

Fortinet Inc. (FTNT)

\$90.72 (As of 03/10/20)

Price Target (6-12 Months): **\$95.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/17/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: B

Summary

Fortinet is benefiting from robust growth in Fortinet Security Fabric, cloud and SD-WAN offerings. Moreover, continued deal wins, especially those of high value, are a key driver. Higher IT spending on cybersecurity is further expected to aid Fortinet to grow faster than the security market. Also, focus on enhancing its UTM portfolio through product development and acquisitions is a tailwind for Fortinet. However, competition from numerous big and small players in the security application market poses a concern. Moreover, increasing consolidation in the security industry is intensifying competition. Rise in the pace of hiring, mostly in sales and marketing, lower sales attrition and M&A spends remain overhangs on margin.

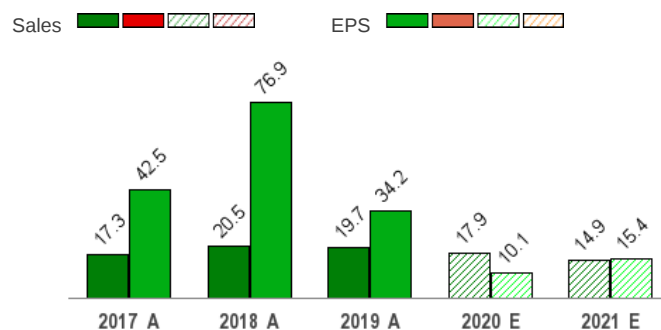
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$121.82 - \$68.87
20 Day Average Volume (sh)	2,017,995
Market Cap	\$15.7 B
YTD Price Change	-15.0%
Beta	1.18
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Security
Zacks Industry Rank	Bottom 28% (183 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	8.6%
Last Sales Surprise	1.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/07/2020
Earnings ESP	0.0%
P/E TTM	36.7
P/E F1	33.4
PEG F1	2.2
P/S TTM	7.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	653 E	711 E	744 E	825 E	2,922 E
2020	561 E	616 E	646 E	721 E	2,542 E
2019	473 A	522 A	548 A	614 A	2,156 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.61 E	\$0.75 E	\$0.84 E	\$0.98 E	\$3.14 E
2020	\$0.51 E	\$0.64 E	\$0.72 E	\$0.84 E	\$2.72 E
2019	\$0.46 A	\$0.58 A	\$0.67 A	\$0.76 A	\$2.47 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 03/10/2020. The reports text is as of 03/11/2020.

Overview

Headquartered in Sunnyvale, CA, Fortinet, Inc. is a provider of network security appliances and Unified Threat Management (UTM) network security solutions to enterprises, service providers and government entities worldwide.

Its solutions are designed to integrate multiple levels of security protection, including firewall, virtual private networking (VPN), antivirus, intrusion prevention (IP), web filtering, anti-spam and wide area network (WAN) acceleration.

Through its products and subscription services, the company provides integrated protection against dynamic security threats while simplifying the IT security infrastructure. Its solutions incorporate application-specific integrated circuits, hardware architecture, operating system, and associated security and networking functions to defend against multiple categories of IT security attacks without impacting network performance.

The company's network security gateways protect customer data, reduce security complexities and lower the total cost of ownership. Customers are able to implement their security policies on traffic between internal networks and the Internet, as well as between internal and private networks shared with partners.

Its flagship UTM solution consists of the FortiGate appliance product line and FortiGuard security subscription services.

