

## NetApp, Inc. (NTAP)

**\$45.14** (As of 05/26/20)

Price Target (6-12 Months): **\$47.00**

Long Term: 6-12 Months

**Zacks Recommendation:**

**Neutral**

(Since: 02/16/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

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

**4-Sell**

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: A

## Summary

NetApp is expected to benefit from improvement in adoption of cloud-integrated all-flash solutions and hybrid multi-cloud offerings. Moreover, increasing deal wins and expanding customer base across varied geographies are likely to be growth catalysts. NetApp's transition to data fabric strategy also holds promise. Further, the exponential rate of data growth bodes well for the company's cloud-integrated storage offerings. However, NetApp faces intense competition from bellwethers such as HP, Dell and IBM. Further, NetApp withdrew fiscal second-quarter and full year guidance due to the coronavirus crisis. Notably, the company has mixed record of earnings surprises in recent quarters. Notably, shares have underperformed the industry on a year-to-date basis.

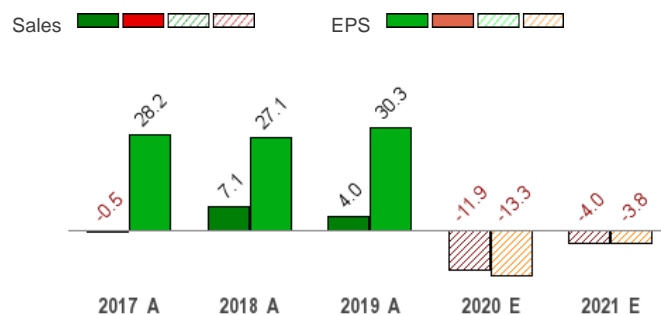
## Price, Consensus & Surprise



## Data Overview

52 Week High-Low	\$65.38 - \$34.66
20 Day Average Volume (sh)	1,808,006
Market Cap	\$10.0 B
YTD Price Change	-27.5%
Beta	1.32
Dividend / Div Yld	\$1.92 / 4.3%
Industry	<a href="#">Computer- Storage Devices</a>
Zacks Industry Rank	Top 34% (86 out of 253)

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



Last EPS Surprise	-2.5%
Last Sales Surprise	-4.0%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	05/27/2020
Earnings ESP	-13.6%

## Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,170 E	1,267 E	1,340 E	1,457 E	5,198 E
2020	1,236 A	1,371 A	1,404 A	1,412 E	5,416 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	\$0.62 E	\$0.88 E	\$1.02 E	\$1.24 E	\$3.77 E
2020	\$0.65 A	\$1.09 A	\$1.16 A	\$1.04 E	\$3.92 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.

P/E TTM	12.6
P/E F1	14.3
PEG F1	1.0
P/S TTM	1.8

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 05/26/2020. The reports text is as of 05/27/2020.

## Overview

NetApp Inc. provides enterprise storage as well as data management software and hardware products and services. The Sunnyvale, CA-based 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.

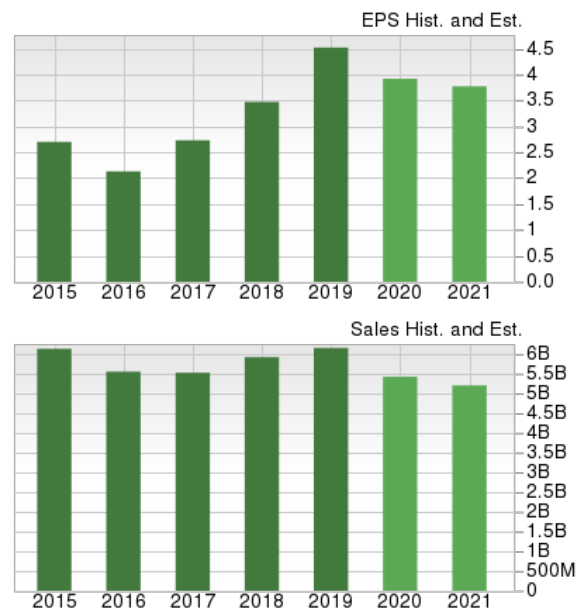
Leveraging these solutions the company addresses both the Storage Area Network (SAN) and Networked Attached Storage (NAS) markets. A networked storage necessarily provides external data repository that can be shared through LAN, thus freeing local storage space. Also, network storage also supports automated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



## Reasons To Buy:

▲ 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 include 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 omn-compatible nature remains the key point for its rapid adoption.

