NetApp, Inc. (NTAP)

$54.24 (As of 02/17/20)

Price Target (6-12 Months): **$59.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 02/16/20) Prior Recommendation: Outperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:A
	Value: A | Growth: C | Momentum: B	

Summary

NetApp's third-quarter fiscal 2020 results reflected lower product revenues due to macroeconomic weakness despite strength in Cloud Data Services and Private Cloud offerings. The company is benefiting from improvement in adoption of cloud-integrated all-flash solutions and hybrid multi-cloud offerings. Also, increasing deal wins and expanding customer base across varied geographies are other positives. NetApp's transition to data fabric strategy holds promise. The exponential rate of data growth bodes well for the company's cloud-integrated storage offerings. Although shares have underperformed in the past year, these factors are expected to help the company grow in the days ahead. However, NetApp faces intense competition from bellwethers such as HP Inc., Dell, and IBM. Further, declining Product revenues remains a headwind.

Price, Consensus & Surprise

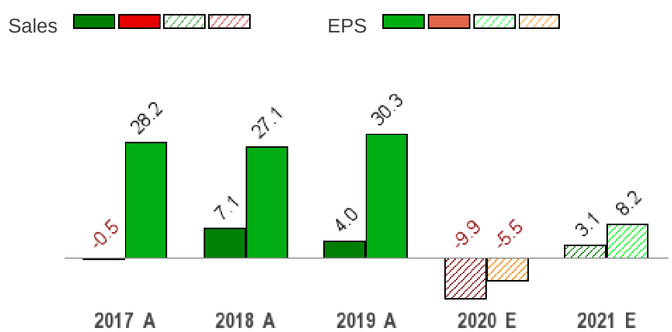
Data Overview

52 Week High-Low	**$78.35 - $44.55**
20 Day Average Volume (sh)	**2,623,138**
Market Cap	**$12.4 B**
YTD Price Change	**-12.9%**
Beta	**1.58**
Dividend / Div Yld	**$1.92 / 3.5%**
Industry	**Computer- Storage Devices**
Zacks Industry Rank	**Top 18% (45 out of 255)**

Last EPS Surprise	**-2.5%**
Last Sales Surprise	**-4.0%**
EPS F1 Est- 4 week change	**-0.1%**
Expected Report Date	**NA**
Earnings ESP	**-5.9%**

P/E TTM	**13.2**
P/E F1	**12.7**
PEG F1	**0.9**
P/S TTM	**2.2**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	1,305 E	1,393 E	1,458 E	1,564 E	5,712 E
2020	1,236 A	1,371 A	1,404 A	1,526 E	5,538 E
2019	1,474 A	1,517 A	1,563 A	1,592 A	6,146 A

EPS Estimates

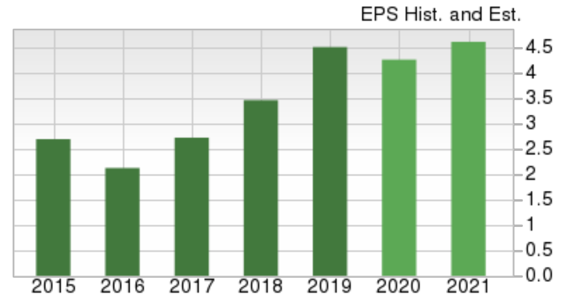
	Q1	Q2	Q3	Q4	Annual*
2021	$0.86 E	$1.09 E	$1.22 E	$1.41 E	$4.62 E
2020	$0.65 A	$1.09 A	$1.16 A	$1.38 E	$4.27 E
2019	$1.04 A	$1.06 A	$1.20 A	$1.22 A	$4.52 A

*Quarterly figures may not add up to annual.

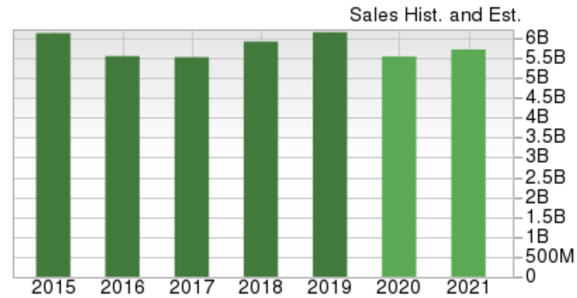
The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/17/2020. The reports text is as of 02/18/2020.