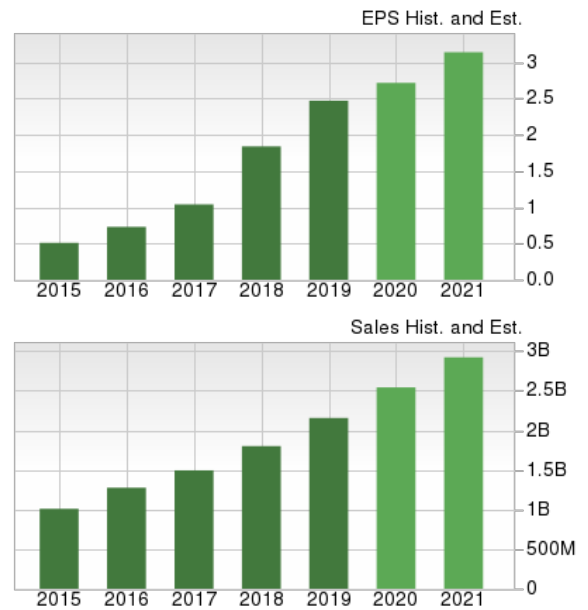
Its products and services are sold through a network of more than 20,000 channel partners worldwide, including distributors, resellers, value-added resellers and managed service providers. The company caters to more than 320,000 customers worldwide that includes most of the Fortune 100 companies.

The company derives a significant portion of total sales from the top 10 biggest distributors, of which Exclusive Networks Group has the highest share and accounted for 20% of 2018 total revenues.

Fortinet reported revenues of \$2.16 billion in 2019, which increased 20% from 2018.

Product revenue was \$788.5 million, up 17% while Service revenue of \$1.37 billion improved 21% year over year.

The company faces significant competition with Palo Alto Networks, CyberArk, Qualys and Cisco in the network security as well as cloud security space.



Reasons To Buy:

- ▲ Fortinet is the market leader in Unified Threat Management (UTM) in terms of revenues and holds a market share of approximately 23.5% in the security app. According to industry analysis, the category is believed to be one of the fastest growing segments in Network Security with a projected growth in the range of high-single to low-double digits. Given the company's sustained focus on enhancing its UTM portfolio through product development and acquisitions, we believe Fortinet will continue to increase its market share in the segment and retain the leadership position.
- ▲ Fortinet's rich experience in the security space and continued delivery of mission-critical solutions will help it to maintain and grow its market share in the cyber security space. Per Gartner's new report, worldwide spending on IT security is expected to grow 10.5% in 2019 from \$114 billion in 2018. Another report from MarketsandMarkets suggests that cyber security market is expected to grow at a CAGR of 10.2% in the 2018-2025 period. Moreover, growing adoption of its Software-Define Wide Area Network (SD-WAN) solutions is a key growth driver. IDC expects SD-WAN market to witness a CAGR of 30.8% over the 2018-2023 period to reach \$5.25 billion. Moreover, Gartner predicts that 50% of new firewall purchases in the distributed network will utilise SD-WAN features by 2023. Being the only vendor, which offers both security and SD-WAN solutions, the company is well-positioned to capitalize on the increasing opportunities in the market.
- ▲ Fortinet has made strategic acquisitions to expedite growth. In 2016, the company acquired AccelOps which helped it in correlating visibility and threat intelligence to its entire network security ecosystem, and simultaneously extend it to third-party vendor solutions. The acquisition of Meru Networks in 2015 helped Fortinet strengthen its cloud capabilities and expand its solutions portfolio. Acquisitions of Coyote Point and XDN in 2013 has not only helped it to broaden the product offerings but also the customer base and geographic reach. Moreover, the 2018 acquisitions of ZoneFox and Bradford Networks are expected to enhance its Security Fabric with additional product capabilities and drive growth further.
- ▲ Fortinet is gaining customer accounts, thereby driving revenue growth. The growing percentage of large deals in the mix is a positive as it increases deferred revenues and visibility. Also, Fortinet boasts a huge customer base of over 320,000. This vast customer base presents the company an opportunity to upsell products within its installed user base. Moreover, any product refresh brings in additional dollars as every enterprise attempts to keep their threat management infrastructure updated.
- ▲ Fortinet is currently focusing on selling more subscription-based services. This unique business model is helping the company in generating stable revenues while expanding margins. Subscription-based service is a high gross margin business (approximately 80%) compared with the hardware-centric model. We believe that the strategy will continue to improve the company's top and bottom-line performances.

