

Fortinet Inc. (FTNT)

\$117.49 (As of 01/20/20)

Price Target (6-12 Months): **\$123.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 01/17/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: D

Growth: A

Momentum: A

Summary

Fortinet is benefiting from solid 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. Bullish guidance for the fourth quarter and the full year are expected to buoy investors' confidence in the stock. Estimates have been stable lately ahead of Fortinet's Q4 earnings release. Shares have outperformed the industry in the past year. 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.

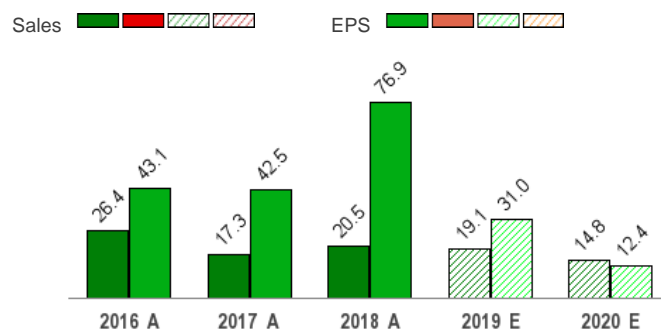
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$119.50 - \$68.15
20 Day Average Volume (sh)	869,723
Market Cap	\$20.1 B
YTD Price Change	10.1%
Beta	1.18
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Security
Zacks Industry Rank	Bottom 33% (169 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	19.6%
Last Sales Surprise	2.7%
EPS F1 Est- 4 week change	0.3%
Expected Report Date	02/06/2020
Earnings ESP	-0.1%
P/E TTM	51.1
P/E F1	43.4
PEG F1	2.9
P/S TTM	9.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2020	554 E	597 E	623 E	685 E	2,463 E
2019	473 A	522 A	548 A	603 E	2,145 E
2018	399 A	441 A	454 A	507 A	1,801 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2020	\$0.54 E	\$0.64 E	\$0.71 E	\$0.80 E	\$2.71 E
2019	\$0.46 A	\$0.58 A	\$0.67 A	\$0.70 E	\$2.41 E
2018	\$0.33 A	\$0.41 A	\$0.44 A	\$0.59 A	\$1.84 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 01/20/2020. The reports text is as of 01/21/2020.

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.

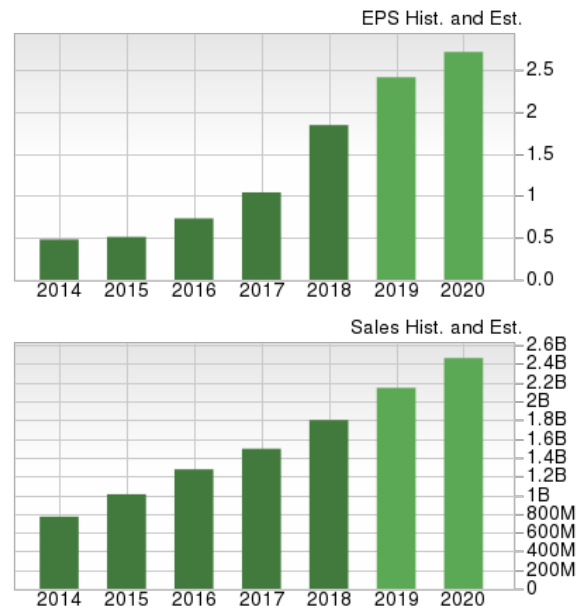
Its flagship UTM solution consists of the FortiGate appliance product line and FortiGuard security subscription services.

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.

In 2018, Fortinet generated revenues of \$1.8 billion, up 20% year over year, of which, 37% came from products and 63% from services.

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 seven 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 16.74. 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 Q3 Earnings & Revenues Top Estimates

Fortinet delivered third-quarter 2019 non-GAAP earnings per share of 67 cents, which beat the Zacks Consensus Estimate of 56 cents and also improved significantly from the year-ago figure of 44 cents.