Overview

Headquartered in Sunnyvale, CA and founded in 1992, NetApp Inc. provides enterprise storage and data management software and hardware products and services. The company's product line comprises two storage platforms - FAS storage platform and E-Series platform.



FAS Storage Platform is based on the NetApp Data ONTAP operating system, which combines storage efficiency, data management and data protection. The FAS product line includes FAS6200, FAS3200 and FAS2000 series. The E-series platform helps in the deployment of Hadoop Big Data infrastructure. The E-series product line comprises EF540 Flash Array and EF550.



Moreover, the company's Cloud Volumes ONTAP storage data management service helps in data protection and storage competence. The company has build relationships with over 300 cloud service providers and hyperscaler providers, which includes Amazon Web Services (AWS), Google, IBM SoftLayer and Microsoft Azure. Further, Cloud Volumes ONTAP offers data access, insights and control to aid customers to move traditional database applications or legacy NAS applications to the cloud.

Leveraging these solutions the company addresses both the Storage Area Network (SAN) and Networked Attached Storage (NAS) markets. A networked storage necessarily provides external data repository that can be shared through LAN, thus freeing local storage space. Also, network storage also supports automated backup programs that prevent data loss.

NetApp also offers support, consulting and training services. The company markets and distributes products worldwide through a direct sales force, value-added resellers, system integrators, original equipment manufacturers and distributors.

NetApp reported revenues of $6.15 billion in fiscal 2019. The company derived 61% of revenues from Products, 15% from Software maintenance, and 24% from Hardware Maintenance and Other Services.

On geographical basis, NetApp generated 56% of revenues in fiscal 2019 from the Americas (the United States, Canada and Latin America), 30% from Europe, Middle East and Africa (EMEA) and the remaining 14% from Asia Pacific (APAC).

NetApp faces stiff competition from companies like HP Inc., Dell, IBM and Oracle.

Reasons To Buy:

▲ The latest forecast for worldwide IT spending by Gartner gave some optimism about NetApp's near-term performance. The research firm expects worldwide IT spending to reach $3.9 trillion in 2020, representing a 3.4% increase from 2019. 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.

NetApp is gaining momentum in flash-based solutions with the newly introduced all-flash array, which will help it to gain traction in the storage market.

▲ NetApp is expected to gain from the shift from traditional dedicated storage to shared storage in virtualized IT infrastructures. The company is gaining traction in the network-attached storage (NAS) market. Enterprises are shifting to NAS primarily due to its easy deployment capabilities and support for several networking environments. Other advantages includes regulatory compliance needs, tremendous growth in digital data due to shift of legacy and media content to digital formats and general IT trends such as server virtualization, need for improved efficiency of storage devices and data center consolidation. NetApp's Data ONTAP software supports storage area network (SAN) and NAS environments and is compatible with various operating systems such as UNIX, Linux, Windows and web environments. This omni-compatible nature remains the key point for its rapid adoption.

▲ NetApp is witnessing higher demand for its flash-based solutions. NetApp recently unveiled AFF C190 cloud-capable all-flash storage solution primarily aimed at expanding presence among smaller enterprises looking to manage business across hybrid cloud platforms. The company also expanded all-flash storage portfolio with NVMe-based AFF A320 system. Further, the company rolled out NetApp ONTAP 9.6, comprehensive NVMe-based storage solution and launched new cloud-based services in order to provide hybrid storage architecture. The company continues to launch new products for all segments of the market. NetApp unveiled the all new AFF A800 array, a high performance, cloud-connected flash system to power AI and compute-intensive applications. The company also launched NetApp ONTAP AI proven architecture, which accelerates accessibility to data as per the scale and speed requirements of AI. The architecture leverages NVIDIA's DGX supercomputers. The company also updated its flagship NetApp ONTAP 9 software which emphasizes on improvements to FabricPool and hybrid cloud data tiering. It also gives support to Microsoft Azure.It also announced new FlexPod solutions to simplify the delivery of cloud infrastructure and deliver focused industry-specific applications. In an effort to extend the utilization of NetApp Data Fabric, the company also announced ONTAP 9.5, MAX Data, Storage GRID SG6060, NetApp Solution Support for FlexPod, and Flash Performance Guarantee solutions. The company also announced a new high-end system that features an NVMe fabric-ready clustered architecture. Moreover, with IT organizations increasingly preferring the flash based storage systems, due to its cost effectiveness, faster speeds in read and write tasks, NetApp with broad portfolio of array-based flash solutions should be able to capitalize on this opportunity.