Product ramp ups, deal wins, continuous growth of the network security market and expected benefits from the ongoing investments are the positives.

Reasons To Sell:

- ▼ We have been noticing that Fortinet is losing business to its rivals. In the last eight quarters, the company's revenue growth rates have been around 20%, which are significantly lower than its previous growths of over 30%. This makes us skeptical about its growth prospects.
- ▼ Near-term prospects for Fortinet are not promising as changing customer spending behavior has recently hit several other players in this space. For the past few months, various competitors in the cyber security space noticed that the companies have been breaking their cybersecurity investment plans into phases and implementing the same over longer periods of time, instead of making a single large investment. This makes us slightly cautious about the company's near-term performance.
- ▼ Fortinet faces competition from numerous big and small players in the security application market. As Internet threats and attacks increase, competition will intensify. Competing firms must deliver prompt and advanced technologies to suit customer requirements and expedite product introduction in order to survive. Moreover, we believe that Fortinet's dominance could be challenged by new entrants, thus forcing it to resort to competitive pricing to maintain and gain further market share.
- ▼ Fortinet currently has a trailing 12 month Price/Book Value (P/B) ratio of 15.15. This level compares unfavorably with what the industry saw over the last year. Hence, valuation looks slightly stretched from a P/B perspective.

Changing customer spending behavior, intensifying competition, an uncertain economic environment and currency fluctuations remain the headwinds.

Last Earnings Report

Fortinet's Q4 Earnings & Revenues Top Estimates

Fortinet delivered fourth-quarter 2019 non-GAAP earnings per share of 76 cents, which beat the Zacks Consensus Estimate of 70 cents and also improved significantly from the year-ago figure of 59 cents.

Moreover, revenues of \$614 million surpassed the consensus estimate of \$604 million and also increased 21% year over year, driven by advanced FortiGate technology with SPU, integrated Security Fabric platform and hybrid multi-cloud offerings.

Quarter in Detail

Segment wise, Product revenues increased 19% year over year to \$238.8 million. The growth was driven by legacy firewall use cases and continued adoption of FortiGate based secure SD-WAN solution.

Services revenues rose 23% to \$375.6 million. Notably, FortiGuard security subscription revenues grew 24% to \$205 million. FortiCare technical support and other service revenues increased 21% to \$170 million.

Billings were up 24% to \$802 million, driven by solid execution and growth across EMEA and APAC.

During the quarter, the company secured 64 total deals worth more than \$1 million. Secure SD-WAN was a leading contributor to growth in the number of deals in excess of \$1 million.

The number of deals more than \$250,000 rose 29% to 469 and the number of deals over \$500K was up 53% to 197.

Geographically, revenues in America were up 23%, APAC up 22%, and EMEA up 19%.

Margins

Gross margin expanded 230 basis points (bps) year over year to 78%. Also, services gross margin expanded 90 bps to 88.2% as well as product gross margin grew 400 bps to 60.9%.

Non-GAAP operating income surged 31.3% to \$529.2 million while non-GAAP operating margin expanded 110 bps to 27%.

Rise in the pace of hiring, mostly in sales and marketing, lower sales attrition and M&A spends were overhangs on margin.

Balance Sheet & Cash Flow

Fortinet exited the reported quarter with cash and cash equivalents, and short-term investments of approximately \$2.07 billion, up from \$1.94 billion recorded at the end of the previous quarter.

During the fourth quarter, the company generated operating cash flow of \$190.4 million compared with \$221.2 million in the previous quarter. Free cash flow was \$143.2 million compared with \$203.7 million in the third quarter.

In the fourth quarter, the company purchased approximately 303,000 shares of common stock for \$23 million.

The company repurchased 1.9 million shares for \$141 million in 2019.

Guidance

For 2020, the company expects revenues in the range of \$2.525-\$2.555 billion.

Moreover, non-GAAP earnings per share are anticipated in the range of \$2.70-\$2.73.

For 2020, billings are expected within \$3.025-\$3.075 billion.