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 witnessing higher demand for its flash-based solutions. In June 2019, NetApp 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 strengthened NetApp's position in the all-flash array market by adding new flash offerings. SolidFire's flash storage arrays, apart from improving cache performance, are primary storage for applications requiring high speed like 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. The acquisition boosts NetApp's flash based storage product portfolio and helps it maintain a dominant position in the flash storage market. We believe that the acquisition will expand NetApp's customer base and market share due to higher demand from enterprises. The acquisition of StackPointCloud, a provider of cloud-based Kubernetes as-a-service (KaaS), has helped to expand NetApp's converged infrastructure capabilities. The new NetApp Kubernetes Service (NKS) designed for multi-cloud deployments supports cloud-based stack for leading cloud platforms, including the likes of AWS, Azure, Google Cloud, and the company's NetApp HCI platform.

▲ Management execution has been favorable in recent times. The solid net-cash balance of \$1.86 billion as of Jan 24, 2020, up from prior-quarter tally of \$1.84 billion, provides the flexibility required to pursue any growth strategy, whether through acquisitions or otherwise. Moreover, the strong balance sheet helps NetApp to continue shareholder friendly initiatives of share repurchase and dividend hike. In third-quarter fiscal 2020, NetApp returned \$608 million share buybacks and dividends. Notably, lower number of outstanding shares drives the bottom line. 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 free cash outflow of \$89 million in the previous quarter. The company's ability to generate solid free cash flow is expected to help it sustain current dividend payout (0.54) level at least in the near term.

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### 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.
- ▼ 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 35.4. This level compares unfavorably with what the industry witnessed in the last year. Additionally, the ratio is higher than the average level of 25.6. Hence, valuation looks stretched from a P/B perspective.

Declining OEM revenues and competition remain the headwinds.

## Last Earnings Report

### NetApp Q3 Earnings Miss, Revenues Decline Y/Y

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

### Quarter Ending 01/2020

Report Date	Feb 12, 2020
Sales Surprise	-3.99%
EPS Surprise	-2.52%
Quarterly EPS	1.16
Annual EPS (TTM)	3.58

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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.

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## Recent News

On May 12, NetApp announced that Cesar Cernuda has been appointed as the president of the company. He will be reporting to CEO George Kurian, effective in July, 2020.

On Apr 29, NetApp announced acquisition of CloudJumper, a cloud software company offering virtual desktop infrastructure (VDI) solutions, and remote desktop services (RDS) which aids enterprises to accelerate public cloud deployments for work from home setup, branch offices and enterprises.

On Mar 30, in an 8K filed with the SEC, NetApp announced the withdrawal of its guidance for fourth quarter and full fiscal year 2020, due to the impact of the global coronavirus pandemic.

On Mar 9, NetApp announced the acquisition of Talon Storage to centralize and consolidate IT storage infrastructure to the public clouds.

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

## Valuation

NetApp's shares are down 27.5% in the year-to-date period and 25.7% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 24% while the Zacks Computer & Technology sector is up 2.7% in the year-to-date period. Over the past year, the Zacks sub-industry is down 6.7%, while the sector is up 19.7%.

The S&P 500 index is down 8.1% in the year-to-date period but up 5.3% in the past year.

The stock is currently trading at 14.12X forward 12-month earnings, which compares to 12.26X for the Zacks sub-industry, 24.05X for the Zacks sector and 21.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 27.38X and as low as 9.06X, with a 5-year median of 17.1X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$47 price target reflects 14.73X 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	14.12	12.26	24.05	21.5
	5-Year High	27.38	16.98	24.05	21.50
	5-Year Low	9.06	9.94	16.72	15.23
	5-Year Median	17.1	12.14	19.24	17.49
P/S F12M	Current	1.91	0.95	3.66	3.33
	5-Year High	3.58	1.41	3.66	3.44
	5-Year Low	1.08	0.8	2.32	2.53
	5-Year Median	2.02	1.16	3.10	3.01
EV/Sales TTM	Current	1.45	1.24	4.14	2.88
	5-Year High	3.22	1.71	4.43	3.46
	5-Year Low	0.49	0.55	2.59	2.14
	5-Year Median	1.39	1.33	3.58	2.82

