

Fortinet Inc. (FTNT)

\$126.59 (As of 08/11/20)

Price Target (6-12 Months): **\$133.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 08/11/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: D

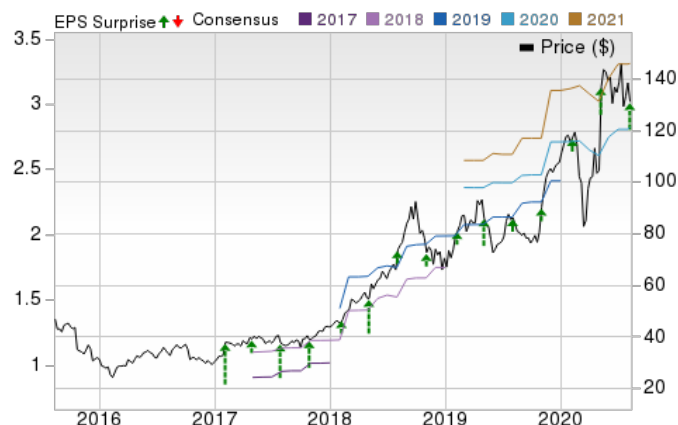
Growth: A

Momentum: A

Summary

Fortinet is benefiting from rising demand for security and networking products amid coronavirus crisis as a huge global workforce is working remotely. It is also 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. Increased hiring, mostly in sales and marketing, and M&A spends remain overhangs on margin.

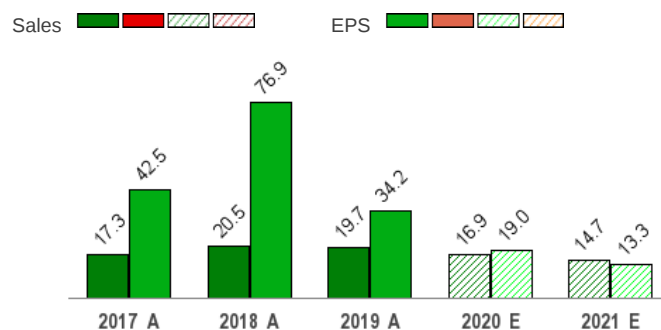
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$151.95 - \$70.20
20 Day Average Volume (sh)	1,510,957
Market Cap	\$20.5 B
YTD Price Change	18.6%
Beta	0.97
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Security
Zacks Industry Rank	Top 49% (124 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	26.2%
Last Sales Surprise	2.8%
EPS F1 Est- 4 week change	7.1%
Expected Report Date	10/29/2020
Earnings ESP	3.0%
P/E TTM	44.4
P/E F1	43.1
PEG F1	2.9
P/S TTM	8.7

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	655 E	697 E	732 E	804 E	2,891 E
2020	577 A	616 A	639 E	703 E	2,520 E
2019	473 A	522 A	548 A	614 A	2,156 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.70 E	\$0.81 E	\$0.85 E	\$1.02 E	\$3.33 E
2020	\$0.60 A	\$0.82 A	\$0.75 E	\$0.86 E	\$2.94 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 08/11/2020. The reports text is as of 08/12/2020.

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.

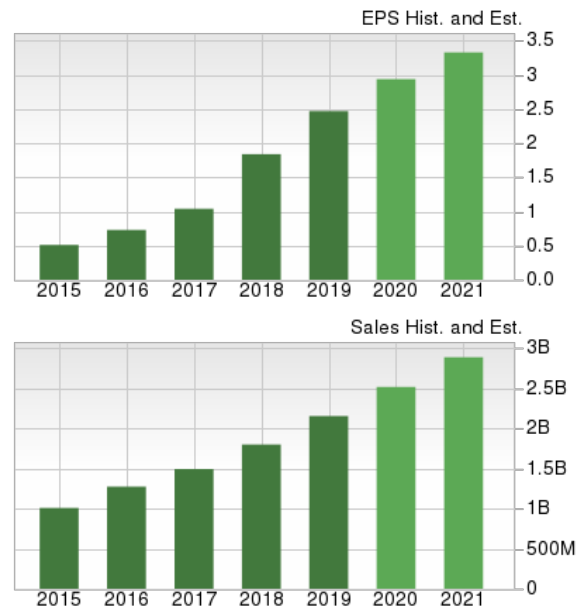
Its products and services are sold through a network of more than 20,000 channel partners worldwide, including distributors, resellers, value-added resellers and managed service providers. The company caters to more than 450,000 customers worldwide that includes most of the Fortune 100 companies.