Non-GAAP gross margin is projected in the range of 77.5-78.5%. Non-GAAP operating margin is anticipated between 23.5% and 24.5%.

For the first quarter of 2020, the company expects revenues of \$555-\$565 million. Billings are estimated in the band of \$635-\$655 million.

Non-GAAP earnings per share are envisioned within 50-52 cents.

Non-GAAP gross margin is expected in the range of 77.5-78.5% whereas non-GAAP operating margin is anticipated between 19% and 20%.

Quarter Ending **12/2019**

Report Date	Feb 06, 2020
Sales Surprise	1.78%
EPS Surprise	8.57%
Quarterly EPS	0.76
Annual EPS (TTM)	2.47

Recent News

On Jan 21, 2020, Fortinet announced that Burger King Brazil, head franchisee of the Burger King and Popeyes Louisiana Kitchen restaurants, has leveraged Fortinet Secure SD-WAN to acquire high-performance networking capabilities to simplify operations and strengthen security across corporate and restaurant locations.

On Jan 6, 2020, Fortinet announced that its Fortinet Security Fabric solutions have been adopted by merchant payment solutions company Yedpay to strengthen security as it migrates its infrastructure to the cloud.

On Dec 16, 2019, Fortinet announced that it is extending the integration of its cloud security portfolio with Google Cloud to provide advanced security to customers migrating to Google Cloud Platform for their workloads and applications.

On Dec 12, 2019, Fortinet announced the acquisition of Security Orchestration, Automation and Response (SOAR) provider CyberSponse for an undisclosed amount. The deal is expected to further extend the automation and incident response capabilities of Fortinet's offerings including FortiAnalyzer, FortiSIEM and FortiGate.

On Nov 4, 2019, Fortinet announced the expansion of the Fortinet Security Fabric's dynamic-cloud security offerings with Microsoft Azure.

On Nov 5, 2019, Fortinet announced that specialty retailer Batteries Plus Bulbs has adopted its Secure SD-WAN solution in order to strengthen security at 740 Stores, without any cost expansion.

On Oct 28, 2019, Fortinet completed the acquisition of advanced endpoint security company enSilo, further enhancing the Fortinet Security Fabric and fortifying its endpoint and network security solutions.

Valuation

Fortinet shares are up 42.4% in the past six months and 43.4% over the trailing 12-month period. Stocks in the Zacks sub-industry have fallen 8.5% while the Zacks Computer & Technology sector has gained 1.8% in the past six months. Over the past year, while the Zacks sub-industry has decreased 16.9%, the sector gained 7.7%.

The S&P 500 Index has plunged 3.9% in the past six months while has increased 2.2% in the past year.

The stock is currently trading at 5.99X forward 12-month sales, which compares to 6.14X for the Zacks sub-industry, 3.24X for the Zacks sector and 3.05X for the S&P 500 index.

Over the past five years, the stock has traded as high as 8.77X and as low as 3.21X, with a 5-year median of 5.31X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$95 price target reflects 6.3X forward 12-month sales.

The table below shows summary valuation data for FTNT

Valuation Multiples - FTNT					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	5.99	6.14	3.24	3.05
	5-Year High	8.77	8.96	3.56	3.44
	5-Year Low	3.21	5.32	2.3	2.54
	5-Year Median	5.31	6.65	3.07	3.01
P/B TTM	Current	14.79	9.22	4.97	4.31
	5-Year High	19.88	10.01	5.09	4.4
	5-Year Low	5.43	4.25	3.13	2.85
	5-Year Median	8.4	6.23	4.2	3.58
EV/Sales TTM	Current	7.72	7.67	3.95	3.05
	5-Year High	8.63	10.68	4.04	3.3
	5-Year Low	3.18	5.26	2.54	2.14
	5-Year Median	5.42	6.93	3.38	2.77

As of 03/10/2020

Industry Analysis Zacks Industry Rank: Bottom 28% (183 out of 253)



