor products and related services contributed nearly 45% of total sales in 2018.

2) Global Enterprise Computing Solutions (29%): Arrow provides enterprise computing solutions to VARs through its global ECS business segment. The computing segment includes products like servers, workstations, storage products, microcomputer boards and systems, design systems, desktop computer systems, software, monitors, printers, flat panel displays, system chassis and enclosures, controllers and communication control equipment.

Total adjusted revenues generated in 2018 were \$29.65 billion, up 10.9% year over year. Moreover, 59% of the revenues came from its operations outside the United States, reflecting the influence of foreign exchange rate on its revenues.



Reasons To Sell:

- ▼ Arrow's near-term financial results are likely to be impacted by the demand and supply chain disruptions of electronics components due to rapidly spreading coronavirus outside of China. Furthermore, organizations are pushing back their big and expensive technology investments due to global economic slowdown concerns, which is anticipated to hamper Arrow's sales in the near-term.
- ▼ Arrow has a highly leveraged balance sheet. The company has always had a good amount of debt on its balance sheet. Its long-term debt was \$2.64 billion as of Dec 31, 2019. Liquidity is low, since cash and liquid assets are just a fraction of its total assets. We think that the company has limited financial flexibility because of its high debt burden and further increases in debt could make investment in the shares risky. Thus, the company has to generate substantial amount of cash flow to effectively service its debt.
- ▼ Arrow derived approximately 56% of total revenue from outside the U.S. in 2019, in the form of key currencies such as pound, Euro, Australian Dollar and Yen. Thus, currency fluctuations can impact overall profitability of the company.
- ▼ Arrow's competitors are also keen on solidifying their respective positions in the electronics distribution market through strategic acquisitions. In the past few years, Avnet acquired RTI Holdings, TSSLink, Nexicore Assets, Ascendant Technology, Seamless Technologies, Inc. and MSC Investoren GmbH (or MSC Group).
- ▼ Arrow is significantly dependent on sales of semiconductors for revenues. The fears of trade war have been an overhang on chip stocks. With China being one of the biggest markets for semiconductors, investors are apprehensive about the impact of a full-fledged trade war on chip stocks. This makes us anxious about the near-term prospects of the company.

An uncertain economic condition, competition from Avnet and Ingram Micro, and a highly leveraged balance sheet remain concerns.

Risks

- Spending on electronic components and computer products is highly dependent on overall IT spending. Gartner expects worldwide IT spending to reach \$3.9 trillion in 2020, representing a 3.4% increase from 2019. The growth will be mainly driven by increased spending by companies toward digitalization and infrastructure build-up. In its earlier report, Gartner had indicated that major technology trends that include Internet of Things (IoT), big data, artificial intelligence (AI) and blockchain have been driving overall IT spending. All this encourages us about the company's near-term prospects.
 - A significant portion of the company's revenues comes from the sales of semiconductors. Despite the recent uncertainties and slowdown in the semiconductor market, per the recent predictions of WSTS, the semiconductor industry is expected to return to modest growth in 2020. Arrow Electronics' sale of semiconductor products accounted for approximately 46%, 45% and 49% of consolidated sales in 2017, 2018 and 2019, respectively. Therefore, an improvement in this market indicates an improvement in the company's business.
 - Arrow's core strength of providing best-in-class services and easy-to-acquire technologies is expected to bolster growth in the future. Moreover, the company has secured significant market share through its broad portfolio of products and services and continued efforts to maximize consumer satisfaction. The company's diverse product range includes ArrowSphere, UC in the Cloud solutions, engineering design capabilities and remote infrastructure-management (Live Virtual Help Desk) services. This platform is particularly designed for aggregating, merchandizing and delivering cloud-related services to system integrators, autonomous software dealers and IT service providers all over the world. There is a huge scope for the company to earn additional revenues through the enhancement of the cloud-related portal. We believe its expertise in understanding market dynamics and strong product portfolio will continue to support growth.
 - Arrow has been active on the acquisitions front. Over the last three decades, the company had acquired as many as 45 businesses. In 2018, the company acquired elfinichips which is specialized in chip designing for products and IoT solutions. The acquisition not only broadened Arrow Electronics' IoT capabilities but also added a large skilled talent pool. Apart from this, the acquisition had been accretive to the electronic parts distributor's top and bottom lines. Acquisitions help Arrow entering new markets, diversify and broaden its product portfolio. We believe, the company's continued acquisitions are expected to be a significant contributor to its revenue stream.
 - Arrow returns cash to investors through share repurchases. Share buybacks are a good way to return cash to investors when growth opportunities are limited. These also have a positive effect on earnings per share. The company repurchased shares worth nearly \$390 million in 2019, reducing its outstanding shares by approximately 6%.
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Last Earnings Report

Arrow's Q4 Earnings Beat, Revenues Miss Estimates

Arrow Electronics reported fourth-quarter 2019 adjusted earnings per share of \$2.20, down 15.1% on a year-over-year basis. However, the figure surpassed the Zacks Consensus Estimate of \$2.17.