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 31% of 2019 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 benefiting from rising demand for security and networking products amid coronavirus crisis. In an effort to contain the coronavirus's spread, a huge global workforce is working remotely. But more people logging into employers' networks means a greater need for security. This trend is positively impacting the demand for Fortinet's products.
- ▲ Fortinet is the market leader in Unified Threat Management (UTM) in terms of revenues and holds a market share of approximately 19.84% in the network security appliances market (as of Jul 2019). 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 a latest research report from Gartner, worldwide information security spending is likely to increase 2.4% year over year to \$123.8 billion in 2020. Moreover, growing adoption of Software-Defined Wide Area Network (SD-WAN) solutions could be a key growth driver for Fortinet in the long-run. The market research firm, MarketsandMarkets, predicts that the market size for SD-WAN solutions could grow to \$4.1 billion by 2023 from \$1 billion in 2018, indicating a CAGR of 32.7%. As there are only few vendors that offers security and SD-WAN solution, Fortinet is well-positioned to capitalize on the increasing opportunities in the market.
- ▲ Fortinet has made strategic acquisitions to expedite growth. The acquisition of AccelOps helped it in correlating visibility and threat intelligence to its entire network security ecosystem, and simultaneously extends it to third-party vendor solutions. The acquisition of Meru Networks helped Fortinet strengthen its cloud capabilities and expand its solutions portfolio. Again, the acquisitions of Coyote Point and XDN have not only helped it to broaden the product offerings but also the customer base and geographic reach. Moreover, the 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 450,000. 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.
- ▲ Fortinet has a strong balance sheet with ample liquidity position and no debt obligations. As of Jun 30, 2020, the company had cash and cash equivalents and short-term investments of approximately \$1.5 billion. During the April-June quarter, the company generated operating cash flow of \$247 million compared with the year-ago quarter's \$195.1 million. Free cash flow was \$216.1 million compared with the \$177.8 million witnessed in the second quarter of 2019.

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 nine 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 37.6. This level compares unfavorably with what the industry saw over the last year. Hence, valuation looks significantly 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 Q2 Earnings and Revenues Surpass Estimates

Fortinet delivered second-quarter 2020 non-GAAP earnings per share of 82 cents, which beat the Zacks Consensus Estimate by 26.2%. The reported figure also improved significantly from the year-ago quarter's 58 cents.

Moreover, revenues of \$615.5 million surpassed the consensus mark of \$598.3 million and increased 18% year over year. This top-line growth was driven by advanced FortiGate technology with SPU, integrated Security Fabric platform and hybrid multi-cloud offerings.

Strategic investments in developing powerful products and services, efforts to expand into adjacent addressable markets and increase the firm's global sales force aided the performance.

Quarter in Detail

Segment wise, Product revenues increased 11.6% year over year to \$211.9 million. This growth was supported by the continued adoption of the FortiGate-based secure SD-WAN solution.

Services revenues climbed 21.6% to \$403.6 million. Notably, FortiGuard security subscription revenues grew 22% to \$223 million. FortiCare technical support and other service revenues climbed 22% to \$181 million.

Billings were up 14% to \$711 million on solid execution and growth across EMEA and APAC.

During the June-end quarter, the company secured 59 total deals worth equal to or more than \$1 million each. Secure SD-WAN was a leading contributor to growth, in terms of the number of deals worth more than \$1 million. Secure SD-WAN accounted for 13 of the large deals won during the second quarter.

Margins

Gross margin expanded 260 basis points (bps) year over year to 79%. Services gross margin expanded 120 bps to 88.5% as well as product gross margin advanced 340 bps to 61%.

Non-GAAP operating income surged 36.6% to \$168.2 million, while non-GAAP operating margin expanded 370 bps to 27.3%.

Balance Sheet & Cash Flow

Fortinet exited the reported quarter with cash and cash equivalents, and short-term investments of \$1.5 billion, up from the \$1.4 billion reported at the end of the previous quarter.

