

Arrow Electronics (ARW)

\$84.47 (As of 01/10/20)

Price Target (6-12 Months): **\$89.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 09/16/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:A

Value: B

Growth: A

Momentum: A

Summary

Arrow is benefiting from strong uptrend in design activity in Asia. Also, progress in cost optimization and focus on long-term growth strategy are positives. Strong momentum in infrastructure software, next generation hardware and hybrid cloud architectures is also encouraging. Arrow expects strength in electronic content in industrial, transportation and automotive industries to help it return to growth in the near term. Moreover, shutdown of PC and mobility device business is expected to enable quicker implementation of new technologies, boosting its business and profitability. However, weak demand for components due to ongoing geopolitical tensions is an overhang. Additionally, expectations for demand recovery are being postponed, which might hurt Arrow's near-term prospects. Shares have underperformed the industry on a year-to-date basis.

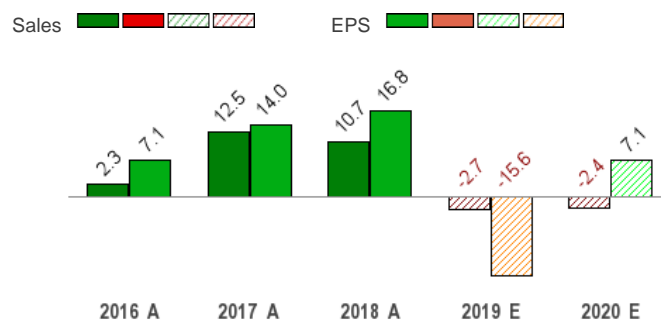
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$86.62 - \$62.35
20 Day Average Volume (sh)	441,305
Market Cap	\$6.9 B
YTD Price Change	-0.3%
Beta	1.36
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Electronics - Parts Distribution
Zacks Industry Rank	Bottom 8% (234 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	11.4%
Last Sales Surprise	0.5%
EPS F1 Est- 4 week change	-0.0%
Expected Report Date	02/06/2020
Earnings ESP	0.0%
P/E TTM	10.7
P/E F1	10.6
PEG F1	4.0
P/S TTM	0.2

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	6,523 E	6,960 E	7,115 E	7,599 E	28,196 E
2019	7,156 A	7,345 A	7,078 A	7,325 E	28,885 E
2018	6,876 A	7,393 A	7,490 A	7,918 A	29,677 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$1.53 E	\$1.91 E	\$2.01 E	\$2.50 E	\$7.98 E
2019	\$1.84 A	\$1.60 A	\$1.86 A	\$2.17 E	\$7.45 E
2018	\$1.88 A	\$2.20 A	\$2.18 A	\$2.57 A	\$8.83 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 01/10/2020. The reports text is as of 01/13/2020.

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.

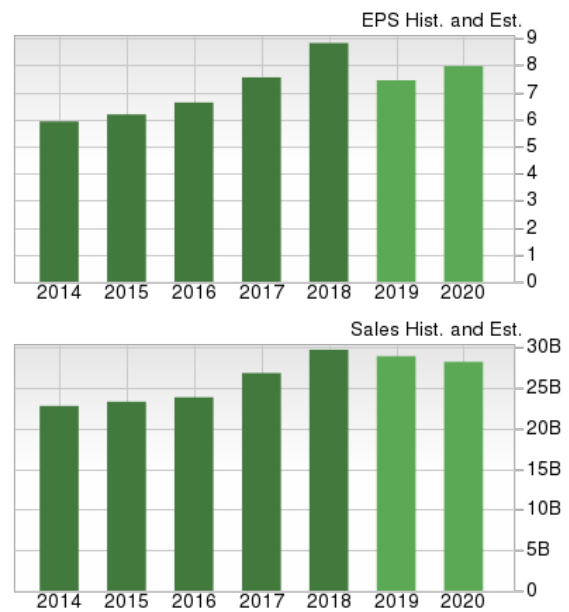
The company serves over 150,000 customers — original equipment manufacturers (OEMs), contract manufacturers (CMs) and commercial customers — through 300 sales facilities and 45 distribution centers in over 80 countries. The company's customer base comprises OEMs, CMs, value-added resellers (VARs) and 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



Reasons To Buy:

▲ Spending on electronic components and computer products is highly dependent on overall IT spending. Gartner expects worldwide IT spending to reach \$3.79 trillion in 2019, representing a 1.1% increase from 2018. 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.

We believe that Arrow's core strength of providing best-in-class services and easy-to-acquire technologies will bolster its growth in the future.

