

## Fortinet Inc. (FTNT)

**\$145.80** (As of 07/10/20)

Price Target (6-12 Months): **\$168.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Outperform**

(Since: 06/10/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

**Zacks Rank:** (1-5)

**1-Strong Buy**

Zacks Style Scores:

VGM:D

Value: F

Growth: B

Momentum: D

## 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.

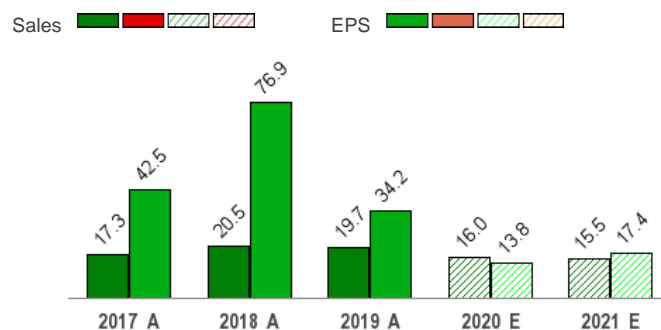
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	<b>\$151.95 - \$70.20</b>
20 Day Average Volume (sh)	<b>1,603,170</b>
Market Cap	<b>\$23.6 B</b>
YTD Price Change	<b>36.6%</b>
Beta	<b>1.01</b>
Dividend / Div Yld	<b>\$0.00 / 0.0%</b>
Industry	<a href="#">Security</a>
Zacks Industry Rank	<b>Top 31% (78 out of 252)</b>

## Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	<b>20.0%</b>
Last Sales Surprise	<b>3.5%</b>
EPS F1 Est- 4 week change	<b>0.0%</b>
Expected Report Date	<b>08/06/2020</b>
Earnings ESP	<b>0.0%</b>
P/E TTM	<b>55.9</b>
P/E F1	<b>51.9</b>
PEG F1	<b>3.5</b>
P/S TTM	<b>10.4</b>

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	655 E	691 E	729 E	811 E	2,888 E
2020	577 A	599 E	629 E	706 E	2,500 E
2019	473 A	522 A	548 A	614 A	2,156 A

## EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.68 E	\$0.77 E	\$0.84 E	\$1.00 E	\$3.30 E
2020	\$0.60 A	\$0.65 E	\$0.72 E	\$0.85 E	\$2.81 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 07/10/2020. The reports text is as of 07/13/2020.

## 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.

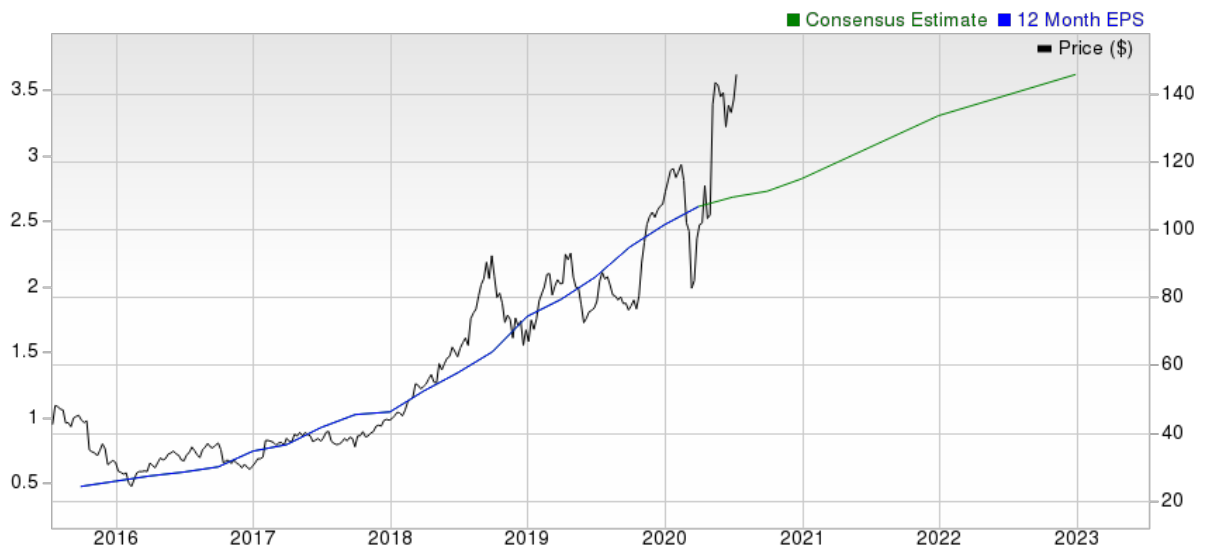
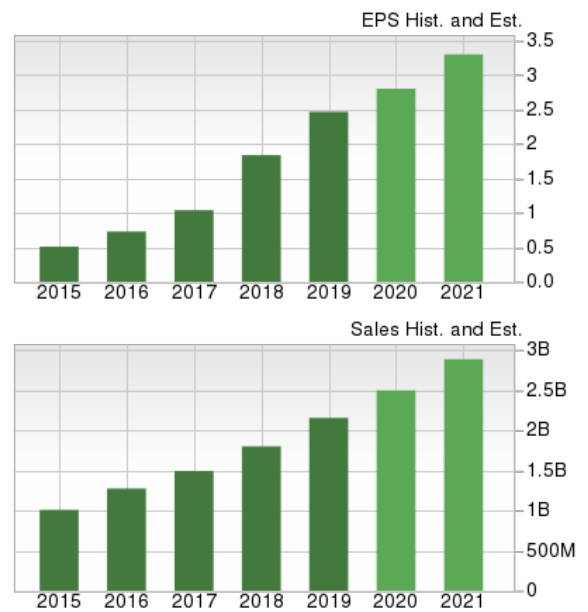
Its products and services are sold through a network of more than 20,000 channel partners worldwide, including distributors, resellers, value-added resellers and managed service providers. The company caters to more than 450,000 customers worldwide that includes most of the Fortune 100 companies.