During the April-June quarter, the company generated operating cash flow of \$247 million compared with the year-ago quarter's \$195.1 million. Free cash flow was \$216.1 million compared with the \$177.8 million witnessed in the second quarter of 2019.

In the second quarter, the company purchased 1.4 million shares of common stock for \$156.1 million. Last month, the company increased its share-repurchase authorization by \$500 million to \$3 billion. As of Aug 6, \$1.05 billion remained under its current authorization limit.

Guidance

For the third quarter of 2020, the company expects revenues of \$630-\$645 million. Billings are estimated in the band of \$705-\$730 million.

Non-GAAP earnings per share are projected at 76-78 cents.

Non-GAAP gross margin is expected in the range of 78-79%, whereas non-GAAP operating margin is anticipated between 25.5% and 26.5%.

Notably, the uncertainty surrounding the coronavirus pandemic might have a material negative impact on Fortinet's third-quarter and annual results.

Quarter Ending 06/2020

Report Date	Aug 06, 2020
Sales Surprise	2.79%
EPS Surprise	26.15%
Quarterly EPS	0.82
Annual EPS (TTM)	2.85

Recent News

On Aug 6, Fortinet unveiled the world's first hyperscale firewall, FortiGate 4400F.

On Jul 20, Fortinet announced it has acquired OPAQ Networks, a Secure Access Service Edge (SASE) cloud provider.

On Jun 18, Fortinet announced that its Secure SD-WAN has been certified to support MEF 3.0 SD-WAN services. The certification will help provide enterprises with a benchmark to select an SD-WAN vendor.

On Jun 9, Fortinet announced that its Secure Software-Defined Wide Area Network (SD-WAN) has been adopted by New Zealand-based telecommunications and digital services company, Spark NZ, to improve application experience and automate network security operations cost-efficiently.

On Jun 4, Fortinet announced that its 2020 Annual Meeting of Stockholders Meeting will be held as a virtual-only meeting on Jun 19.

On May 26, Fortinet announced that the Fortinet Secure SD-WAN is experiencing continued momentum with network service providers.

On May 19, Fortinet announced that consumer and commercial services company, Rollins Inc., has selected Fortinet Secure SD-WAN to reduce network outages, improve user experience and application performance.

On May 18, Fortinet achieved the Department of Defense Information Network Approved Products List certification, which will enable Fortinet's products to be sold to the Department of Defense agencies.

On May 6, Fortinet announced that its Secure SD-WAN and SD-Branch solutions has been chosen by the Nippon Telegraph and Telephone West Corporation to enhance its "FLET'S SDx" subscription service.

On Apr 28, Fortinet made its entire online, self-paced catalogue of advanced Network Security Expert training courses free of cost to encourage the proliferation of more information about cybersecurity.

On Feb 24, Fortinet announced FortiAI, an on-premises appliance that utilizes self-learning Deep Neural Networks to accelerate threat diversion and handle time consuming, manual security analyst tasks.

On Feb 18, Fortinet introduced the company's seventh generation network processor — the FortiGate 1800F Next-Generation Firewall powered by NP7 — to enable large enterprises to achieve internal segmentation, scale, improved performance, detection, and enforcement capabilities.

On Jan 21, 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, 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.

Valuation

Fortinet shares are up 18.5% in the year so far, and 50.9% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have increased 9.5% and 17.9% YTD, respectively. Over the past year, while the Zacks sub-industry increased 17%, the sector gained 31.8%.

The S&P 500 Index has increased 3.3% YTD and gained 14% in the past year.

The stock is currently trading at 7.48X forward 12-month sales, which compares to 7.57X for the Zacks sub-industry, 3.99X for the Zacks sector and 3.67X for the S&P 500 index.

Over the past five years, the stock has traded as high as 8.95X and as low as 3.21X, with a 5-year median of 5.26X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$133 price target reflects 7.85X 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	7.48	7.57	3.99	3.67
	5-Year High	8.95	8.35	4.01	3.67
	5-Year Low	3.21	5.32	2.32	2.53
	5-Year Median	5.26	6.63	3.14	3.05
P/B TTM	Current	37.62	11.71	6.14	4.68
	5-Year High	44.46	12.40	6.34	4.68
	5-Year Low	5.43	4.25	3.16	2.83
	5-Year Median	11.40	7.25	4.42	3.74
EV/Sales TTM	Current	8.04	7.84	4.59	3.23
	5-Year High	9.77	9.32	4.59	3.46
	5-Year Low	3.18	4.89	2.58	2.14
	5-Year Median	5.43	6.80	3.65	2.86