▲ A significant portion of the company's revenues comes from the sales of semiconductors. Per the Semiconductor Industry Association (SIA), worldwide sales of semiconductors reached \$468.8 billion in 2018, reflecting an increase of 13.7% year-over-year. Despite the recent uncertainties and slowdown in the semiconductor market, per the predictions of WSTS in the last quarter of 2018, the semiconductor industry is expected to return to modest growth in 2020. Arrow Electronics' sale of semiconductor products accounted for approximately 42%, 46% and 45% of consolidated sales in 2016, 2017 and 2018, 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. Most recently in January 2018, the company acquired eInfochips which is specialized in chip designing for products and IoT solutions. The acquisition of eInfochips will not only broaden Arrow Electronics' IoT capabilities but will also add a large skilled talent pool. Apart from this, the acquisition will be accretive to the electronic parts distributor's top and bottom lines. Acquisitions are likely to enable Arrow to enter markets, diversify and broaden its product portfolio and maintain its leading position. 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 nearly \$271.4 million in 2018. The company has \$729 million remaining under its share repurchase program as of Dec 31, 2018.

Reasons To Sell:

- ▼ 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 \$2.94 billion as of Sep 30, 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 59% of total revenue from outside the U.S. in 2018, 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.

Last Earnings Report

Arrow's Q3 Earnings Top Estimates, Down Y/Y

Arrow reported third-quarter 2019 adjusted earnings per share of \$1.86, which decreased 13.5% on a year-over-year basis. However, the figure surpassed the Zacks Consensus Estimate of \$1.67.

Revenues came in at \$7.08 billion, down 5.5% from the year-ago quarter. As adjusted, revenues were down 3% year over year. The figure, however, beat the consensus estimate of \$7.06 billion.

Demand for components declined during the third quarter as a result of ongoing geopolitical tensions. Demand from smaller customers was weaker than expected. Moreover, U.S. tariffs took a toll on the company's top line.

Additionally, consumption of Arrow's European exports declined. Expectations for demand recovery are being pushed further out into 2020. Moreover, design activities remained slow.

Further, the company faced foreign currency headwinds amounting to \$103 million on sales and 4 cents on earnings during the quarter.

However, strong uptrend in design activity in Asia was a breather. Also, progress in cost optimization, focus on long-term growth strategy, and commitment toward the expansion of engineering were positives.

Segmental Details

Adjusted revenues from Global Components decreased 4% year over year to \$5.05 billion. The segment gained from design activity. On a reported basis, revenues declined 6%.

Region wise, the segment's adjusted revenues from the Americas decreased 15% due to high levels of inventory with customers. Also, adjusted sales from Asia climbed 5%. Global components contribution from Europe fell 2% on an adjusted basis due to lower demand for products from Arrow's exporting customers.

Adjusted revenues from Global Enterprise Computing Solutions (ECS) came in at \$2.03 billion, down 1.6% year over year. Also, revenues from this segment declined 3.8% 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.

ECS revenues from the Americas declined 2.3% after adjusting for foreign currency changes. Adjusted sales from Europe inched up 0.1% year over year but declined 6.3% on a reported basis.

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

Moreover, backlog and lead times declined year over year in the reported quarter. Lead times contracted more for semiconductors than for passive and electromechanical parts. The overall book to bill remained below parity at 0.91.

Margins

Non-GAAP gross profit decreased 12.1% from the prior-year quarter to \$796.4 million.

Arrow's non-GAAP operating income plunged 18.9% to \$252.6 million. Non-GAAP operating margin of 3.6% was 60 basis points lower.

Demand shift to lower margin products coupled with lower revenues kept margins under pressure.

However, Arrow's focus on realigning the enterprise computing solutions business toward new technologies and nontraditional customers was a positive.

Balance Sheet and Cash Flow

Arrow exited the quarter with cash and cash equivalents of \$262.3 million compared with \$270 million in the previous quarter.

Long-term debt was \$2.94 billion compared with \$3.20 billion at the end of the prior quarter.

The company's cash flow from operations was \$286.8 million.

In the third quarter, Arrow returned approximately \$100 million to shareholders through stock repurchase program, and was left with approximately \$439 million of authorization.

Guidance

Excluding the financial impact from the PC and mobility asset disposition business, for the fourth quarter of 2019, sales are expected between \$7.13 billion and \$7.53 billion.

Global components sales are projected in the range of \$4.63-\$4.83 billion. Global ECS sales are estimated to be \$2.5-\$2.7 billion.

Interest and other expenses will presumably be about \$52 million, as a result of which, the company projects non-GAAP earnings per share in the range of \$2.10-\$2.26. Average non-GAAP tax rate around the low end of the 23-25% range is included in the guidance.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	0.52%
EPS Surprise	11.38%
Quarterly EPS	1.86
Annual EPS (TTM)	7.87

Management expects ECS operating income to increase in the fourth quarter. Moreover, strong cash flow is expected in the fourth quarter.

Foreign currency headwind of approximately \$100 million on sales and 5 cents on earnings per share is expected in the fourth quarter.

Moreover, the winding down of PC and mobility device disposition business is expected to enable accelerated implementation of next generation technologies like AI, industrial automation, smart cities and vehicles. This is likely to boost the company's business and returns to shareholders.

Recent News

On Nov 4, 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.

On Sep 4, Arrow Electronics expanded its relationship with Red Hat to include distribution capabilities across North America.