Moreover, revenues of \$548 million surpassed the consensus estimate of \$533 million and increased 21% year over year as well, driven by strong growth in Fortinet Security Fabric, cloud and SD-WAN offerings. Strength in the Americas and EMEA regions was a key driver.

The better-than-expected third-quarter results coupled with a bullish guidance for the fourth quarter and the full year are expected to buoy investors' confidence in the stock. Notably, the company's guidance raised for the full year led to a share price rally of more than 10% in the extended trading session on Thursday.

For 2019, the company expects revenues in the range of \$2.135-\$2.150 billion compared with \$2.10-\$2.12 billion estimated earlier. The Zacks Consensus Estimate is pegged at \$2.11 billion.

Moreover, non-GAAP earnings per share expectations were also lifted to \$2.39-\$2.41 from \$2.23-\$2.26. The Zacks Consensus Estimate stands at \$2.25.

Quarter in Detail

Segment wise, Product revenues increased 20% year over year to \$197.1 million. Services revenues too jumped 21% to \$350.4 million.

Total deferred revenues of \$1.95 billion as of Sep 30, 2019 grew 26%. Billings were up 19% as well on a year-over-year basis to \$626.6 million.

During the quarter, the company secured 53 total deals worth more than \$1 million compared with 30 deals in the year-ago period and 46 sequentially.

While revenues from the Americas (44% of total revenues) grew 24% year over year to \$241 million, revenues from the EMEA (Europe, Middle East and Africa) region (37%) increased 21% to \$201 million and that from APAC (Asia Pacific) region (19%) rose 12% to \$106 million.

Margins

Gross margin expanded 170 basis points (bps) year over year to 78.2%. Also, services gross margin expanded 70 bps to 88% as well as product gross margin grew 330 bps to 60.7%.

Non-GAAP operating expense as a percentage of revenues declined 80 bps to 51.8%.

Non-GAAP operating income surged 33.3% to \$144.6 million while non-GAAP operating margin expanded 200 bps to 26%.

Balance Sheet & Cash Flow

Fortinet exited the reported quarter with cash and cash equivalents, and short-term investments of approximately \$1.94 billion, up from \$1.83 billion recorded at the end of the previous quarter.

During the third quarter, the company generated operating cash flow of \$221.2 million compared with \$195.1 million in the previous quarter. Free cash flow was \$203.7 million compared with \$177.8 million in the second quarter.

Guidance

For 2019, billings are now expected within \$2.55-\$2.565 billion, up from \$2.51-\$2.54 billion.

Non-GAAP gross margin is projected in the range of 76.5-77%, up from 75.5-76.5% predicted earlier. Non-GAAP operating margin is now anticipated between 24% and 24.5%, up from the previously guided 23-23.5% range.

For the fourth quarter of 2019, the company expects revenues of \$595-\$610 million. The consensus estimate is pegged at \$585.76 million. Billings are estimated in the band of \$750-\$765 million.

Non-GAAP earnings per share are envisioned within 69-71 cents. The Zacks Consensus Estimate is pegged at 64 cents.

Non-GAAP gross margin is forecast in the range of 75.5-76.5% whereas non-GAAP operating margin is anticipated between 25.5% and 26%.

Quarter Ending **09/2019**

Report Date	Oct 31, 2019
Sales Surprise	2.70%
EPS Surprise	19.64%
Quarterly EPS	0.67
Annual EPS (TTM)	2.30

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 34.2% in the past six months and 68.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector have gained 9.5% and 16.4%, respectively in the past six months. Over the past year, while the Zacks sub-industry has increased 26.4%, the sector gained 35.3%.

The S&P 500 Index has risen 12.12% in the past six months and 25.7% in the past year.