As of 05/26/2020

## Industry Analysis Zacks Industry Rank: Top 34% (86 out of 253)



## Top Peers

Company (Ticker)	Rec	Rank
Nutanix Inc. (NTNX)	Outperform	2
International Business Machines Corporation (IBM)	Neutral	4
Oracle Corporation (ORCL)	Neutral	3
Pure Storage, Inc. (PSTG)	Neutral	3
Seagate Technology PLC (STX)	Neutral	2
Teradata Corporation (TDC)	Neutral	3
Western Digital Corporation (WDC)	Neutral	3
Hewlett Packard Enterprise Company (HPE)	Underperform	4

Industry Comparison Industry: Computer- Storage Devices				Industry Peers		
	NTAP	X Industry	S&P 500	HPE	IBM	PSTG
Zacks Recommendation (Long Term)	Neutral	-	-	Underperform	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	4	3
VGM Score	A	-	-	B	B	C
Market Cap	9.98 B	1.31 B	21.18 B	12.14 B	108.11 B	4.50 B
# of Analysts	8	7	14	6	6	9
Dividend Yield	4.25%	0.00%	2.03%	5.10%	5.35%	0.00%
Value Score	A	-	-	A	B	F
Cash/Price	0.30	0.24	0.06	0.43	0.11	0.30
EV/EBITDA	5.54	5.54	12.37	4.35	8.47	-48.48
PEG Ratio	0.98	5.78	2.88	1.72	3.16	NA
Price/Book (P/B)	35.40	4.49	2.90	0.75	5.37	5.36
Price/Cash Flow (P/CF)	9.00	9.92	11.55	2.48	6.16	NA
P/E (F1)	14.33	20.16	21.24	6.66	10.79	NA
Price/Sales (P/S)	1.78	1.22	2.24	0.44	1.41	2.74
Earnings Yield	7.00%	1.42%	4.57%	14.97%	9.27%	-5.76%
Debt/Equity	4.06	0.20	0.76	0.71	2.62	0.69
Cash Flow (\$/share)	5.02	0.07	6.96	3.79	19.75	-0.17
Growth Score	B	-	-	C	C	A
Hist. EPS Growth (3-5 yrs)	26.08%	-6.87%	10.87%	-3.21%	-3.16%	NA
Proj. EPS Growth (F1/F0)	-6.04%	-0.83%	-10.31%	-20.06%	-11.89%	-432.76%
Curr. Cash Flow Growth	21.12%	-28.62%	5.46%	-2.58%	2.09%	-37.62%
Hist. Cash Flow Growth (3-5 yrs)	2.57%	6.16%	8.55%	-3.09%	-3.76%	11.70%
Current Ratio	1.20	1.49	1.29	0.89	0.96	3.08
Debt/Capital	80.25%	40.71%	44.54%	41.54%	72.36%	40.71%
Net Margin	18.19%	-2.58%	10.59%	-0.13%	11.78%	-12.23%
Return on Equity	123.49%	1.66%	16.29%	12.35%	57.55%	-20.80%
Sales/Assets	0.71	0.90	0.55	0.52	0.50	0.75
Proj. Sales Growth (F1/F0)	-4.04%	0.00%	-2.34%	-10.61%	-5.40%	-0.97%
Momentum Score	A	-	-	B	A	C
Daily Price Chg	1.03%	0.88%	2.82%	2.73%	2.85%	3.56%
1 Week Price Chg	5.43%	6.67%	4.99%	0.66%	1.21%	13.86%
4 Week Price Chg	6.79%	2.67%	3.55%	-3.88%	-3.57%	20.44%
12 Week Price Chg	-1.68%	1.97%	-4.95%	-25.18%	-5.54%	10.85%
52 Week Price Chg	-25.63%	-5.78%	-3.04%	-33.52%	-6.67%	5.91%
20 Day Average Volume	1,808,006	267,017	2,429,758	9,597,374	4,360,389	2,716,375
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	-4.50%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	-2.27%	-4.50%	0.00%	0.00%
(F1) EPS Est 12 week change	-20.24%	-22.62%	-16.39%	-23.75%	-15.53%	-120.32%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	-4.03%	-22.66%	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	A
Growth Score	B
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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