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.



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## 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 Mar 31, 2020, the company had cash and cash equivalents and short-term investments of approximately \$1.4 billion.

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

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## Risks

- 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 43.9. This level compares unfavorably with what the industry saw over the last year. Hence, valuation looks slightly stretched from a P/B perspective.
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## Last Earnings Report

### Fortinet Q1 Earnings and Revenues Surpass Estimates

Fortinet delivered first-quarter 2020 non-GAAP earnings per share of 60 cents, which beat the Zacks Consensus Estimate by 20% and improved significantly from the year-ago quarter's 46 cents.

Moreover, revenues of \$576.9 million surpassed the consensus mark of \$557 million and increased 22% year over year, 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 its global sales force drove the performance.

### Quarter in Detail

Segment-wise, Product revenues increased 18.2% year over year to \$192.3 million. The growth was driven by the continued adoption of the FortiGate-based secure SD-WAN solution.

Services revenues rose 24.1% to \$384.6 million.

Billings were up 21.1% to \$667.8 million, driven by solid execution and growth across EMEA and APAC.

During the quarter, the company secured 38 total deals worth equal to or more than \$1 million each.

The number of deals worth more than \$250,000 rose 21.4% to 323 and the number of deals worth more than \$500K was up 11.1% to 120.

Geographically, revenues in America were up 20.8%, APAC up 20.1% and EMEA up 24.5%.

### Margins

Gross margin expanded 150 basis points (bps) year over year to 78.7%. Services gross margin expanded 30 bps to 87.4% as well as product gross margin grew 300 bps to 61.4%.

Non-GAAP operating income surged 33% to \$128.4 million, while non-GAAP operating margin expanded 190 bps to 22.3%.

### Balance Sheet & Cash Flow

Fortinet exited the reported quarter with cash and cash equivalents, and short-term investments of approximately \$1.4 billion, down from \$2.07 billion reported at the end of the previous quarter.

During the first quarter, the company generated operating cash flow of \$319.4 million compared with \$190.4 million in the previous quarter. Free cash flow was \$241.8 million compared with \$143.2 million in the fourth quarter of 2019.

In the first quarter, the company purchased approximately 10 million shares of common stock for \$899.9 million.

### Guidance

For the second quarter of 2020, the company expects revenues of \$590-\$605 million. Billings are estimated in a band of \$700-\$725 million.

Non-GAAP earnings per share are envisioned to be 64-66 cents.

Non-GAAP gross margin is expected in the range of 77.5-78.5%, whereas non-GAAP operating margin is anticipated between 23% and 24%.

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

Quarter Ending **03/2020**

Report Date	May 06, 2020
Sales Surprise	3.53%
EPS Surprise	20.00%
Quarterly EPS	0.60
Annual EPS (TTM)	2.61

## Recent News

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 36.6% in the year so far, and 71.5% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have increased 13.7% and 16.8% YTD, respectively. Over the past year, while the Zacks sub-industry increased 16.2%, the sector gained 26.9%.