The stock is currently trading at 8.11X forward 12-month sales, which compares to 8.01X for the Zacks sub-industry, 3.74X for the Zacks sector and 3.57X 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 \$123 price target reflects 8.52X 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	8.11	8.01	3.74	3.57
	5-Year High	8.77	8.96	3.74	3.574
	5-Year Low	3.21	5.32	2.3	2.54
	5-Year Median	5.31	6.76	3.01	3
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 01/20/2020

Industry Analysis Zacks Industry Rank: Bottom 33% (169 out of 254)



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
Proofpoint, Inc. (PFPT)	Neutral
Qualys, Inc. (QLYS)	Neutral

Industry Comparison Industry: Security				Industry Peers		
	FTNT Neutral	X Industry	S&P 500	CHKP Neutral	CSCO Neutral	PANW Neutral
VGM Score	B	-	-	D	C	D
Market Cap	20.09 B	3.71 B	24.65 B	17.32 B	207.96 B	23.71 B
# of Analysts	13	11.5	13	16	12	17
Dividend Yield	0.00%	0.00%	1.73%	0.00%	2.86%	0.00%
Value Score	D	-	-	C	C	F
Cash/Price	0.10	0.10	0.04	0.10	0.14	0.12
EV/EBITDA	45.74	40.42	14.11	15.43	11.22	51.57
PEG Ratio	2.91	2.31	2.08	2.08	2.57	2.10
Price/Book (P/B)	16.74	9.51	3.39	4.83	6.04	15.64
Price/Cash Flow (P/CF)	58.55	47.89	13.81	20.40	14.25	47.89
P/E (F1)	43.58	43.34	19.19	17.68	15.08	48.86
Price/Sales (P/S)	9.81	8.20	2.69	8.76	4.00	7.86
Earnings Yield	2.31%	2.18%	5.21%	5.65%	6.63%	2.04%
Debt/Equity	0.00	0.00	0.72	0.00	0.42	1.20
Cash Flow (\$/share)	2.01	1.08	6.94	5.57	3.44	5.05
Growth Score	A	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	91.94%	14.71%	10.56%	10.73%	8.00%	NA
Proj. EPS Growth (F1/F0)	12.52%	11.30%	7.57%	5.24%	4.86%	-9.09%
Curr. Cash Flow Growth	128.85%	59.09%	14.73%	1.83%	6.95%	119.25%
Hist. Cash Flow Growth (3-5 yrs)	36.70%	23.40%	9.00%	5.13%	3.53%	69.30%
Current Ratio	1.84	1.78	1.24	1.63	1.70	1.78
Debt/Capital	0.00%	0.00%	42.99%	0.00%	29.63%	54.51%
Net Margin	19.23%	9.33%	11.14%	40.05%	21.15%	-3.42%
Return on Equity	25.46%	7.41%	17.16%	21.86%	35.01%	2.43%
Sales/Assets	0.62	0.50	0.55	0.34	0.53	0.48
Proj. Sales Growth (F1/F0)	14.83%	14.56%	4.16%	3.83%	-1.63%	19.43%
Momentum Score	A	-	-	D	C	C
Daily Price Chg	-1.34%	-0.90%	0.27%	-0.90%	-0.06%	-0.49%
1 Week Price Chg	2.80%	2.43%	0.39%	0.29%	-1.05%	0.44%
4 Week Price Chg	7.27%	5.66%	2.95%	0.95%	2.38%	5.66%
12 Week Price Chg	45.12%	15.15%	7.76%	4.84%	5.62%	9.25%
52 Week Price Chg	61.72%	19.07%	22.29%	7.36%	10.88%	19.07%
20 Day Average Volume	869,723	526,993	1,536,375	764,017	16,480,158	733,350
(F1) EPS Est 1 week change	0.34%	0.00%	0.00%	-0.40%	0.00%	0.00%
(F1) EPS Est 4 week change	0.34%	0.00%	0.00%	-0.28%	0.00%	0.00%
(F1) EPS Est 12 week change	15.09%	4.17%	-0.40%	-0.40%	-3.29%	-146.67%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-0.74%	0.00%	0.00%

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	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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