Revenues came in at \$7.34 billion, down 7% from the year-ago quarter. As adjusted, revenues slipped 5% year over year. The revenue figure also missed the consensus estimate of \$7.36 billion.

Demand for components remained low during the fourth quarter, as a result of the prevalent geopolitical tensions. Demand from smaller customers was weaker than expected. Moreover, U.S. tariffs strained the company's top-line growth.

Additionally, consumption of Arrow's European exports continued to decline.

However, strong uptrend in design activity across all regions was a breather.

Segmental Details

Adjusted revenues from Global Components decreased 8% year over year to \$4.74 billion. On a reported basis, revenues declined 10%.

Region wise, the segment's adjusted revenues from the Americas dipped 15% due to high levels of inventory with customers. Adjusted sales from Asia Pacific climbed 4% year over year. Global components contribution from Europe fell 12% on an adjusted basis due to softer demand for products from Arrow's exporting customers. Components sales in the Americas decreased 16% year over year as adjusted.

Adjusted revenues from Global Enterprise Computing Solutions (ECS) came in at \$2.60 billion, down 1% year over year. Also, revenues from this segment declined 2% on a reported basis. Decline in legacy systems took a toll on revenues from this segment. However, strong momentum infrastructure software, next-generation hardware and hybrid cloud architectures were positives.

Billings for the ECS segment grew at a low single-digit rate, year over year, during the fourth quarter.

ECS revenues from the Americas declined 3% after adjusting for foreign-currency changes. Adjusted sales from Europe climbed 4% year over year.

Many customers continued to shift their manufacturing operations and design work out of the United States to avoid tariffs. This posed a significant threat to Arrow.

Notably, backlog improved sequentially. However, lead times declined year over year in the fourth quarter. The overall book to bill improved and reached near parity at 0.99.

Margins

Arrow's gross profit decreased 15.6% from the prior-year quarter to \$822.9 million.

Operating income dropped 28.8% to \$238.1 million.

Arrow's focus on realigning the enterprise computing solutions business toward new technologies and non-traditional customers was a positive.

Balance Sheet and Cash Flow

Arrow exited the fourth quarter with cash and cash equivalents of \$300.1 million compared with the previous quarter's \$262.3 million.

Long-term debt was \$2.64 billion compared with the \$2.94 billion witnessed at the end of the prior quarter.

The company's cash flow from operations was \$494.8 million.

In the fourth quarter, Arrow returned approximately \$100 million to shareholders through stock-repurchase program, and was left with approximately \$339 million of authorization.

Full-Year Highlights

Arrow recorded full-year 2019 revenues of \$28.67 billion, flat year over year. Adjusted earnings of \$7.55 per share came in 14.9% lower than the prior-year level.

Guidance

For the first quarter of 2020, sales are expected between \$6.23 billion and \$6.63 billion.

Global components sales are projected at \$4.55-\$4.75 billion. Global ECS sales are estimated to be \$1.68-\$1.88 billion.

Interest and other expenses will presumably be about \$52 million, as a result of which, the company projects non-GAAP earnings per share of \$1.29-\$1.39.

Quarter Ending 12/2019

Report Date	Feb 06, 2020
Sales Surprise	0.18%
EPS Surprise	1.38%
Quarterly EPS	2.20
Annual EPS (TTM)	7.50

A foreign-exchange headwind of about \$30 million is expected to be an overhang on the top line.

Several delays and extended lead times of China-manufactured products is expected in the current quarter due to business and transportation shutdowns, as well as the extended New Year Holiday week issued by the Chinese government.

Additionally, the first quarter of 2020 will close on Mar 28, two days earlier than the first quarter of 2019. This is expected to negatively impact sales by approximately \$225 million and earnings per share by approximately 11 cents. The new closing date will impact only the global enterprise computing solutions.

Recent News

On Jan 30, 2020, Arrow Electronics partnered with Microchip Technology on an engineering services project to simplify connectivity and security across industrial, smart building and energy markets.

On Nov 4, 2019, Arrow Electronics announced enhancements to its multi-tier cloud platform, ArrowSphere. The new functionalities will enable channel customers to customize multi-vendor solutions for their clients.

Valuation

Arrow's shares have plunged 20.8% in the past six months, and 22.3% over the trailing 12 months. Stocks in the Zacks sub-industry have fallen 13.2% while the Zacks Computer & Technology sector has rallied 4.4% in the past six months, respectively. Over the past year, while the Zacks sub-industry has decreased 11.4%, the sector gained 10.8%.

The S&P 500 Index has declined 0.7% in the past six months, while has gained 5.6% in the past year.

The stock is currently trading at 7.82X forward 12-month earnings, which compares with 9.16X for the Zacks sub-industry, 19.92X for the Zacks sector and 17.01X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 11.51X and as low as 7X, with a 5-year median of 9.18X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$52 price target reflects 6.65X forward 12-months earnings.