As of 08/11/2020

Industry Analysis Zacks Industry Rank: Top 49% (124 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Check Point Software Technologies Ltd. (CHKP)	Neutral	2
CyberArk Software Ltd. (CYBR)	Neutral	4
FireEye, Inc. (FEYE)	Neutral	2
F5 Networks, Inc. (FFIV)	Neutral	2
Juniper Networks, Inc. (JNPR)	Neutral	3
Palo Alto Networks, Inc. (PANW)	Neutral	3
Proofpoint, Inc. (PFPT)	Neutral	2
Qualys, Inc. (QLYS)	Neutral	3

Industry Comparison Industry: Security				Industry Peers		
	FTNT	X Industry	S&P 500	CHKP	CSCO	PANW
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	2	2	3
VGM Score	A	-	-	D	B	D
Market Cap	20.49 B	4.09 B	23.61 B	18.04 B	199.25 B	25.45 B
# of Analysts	12	10.5	14	12	12	14
Dividend Yield	0.00%	0.00%	1.69%	0.00%	3.05%	0.00%
Value Score	D	-	-	C	C	D
Cash/Price	0.07	0.09	0.07	0.09	0.14	0.08
EV/EBITDA	34.94	31.22	13.32	16.64	10.52	57.39
PEG Ratio	2.89	2.52	2.95	2.56	2.79	1.88
Price/Book (P/B)	37.62	9.61	3.22	5.29	5.58	34.17
Price/Cash Flow (P/CF)	43.46	41.26	12.79	20.87	13.72	50.50
P/E (F1)	43.28	43.08	22.02	18.77	15.05	43.90
Price/Sales (P/S)	8.70	7.80	2.57	8.90	3.94	7.80
Earnings Yield	2.32%	2.30%	4.29%	5.33%	6.65%	2.28%
Debt/Equity	0.00	0.74	0.77	0.00	0.32	2.45
Cash Flow (\$/share)	2.91	2.13	6.94	5.94	3.44	5.05
Growth Score	A	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	122.35%	10.74%	10.41%	9.71%	9.03%	NA
Proj. EPS Growth (F1/F0)	18.96%	7.52%	-6.51%	7.75%	-0.37%	21.32%
Curr. Cash Flow Growth	45.71%	45.71%	5.22%	-0.22%	6.95%	119.25%
Hist. Cash Flow Growth (3-5 yrs)	46.74%	37.87%	8.55%	4.14%	3.53%	69.30%
Current Ratio	1.37	1.65	1.34	1.44	1.59	1.29
Debt/Capital	0.00%	50.57%	44.59%	0.00%	24.49%	70.98%
Net Margin	17.46%	7.12%	10.13%	41.21%	21.32%	-7.01%
Return on Equity	40.58%	5.88%	14.59%	24.29%	36.47%	-6.50%
Sales/Assets	0.67	0.48	0.51	0.36	0.54	0.48
Proj. Sales Growth (F1/F0)	16.88%	6.89%	-1.45%	2.71%	0.20%	16.98%
Momentum Score	A	-	-	F	D	B
Daily Price Chg	-0.23%	-1.16%	-0.17%	-0.52%	-1.13%	-1.16%
1 Week Price Chg	-5.28%	-1.29%	2.30%	-1.29%	0.70%	2.08%
4 Week Price Chg	-5.87%	2.76%	6.41%	4.74%	2.01%	4.04%
12 Week Price Chg	-12.59%	11.82%	15.42%	17.53%	5.80%	12.36%
52 Week Price Chg	50.86%	14.73%	2.88%	12.09%	-10.49%	14.73%
20 Day Average Volume	1,510,957	735,757	2,007,486	1,405,858	16,660,434	735,757
(F1) EPS Est 1 week change	7.12%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	7.12%	1.60%	1.84%	4.41%	0.00%	0.00%
(F1) EPS Est 12 week change	11.35%	3.86%	2.40%	4.52%	2.54%	27.18%
(Q1) EPS Est Mthly Chg	7.69%	3.40%	0.72%	3.40%	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	D
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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