▲ The acquisition of SolidFire in 2016 has further strengthened NetApp's position in the all-flash array market by adding new flash offerings. SolidFire's flash storage arrays, instead of focusing on improving cache performance, act as primary storage for applications requiring high speed, such as in cloud computing and virtualization. This simplifies the storage system while decreasing fetching time, thereby increasing speed. Further, SolidFire's flash arrays are built on Next Generation Data Centers that simplify data center operations and enable rapid deployments of new applications. NetApp has a dominant position in the flash storage market. The acquisition is expected to boost NetApp's flash based storage product portfolio going forward. We believe that the acquisition will expand NetApp's customer base and market share due to higher demand from enterprises going forward. The company also recently acquired StackPointCloud, a provider of cloud-based Kubernetes as-a-service ("KaaS"), for an undisclosed amount in a bid to release Kubernetes service. NetApp's converged infrastructure capabilities continued to expand as a result. The new NetApp Kubernetes Service ("NKS") designed for multi-cloud deployments supports cloud-based stack for leading cloud platforms, including the likes of Amazon's Amazon Web Services ("AWS"), Microsoft's Azure, Google Cloud, and the company's NetApp HCI platform.

Reasons To Sell:

- NetApp's original equipment manufacturer (OEM) revenues have been declining. The company's OEM revenues continue declining in straight two fiscals as OEM customers such as IBM, Teradata, Fujitsu, etc., are developing their own product lines or are reacting to the weak demand environment.

Declining OEM revenues and competition remain the headwinds.

- NetApp is heavily dependent on sales through indirect channels, value-added resellers, systems integrators, distributors, OEMs and strategic business partners, which accounted for approximately 80% of revenues in fiscal 2019. Thus, loss of any key customer, reseller or distributor could affect the company's overall results.

- NetApp faces intense competition from bellwethers such as HP Inc., Dell, IBM and Oracle. These companies have greater financial strength and capacity to develop a technology potentially disrupting NetApp's present line of business.

- NetApp stock currently has a trailing 12 month P/B ratio of 43.9. This level compares unfavorably with what the industry witnessed in the last year. Additionally, the ratio is higher than the average level of 14.78 and is near the high end of the valuation range in this period. Hence, valuation looks stretched from a P/B perspective.

Last Earnings Report

NetApp Q3 Earnings Miss, Revenues Decline Y/Y

Quarter Ending	01/2020
Report Date	Feb 12, 2020
Sales Surprise	-3.99%
EPS Surprise	-2.52%
Quarterly EPS	1.16
Annual EPS (TTM)	4.12

NetApp, Inc. reported third-quarter fiscal 2020 non-GAAP earnings of $1.16 per share, which missed the Zacks Consensus Estimate by 2.5%.

Moreover, the figure declined 3.3% from the year-ago quarter. Nonetheless, the bottom line came within the guided range of $1.14 and $1.22 per share.

Revenues of $1.404 billion lagged the Zacks Consensus Estimate by 4%. Moreover, the figure declined 10.2% from the year-ago quarter due to macroeconomic headwinds and unpredictability in large enterprise purchasing behavior. Nonetheless, the top line came within the guided range of $1.39-$1.54 billion.

Region wise, the Americas, EMEA and Asia Pacific accounted for 50%, 35% and 15% of total revenues, respectively.

Direct and Indirect revenues represented 21% and 79%, respectively, of total revenues.

Quarter in Detail

Product revenues (56.1% of total revenues) decreased 18.6% year over year to $787 billion owing to macroeconomic headwinds.

Per management, broader weakness in macroeconomic environment is compelling enterprises to trim capital expenditure, which is affecting storage business.