The table below shows summary valuation data for ARW

Valuation Multiples - ARW					
		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	7.82	9.16	19.92	17.01
	5-Year High	11.51	12.3	22.04	19.34
	5-Year Low	7.00	7.71	16.87	15.18
	5-Year Median	9.18	9.66	19.34	17.42
EV/S TTM	Current	0.25	0.27	3.87	3.01
	5-Year High	0.40	0.44	4.43	3.46
	5-Year Low	0.25	0.26	2.54	2.14
	5-Year Median	0.34	0.33	3.52	2.82
EV/EBITDA TTM	Current	6.99	6.62	11.18	11.04
	5-Year High	8.48	9.08	12.67	12.87
	5-Year Low	5.59	5.09	7.68	8.49
	5-Year Median	7.19	7.07	10.59	10.79

As of 03/09/2020

Industry Analysis Zacks Industry Rank: Top 43% (108 out of 253)



Top Peers

Applied Materials, Inc. (AMAT)	Outperform
AMETEK, Inc. (AME)	Neutral
KLA Corporation (KLAC)	Neutral
NVIDIA Corporation (NVDA)	Neutral
Teledyne Technologies Incorporated (TDY)	Neutral
Tech Data Corporation (TECD)	Neutral
WESCO International, Inc. (WCC)	Neutral
Avnet, Inc. (AVT)	Underperform

Industry Comparison Industry: Electronics - Parts Distribution				Industry Peers		
	ARW Underperform	X Industry	S&P 500	AVT Underperform	NVDA Neutral	TDY Neutral
VGM Score	A	-	-	A	C	B
Market Cap	4.89 B	1.96 B	19.13 B	2.78 B	150.21 B	11.13 B
# of Analysts	4	4	13	4	12	2
Dividend Yield	0.00%	0.00%	2.26%	3.01%	0.26%	0.00%
Value Score	B	-	-	A	F	D
Cash/Price	0.06	0.11	0.05	0.16	0.07	0.02
EV/EBITDA	22.40	5.93	11.99	5.37	41.69	19.46
PEG Ratio	2.93	1.38	1.68	1.38	2.49	NA
Price/Book (P/B)	1.02	0.70	2.64	0.70	12.31	4.08
Price/Cash Flow (P/CF)	5.70	5.70	10.70	3.74	46.69	21.90
P/E (F1)	7.86	9.65	15.44	14.28	31.49	26.80
Price/Sales (P/S)	0.17	0.17	2.05	0.15	13.76	3.52
Earnings Yield	12.42%	10.65%	6.47%	6.99%	3.18%	3.73%
Debt/Equity	0.54	0.54	0.70	0.36	0.21	0.32
Cash Flow (\$/share)	10.65	7.46	7.01	7.46	5.26	13.88
Growth Score	A	-	-	B	A	A
Hist. EPS Growth (3-5 yrs)	8.39%	5.55%	10.85%	-4.91%	43.93%	17.08%
Proj. EPS Growth (F1/F0)	-0.23%	2.55%	6.25%	-52.49%	34.63%	7.90%
Curr. Cash Flow Growth	-14.43%	-0.83%	6.09%	-8.48%	-20.70%	14.47%
Hist. Cash Flow Growth (3-5 yrs)	1.86%	1.86%	8.52%	1.13%	28.68%	11.00%
Current Ratio	1.52	2.34	1.24	2.38	7.67	1.72
Debt/Capital	35.17%	35.17%	42.57%	26.66%	17.30%	24.25%
Net Margin	-0.71%	0.55%	11.69%	0.55%	25.60%	12.72%
Return on Equity	12.67%	10.30%	16.74%	7.86%	26.08%	15.67%
Sales/Assets	1.78	1.78	0.54	2.11	0.71	0.73
Proj. Sales Growth (F1/F0)	-3.07%	0.00%	3.76%	-8.34%	21.61%	6.26%
Momentum Score	A	-	-	A	D	B
Daily Price Chg	-10.35%	-7.35%	-7.65%	-7.65%	-7.74%	-9.99%
1 Week Price Chg	0.88%	0.00%	-0.67%	-1.56%	-1.49%	0.09%
4 Week Price Chg	-21.35%	-11.23%	-19.26%	-22.23%	-6.67%	-20.53%
12 Week Price Chg	-28.64%	-17.80%	-17.26%	-34.81%	9.01%	-12.48%
52 Week Price Chg	-22.30%	-22.30%	-6.83%	-34.84%	52.31%	33.72%
20 Day Average Volume	647,797	527,001	2,684,709	951,854	17,488,726	227,646
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-2.81%	-0.19%	-0.06%	-0.38%	6.07%	0.35%
(F1) EPS Est 12 week change	-5.64%	-2.75%	-0.46%	-6.47%	6.99%	-0.31%
(Q1) EPS Est Mthly Chg	-0.37%	-0.19%	-0.40%	-1.14%	14.90%	-0.85%

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	B
Growth Score	A
Momentum Score	A
VGM Score	A

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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