The S&P 500 Index has declined 0.7% YTD and increased 6.3% in the past year.

The stock is currently trading at 8.71X forward 12-month sales, which compares to 8.22X for the Zacks sub-industry, 3.99X for the Zacks sector and 3.55X 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 Outperform recommendation indicates that the stock will perform better than the market. Our \$168 price target reflects 10.02X 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	8.71	8.22	3.99	3.55
	5-Year High	8.95	8.77	3.99	3.55
	5-Year Low	3.21	5.31	2.33	2.52
	5-Year Median	5.26	6.62	3.12	3.04
P/B TTM	Current	43.95	11.92	6.04	4.37
	5-Year High	45.09	11.99	6.04	4.65
	5-Year Low	5.43	4.31	3.32	2.81
	5-Year Median	10.91	7.21	4.28	3.69
EV/Sales TTM	Current	9.81	8.25	4.64	3.18
	5-Year High	10.08	9.63	4.64	3.35
	5-Year Low	3.18	4.84	2.67	2.10
	5-Year Median	5.43	6.60	3.58	2.84

As of 07/10/2020

## Industry Analysis Zacks Industry Rank: Top 31% (78 out of 252)



## Top Peers

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

Industry Comparison Industry: Security				Industry Peers		
	FTNT	X Industry	S&P 500	CHKP	CSCO	PANW
Zacks Recommendation (Long Term)	Outperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	1	-	-	4	3	3
VGM Score	D	-	-	D	B	D
Market Cap	23.57 B	4.16 B	21.61 B	17.38 B	197.01 B	24.82 B
# of Analysts	12	11	14	12	12	14
Dividend Yield	0.00%	0.00%	1.92%	0.00%	3.09%	0.00%
Value Score	F	-	-	C	B	D
Cash/Price	0.06	0.09	0.07	0.11	0.15	0.09
EV/EBITDA	40.85	34.88	12.75	15.82	10.39	55.97
PEG Ratio	3.46	2.89	2.87	2.57	2.75	2.23
Price/Book (P/B)	43.83	10.84	3.01	5.01	5.52	33.33
Price/Cash Flow (P/CF)	50.05	43.33	11.53	20.10	13.56	49.26
P/E (F1)	51.89	51.95	21.07	18.86	14.83	51.95
Price/Sales (P/S)	10.43	7.61	2.23	8.65	3.90	7.61
Earnings Yield	1.93%	1.93%	4.48%	5.30%	6.75%	1.92%
Debt/Equity	0.00	0.68	0.76	0.00	0.32	2.45
Cash Flow (\$/share)	2.91	2.13	6.94	5.94	3.44	5.05
Growth Score	B	-	-	C	B	D
Hist. EPS Growth (3-5 yrs)	116.19%	10.02%	10.90%	10.02%	9.03%	NA
Proj. EPS Growth (F1/F0)	13.56%	-6.24%	-9.99%	3.33%	1.48%	-12.07%
Curr. Cash Flow Growth	45.71%	45.71%	5.51%	-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	1.32	1.50	1.30	1.54	1.59	1.29
Debt/Capital	0.00%	41.80%	44.46%	0.00%	24.49%	70.98%
Net Margin	16.44%	8.29%	10.62%	41.03%	21.32%	-7.01%
Return on Equity	32.91%	6.60%	15.75%	23.45%	36.47%	-6.50%
Sales/Assets	0.65	0.48	0.55	0.35	0.54	0.48
Proj. Sales Growth (F1/F0)	15.92%	8.15%	-2.52%	0.57%	-5.13%	16.53%
Momentum Score	D	-	-	C	C	C
Daily Price Chg	-2.54%	0.00%	1.51%	0.61%	-0.09%	0.15%
1 Week Price Chg	2.89%	3.81%	3.66%	2.54%	-1.47%	2.28%
4 Week Price Chg	10.68%	12.18%	1.85%	13.27%	6.85%	12.18%
12 Week Price Chg	32.25%	18.14%	12.57%	13.86%	12.43%	30.83%
52 Week Price Chg	73.45%	0.18%	-7.10%	0.18%	-18.57%	14.38%
20 Day Average Volume	1,603,170	788,035	2,339,510	864,795	25,086,772	1,305,490
(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%	0.00%	0.00%	-0.12%	0.04%	0.00%
(F1) EPS Est 12 week change	9.79%	-1.20%	-7.77%	-0.46%	3.17%	28.57%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

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## 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.

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### 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	F
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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### Disclosures

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