Revenues from products under Strategic grouping came in at $483 million, down 6.6% year over year. The offerings include All-flash FAS products, enterprise software license agreements, private cloud solutions, and other add-on hardware and software product options.

Revenues from products under Mature grouping came in at $304 million, down 32.4% year over year. The offerings include Hybrid FAS products, and related add-on OS software and hardware, branded E-Series and OEM products.

Software Maintenance revenues (18.7%) came in at $263 million, up 10%.

Hardware Maintenance and Other Services revenues (18.7%) were $354 million, down 0.8% from the year-ago quarter.

Revenues from Hardware Maintenance Support Contracts came in at $293 million, up 0.3% year over year. Revenues from Professional and Other Services came in at $61 million, down 6.2%.

Key Metrics

During the fiscal third quarter, the company's All-Flash Array Business annualized net revenue run rate came in at $2.3 billion.

Cloud Data Services recorded annualized recurring revenues of $83 million, up 146% year over year. Robust adoption of Microsoft Azure NetApp Files was a key driver.

Private Cloud business recorded run rate of $344 million, which remained flat year over year.

Product Rollouts in Q3

NetApp introduced storage systems — the NetApp AFF A400 end-to-end NVMe all-flash system, the NetApp FAS8700 high-end hybrid flash array, and the FAS8300 next-generation mid-range hybrid flash array.

The company announced NetApp StorageGRID enhancements — StorageGRID 11.3 software, SGF6024 all-flash appliance, SG6060 expansion appliance, SG1000 service appliance, and StorageGRID tiering to Azure Blob storage to meet increasing demand for object storage.

Additionally, NetApp introduced three features for NetApp Cloud Insights including Kubernetes Topology Visualization, NetApp Cloud Secure Insider Threat Detection, and NetApp Active IQ Integration.

Moreover, the company enhanced NetApp Cloud Volumes ONTAP for Amazon's cloud-arm Amazon Web Services (AWS) with new NetApp Cloud Backup Service, the new NetApp Cloud Compliance service, and the ability to leverage NVMe flash available on virtual compute instances.

In the third quarter, NetApp expanded its multiprotocol file services to encompass NFSv4.1, NFSv3, and SMB for both Azure NetApp Files and NetApp Cloud Volumes Service for AWS. With this expansion, NetApp now delivers the widest range of support for Microsoft Windows and Linux workloads.

Further, NetApp released NetApp ONTAP System Manager 9.7, which offers expanded integration of hybrid cloud, with seamless and efficient migration of tiered data between private and public clouds by using FabricPool, symmetric active-active host-to-LUN access, and extended scale-out NAS deployments.

NetApp also introduced support for software RAID configurations backed by NVMe drives.

Partnerships Remain Noteworthy

NetApp expanded partnership with Alphabet's Google Cloud Services that included the general availability of NetApp Cloud Volumes ONTAP and Cloud Volumes Service for Google Cloud. The expansion also includes the availability of Cloud Volumes Service in the U.K. region and support for Anthos on Cloud Volumes ONTAP, Cloud Volumes Service, and NetApp HCI.

Additionally, in partnership with NVIDIA, NetApp unveiled NVIDIA DGX SuperPOD, which helps simplify supercomputing and enables AI for high-performance computing (HPC) teams. NetApp and NVIDIA also announced their collaboration on the NVIDIA Magnum IO, a multi-GPU, multi-node networking and storage I/O optimization stack.

Moreover, Enterprise Networking Solutions, Inc. was granted a 3-year contract by the State of California Department of General Services to deliver NetApp data center modernization and hybrid cloud infrastructure solutions to the State of California.

Operating Details

Non-GAAP gross margin was 67.8%, which expanded 410 basis points (bps) from the year-ago quarter.

On a non-GAAP basis, Product gross margin of 55.4% expanded 280 bps, Software Maintenance gross margin of 95.4% contracted 40 bps, and Hardware Maintenance and Other Services gross margin expanded 260 bps to 74.9% year over year.

Non-GAAP operating expenses increased 1.7% year over year to $640 million.

Non-GAAP operating margin contracted 130 bps to 22.2%.