Top Peers

Check Point Software Technologies Ltd. (CHKP)	Neutral
CyberArk Software Ltd. (CYBR)	Neutral
FireEye, Inc. (FEYE)	Neutral
F5 Networks, Inc. (FFIV)	Neutral
Juniper Networks, Inc. (JNPR)	Neutral
Palo Alto Networks, Inc. (PANW)	Neutral
Qualys, Inc. (QLYS)	Neutral
Proofpoint, Inc. (PFPT)	Underperform

Industry Comparison Industry: Security				Industry Peers		
	FTNT Neutral	X Industry	S&P 500	CHKP Neutral	CSCO Neutral	PANW Neutral
VGM Score	B	-	-	C	B	F
Market Cap	15.65 B	3.03 B	20.21 B	14.12 B	169.97 B	16.70 B
# of Analysts	14	11.5	13	16	12	17
Dividend Yield	0.00%	0.00%	2.18%	0.00%	3.49%	0.00%
Value Score	D	-	-	C	B	D
Cash/Price	0.12	0.13	0.05	0.11	0.16	0.18
EV/EBITDA	25.03	25.03	12.36	12.38	9.08	34.98
PEG Ratio	2.23	2.19	1.78	1.98	2.10	1.57
Price/Book (P/B)	11.74	8.55	2.77	3.96	4.78	10.38
Price/Cash Flow (P/CF)	31.15	30.49	11.04	16.37	11.65	33.13
P/E (F1)	33.47	33.40	16.09	14.36	12.30	36.39
Price/Sales (P/S)	7.26	6.99	2.17	7.08	3.30	5.35
Earnings Yield	3.00%	2.87%	6.20%	6.97%	8.13%	2.75%
Debt/Equity	0.00	0.61	0.70	0.00	0.41	1.13
Cash Flow (\$/share)	2.91	2.13	7.01	5.66	3.44	5.05
Growth Score	A	-	-	D	C	D
Hist. EPS Growth (3-5 yrs)	106.16%	15.24%	10.85%	10.41%	8.60%	NA
Proj. EPS Growth (F1/F0)	9.98%	2.50%	6.14%	5.36%	5.08%	-15.56%
Curr. Cash Flow Growth	45.71%	45.71%	6.09%	-0.44%	6.95%	119.25%
Hist. Cash Flow Growth (3-5 yrs)	46.74%	34.15%	8.52%	4.09%	3.53%	69.30%
Current Ratio	1.88	1.59	1.24	1.53	1.81	1.78
Debt/Capital	0.00%	40.81%	42.57%	0.00%	28.97%	53.01%
Net Margin	15.14%	8.95%	11.69%	41.39%	21.44%	-5.58%
Return on Equity	27.51%	7.14%	16.74%	23.10%	36.40%	-2.19%
Sales/Assets	0.62	0.46	0.54	0.35	0.55	0.46
Proj. Sales Growth (F1/F0)	17.89%	14.30%	3.71%	2.93%	-1.78%	16.35%
Momentum Score	B	-	-	B	C	F
Daily Price Chg	4.11%	3.20%	4.87%	1.05%	5.58%	5.47%
1 Week Price Chg	-2.51%	-2.51%	-0.67%	-5.01%	-0.63%	-4.58%
4 Week Price Chg	-22.67%	-16.73%	-15.65%	-21.33%	-18.42%	-32.15%
12 Week Price Chg	-14.70%	-8.43%	-13.60%	-16.45%	-13.70%	-27.40%
52 Week Price Chg	10.10%	-9.87%	-2.27%	-23.48%	-23.15%	-30.29%
20 Day Average Volume	2,017,995	724,225	2,778,843	1,578,503	38,234,684	2,215,559
(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%	-0.84%	-0.16%	-0.13%	0.58%	-445.95%
(F1) EPS Est 12 week change	5.48%	-8.59%	-0.57%	0.01%	0.58%	-445.95%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-0.49%	0.00%	0.19%	-266.13%

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	B
VGM Score	B

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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