Valuation

Arrow's shares have gained 22.6% in the past six months, and 15.1% over the trailing 12 months. Stocks in the Zacks sub-industry grew 20.4%, while the Zacks Computer & Technology sector have risen 13% in the past six months. Over the past year, the Zacks sub-industry and the sector gained 18.8% and 34.2%, respectively.

The S&P 500 Index has gained 9% in the past six months and 17.6% in the past year.

The stock is currently trading at 10.52X forward 12-month earnings, which compares with 11.54X for the Zacks sub-industry, 22.67X for the Zacks sector and 18.88X 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 9.17X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$89 price target reflects 11.04X 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	10.52	11.54	22.67	18.88
	5-Year High	11.51	12.3	22.67	19.34
	5-Year Low	7	7.71	16.86	15.17
	5-Year Median	9.17	9.73	19.24	17.44
EV/Sales TTM	Current	0.32	0.33	4.29	3.27
	5-Year High	0.4	0.44	4.29	3.3
	5-Year Low	0.28	0.26	2.56	2.16
	5-Year Median	0.34	0.33	3.44	2.8
EV/EBITDA TTM	Current	8.13	7.3	11.62	11.51
	5-Year High	8.38	9.08	12.58	12.84
	5-Year Low	5.59	5.09	7.67	8.48
	5-Year Median	7.17	7.12	10.37	10.56

As of 01/10/2020

Industry Analysis Zacks Industry Rank: Bottom 8% (234 out of 254)



Top Peers

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

Industry Comparison Industry: Electronics - Parts Distribution				Industry Peers		
	ARW Neutral	X Industry	S&P 500	AVT Neutral	NVDA Neutral	TDY Outperform
VGM Score	A	-	-	B	C	C
Market Cap	6.88 B	2.89 B	24.03 B	4.29 B	149.52 B	13.33 B
# of Analysts	4	4	13	4	11	2
Dividend Yield	0.00%	0.00%	1.78%	1.98%	0.26%	0.00%
Value Score	B	-	-	B	F	D
Cash/Price	0.04	0.06	0.04	0.16	0.07	0.01
EV/EBITDA	7.05	9.10	14.04	7.28	33.73	26.38
PEG Ratio	3.92	1.78	2.02	1.96	4.70	4.28
Price/Book (P/B)	1.48	1.11	3.32	1.08	13.33	5.19
Price/Cash Flow (P/CF)	7.26	8.70	13.52	5.69	36.49	29.83
P/E (F1)	10.50	11.80	18.82	20.34	43.97	32.14
Price/Sales (P/S)	0.23	0.29	2.63	0.22	14.93	4.33
Earnings Yield	9.45%	8.54%	5.31%	4.92%	2.28%	3.11%
Debt/Equity	0.62	0.62	0.72	0.36	0.22	0.33
Cash Flow (\$/share)	11.63	7.46	6.94	7.46	6.70	12.25
Growth Score	A	-	-	B	B	B
Hist. EPS Growth (3-5 yrs)	9.29%	3.27%	10.56%	-4.31%	47.42%	15.23%
Proj. EPS Growth (F1/F0)	7.08%	5.23%	7.49%	-49.21%	-16.32%	9.17%
Curr. Cash Flow Growth	16.28%	14.34%	14.83%	-8.48%	29.72%	21.28%
Hist. Cash Flow Growth (3-5 yrs)	8.09%	3.29%	9.00%	1.13%	41.59%	11.35%
Current Ratio	1.61	2.23	1.23	2.23	8.42	1.48
Debt/Capital	38.28%	38.28%	42.99%	26.64%	17.98%	24.67%
Net Margin	-0.29%	0.71%	11.08%	0.71%	24.08%	12.27%
Return on Equity	13.21%	10.57%	17.16%	9.43%	22.02%	15.52%
Sales/Assets	1.78	1.78	0.55	2.13	0.69	0.74
Proj. Sales Growth (F1/F0)	-2.38%	0.00%	4.20%	-7.82%	-8.07%	7.35%
Momentum Score	A	-	-	F	D	D
Daily Price Chg	-0.33%	0.00%	-0.33%	-0.35%	0.53%	-0.15%
1 Week Price Chg	0.15%	0.00%	-0.30%	-1.22%	-0.34%	3.52%
4 Week Price Chg	-0.76%	0.00%	1.71%	-0.35%	9.04%	4.95%
12 Week Price Chg	11.07%	11.07%	6.05%	1.99%	25.75%	13.84%
52 Week Price Chg	16.46%	4.43%	22.39%	4.43%	68.23%	68.87%
20 Day Average Volume	441,305	441,305	1,580,816	686,507	6,849,572	216,935
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.03%	0.00%	0.00%	0.00%	-0.16%	0.00%
(F1) EPS Est 12 week change	0.48%	-1.14%	-0.50%	-34.77%	6.03%	3.17%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	NA

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	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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock. The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment. This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time. ZIR is not a broker-dealer. ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients. Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.