Balance Sheet & Cash Flow

NetApp exited the quarter ending Jan 24, 2019, with $3.008 billion in cash, cash equivalents and investments compared with $2.987 billion in the previous quarter. Long-term debt (including current portion) was $1.146 billion compared with $1.145 billion in the previous quarter.

The company generated net cash from operations of $420 million during the quarter compared with $53 million utilized in the fiscal second quarter.

Free cash flow was $388 million compared with ($89) million in the previous quarter.

Further, the company repurchased shares worth $500 million and paid out dividends worth $108 million in the reported quarter.

NetApp announced quarterly cash dividend of 48 cents per share to be paid out on Apr 22, 2020, to shareholders of record as of Apr 3, 2020.

Guidance

NetApp is banking on improvement in adoption of hybrid multi-cloud offerings, Cloud Data Services and Private Cloud offerings.

NetApp anticipates non-GAAP earnings for fourth-quarter fiscal 2020 between $1.28 and $1.36 per share.

Moreover, net revenues are anticipated to be in the range of $1.455-$1.605 billion.

For fourth-quarter fiscal 2020, NetApp expects non-GAAP gross margin to be in the range of 66-67% and non-GAAP operating margin to be in the range of 23%-24%.

For fiscal 2020, NetApp updated guidance. The company now anticipates net revenues to decline 8% from fiscal 2019. In the prior guidance, management had anticipated revenues to decline in the 5-10% range.

Non-GAAP earnings per share are now projected to decline 5% to 8% on a year-over-year basis, excluding contribution from buybacks.

The company anticipates non-GAAP gross margin to be in the range of 67-68%. Non-GAAP operating margin is projected to be around 21%

Recent News

On **Jan 24, 2020** NetApp announced renewal of the official sponsorship of the Ducati Corse motorcycle racing team for 2020 MotoGP World Championship.

On **Dec 4, 2019**, NetApp secured a three-year contract by the State of California Department of General Services (DGS). Per the terms of the contract, NetApp's hybrid cloud infrastructure and data center modernization solutions will be delivered by Enterprise Networking Solutions, Inc.

On **Nov 20, 2019**, NetApp, in collaboration with Google Cloud, announced availability of NetApp Cloud Volumes Service, and NetApp Cloud Volumes ONTAP for Google Cloud, to help enterprises accelerate workloads across hybrid cloud architecture.

On **Nov 13, 2019**, NetApp announced quarterly cash dividend of 48 cents per share payable on Jan 22, 2019, to shareholders on record as of Jan 3, 2019.

Valuation

NetApp's shares are up 17.3% in the past six-month period but down 13% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Computer & Technology sector are up 16.8% and 23.1% in the past six-month period, respectively. Over the past year, the Zacks sub-industry and the sector are up 8.3% and 31.1%, respectively.

The S&P 500 index is up 17.2% in the past six-month period and 23.3% in the past year.

The stock is currently trading at 11.91X forward 12-month earnings, which compares to 14.4X for the Zacks sub-industry, 23.15X for the Zacks sector and 19.35X for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.38X and as low as 9.95X, with a 5-year median of 17.2X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our $59 price target reflects 12.96X forward 12-month earnings.

The table below shows summary valuation data for NTAP

Valuation Multiples - NTAP

		Stock	Sub-Industry	Sector	S&P 500
P/E F 12M	Current	11.91	14.4	23.15	19.35
	5-Year High	27.38	16.11	23.15	19.35
	5-Year Low	9.95	9.68	16.87	15.18
	5-Year Median	17.2	12.27	19.32	17.47
P/S F12M	Current	2.18	1.15	3.79	3.58
	5-Year High	3.58	1.53	3.79	3.58
	5-Year Low	1.08	0.82	2.3	2.54
	5-Year Median	2.02	1.15	3.02	3
EV/Sales TTM	Current	1.8	1.55	4.51	3.32
	5-Year High	3.22	1.69	4.51	3.32
	5-Year Low	0.49	0.55	2.56	2.16
	5-Year Median	1.36	1.33	3.47	2.79

As of 02/14/2020

Industry Analysis **Zacks Industry Rank:** Top 18% (45 out of 255)

Top Peers

Pure Storage, Inc. **(PSTG)**	Outperform
Seagate Technology PLC **(STX)**	Outperform
Western Digital Corporation **(WDC)**	Outperform
International Business Machines Corporation **(IBM)**	Neutral
Nutanix Inc. **(NTNX)**	Neutral
Oracle Corporation **(ORCL)**	Neutral
Teradata Corporation **(TDC)**	Neutral
Hewlett Packard Enterprise Company **(HPE)**	Underperform

Industry Comparison Industry: Computer- Storage Devices

Industry Peers

	NTAP Neutral	X Industry	S&P 500	HPE Underperform	IBM Neutral	PSTG Outperform
VGM Score	A	-	-	A	B	C
Market Cap	12.38 B	903.69 M	24.61 B	18.67 B	133.47 B	4.92 B
# of Analysts	8	7	13	7	8	9
Dividend Yield	3.54%	0.00%	1.78%	3.32%	4.30%	0.00%
Value Score	A	-	-	B	A	F
Cash/Price	0.23	0.20	0.04	0.20	0.08	0.26
EV/EBITDA	7.19	7.45	14.06	5.70	11.13	-49.82
PEG Ratio	0.86	2.21	2.09	1.17	2.06	2.21
Price/Book (P/B)	23.10	6.70	3.29	1.10	7.38	6.32
Price/Cash Flow (P/CF)	10.81	11.39	13.65	3.81	7.99	NA
P/E (F1)	12.60	15.54	19.21	7.78	11.28	47.67
Price/Sales (P/S)	2.21	1.37	2.70	0.64	1.73	3.13
Earnings Yield	7.87%	5.10%	5.19%	12.88%	8.87%	2.12%
Debt/Equity	2.14	0.37	0.71	0.55	3.40	0.73
Cash Flow ($/share)	5.02	0.42	6.92	3.79	18.86	-0.29
Growth Score	C	-	-	A	D	A
Hist. EPS Growth (3-5 yrs)	23.42%	-4.75%	10.85%	-4.78%	-3.50%	NA
Proj. EPS Growth (F1/F0)	-5.50%	11.11%	7.17%	4.84%	4.30%	59.38%
Curr. Cash Flow Growth	21.12%	-6.25%	8.56%	-2.58%	-1.93%	-39.40%
Hist. Cash Flow Growth (3-5 yrs)	2.57%	-0.23%	8.36%	-3.09%	-5.41%	1.04%
Current Ratio	1.31	1.43	1.23	0.79	1.09	3.31
Debt/Capital	68.11%	41.09%	42.91%	35.39%	77.29%	42.29%
Net Margin	18.19%	-2.58%	11.81%	3.60%	12.23%	-14.11%
Return on Equity	103.11%	2.77%	16.86%	13.55%	65.38%	-24.66%
Sales/Assets	0.70	0.90	0.54	0.57	0.53	0.75
Proj. Sales Growth (F1/F0)	-9.40%	1.39%	3.85%	0.19%	1.89%	18.86%
Momentum Score	B	-	-	A	B	D
Daily Price Chg	-1.70%	-0.43%	0.06%	-1.77%	-2.34%	0.16%
1 Week Price Chg	7.38%	0.00%	2.47%	5.81%	6.73%	3.31%
4 Week Price Chg	-17.04%	-1.16%	0.59%	-8.43%	9.22%	-0.26%
12 Week Price Chg	-10.64%	-1.68%	6.98%	-15.46%	12.60%	-4.74%
52 Week Price Chg	-14.80%	-1.55%	16.62%	-9.69%	10.42%	-0.58%
20 Day Average Volume	2,623,138	282,283	2,020,569	8,527,324	6,817,420	2,526,056
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.08%	0.00%	-0.05%	-0.61%	1.15%	0.00%
(F1) EPS Est 12 week change	-0.08%	-0.04%	-0.17%	0.22%	1.34%	-6.98%
(Q1) EPS Est Mthly Chg	-0.02%	0.00%	-0.24%	0.00%	-8.66%	0.00%

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.

Value Score	A
Growth Score	C
Momentum Score	B
VGM Score	A

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.

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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