

## NetApp, Inc. (NTAP)

**\$43.91** (As of 08/27/20)

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: B

Growth: B

Momentum: A

### Summary

NetApp's fiscal first-quarter results reflect strength in all-flash business, and solid uptake of File, Block and Object Software, and Public Cloud Services. Also, upbeat guidance for fiscal second quarter, bodes well. NetApp is well positioned to benefit from improvement in adoption of cloud-integrated all-flash solutions and hybrid multi-cloud offerings. Moreover, recent acquisitions of Spot, Cloud Jumper and Talon Storage have been immediately accretive to revenues, which bodes well. Notably, shares of NetApp have outperformed the industry on a year-to-date basis. However, coronavirus crisis-induced sluggish IT spending and supply chain constraints, are likely to weigh on revenues. Growing expenses on product enhancements amid intensifying competition from Pure Storage in the all-flash storage market, is likely to limit margin expansion.

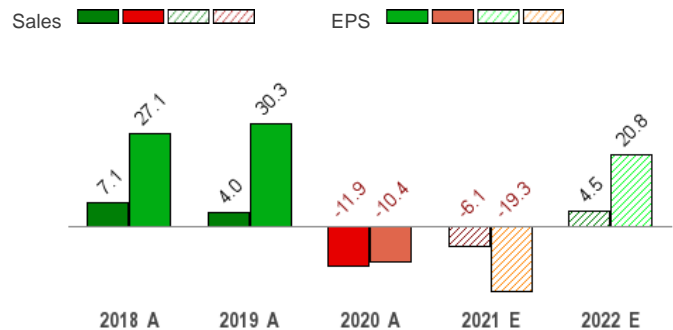
### Price, Consensus & Surprise



### Data Overview

52 Week High-Low	\$65.38 - \$34.66
20 Day Average Volume (sh)	4,005,681
Market Cap	\$9.7 B
YTD Price Change	-29.5%
Beta	1.27
Dividend / Div Yld	\$1.92 / 4.4%
Industry	<a href="#">Computer- Storage Devices</a>
Zacks Industry Rank	Bottom 4% (241 out of 252)

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



Last EPS Surprise	82.5%
Last Sales Surprise	13.5%
EPS F1 Est- 4 week change	-0.9%
Expected Report Date	11/11/2020
Earnings ESP	1.8%
P/E TTM	10.5
P/E F1	13.4
PEG F1	1.1
P/S TTM	1.8

### Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	1,223 E	1,287 E	1,341 E	1,460 E	5,309 E
2021	1,303 A		1,301 E	1,408 E	5,082 E
2020	1,236 A	1,371 A	1,404 A	1,401 A	5,412 A

### EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$0.72 E	\$0.92 E	\$1.05 E	\$1.29 E	\$3.95 E
2021	\$0.73 A	\$0.75 E	\$0.90 E	\$1.13 E	\$3.27 E
2020	\$0.65 A	\$1.09 A	\$1.16 A	\$1.19 A	\$4.05 A

\*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/27/2020. The reports text is as of 08/28/2020.

## Overview

NetApp 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. The company's all-flash storage portfolio comprises NVMe-based storage systems and new cloud-based services in order to provide hybrid storage architecture.

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 built 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.

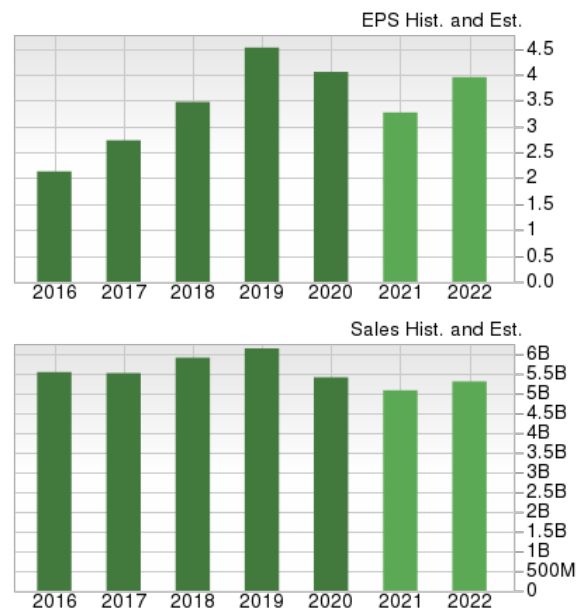
Leveraging these solutions, the company addresses both the Storage Area Network (SAN) and Networked Attached Storage (NAS) markets. A networked storage necessarily provides external data repository that can be shared through LAN, thus freeing local storage space. Also, network storage also supports automated 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 \$5.412 billion in fiscal 2020. The company derived 55.3% of revenues from Products, 19.1% from Software maintenance, and 25.6% from Hardware Maintenance and Other Services.

On geographical basis, NetApp generated 53% of revenues in fiscal 2020 from the Americas (the United States, Canada and Latin America), 32% from Europe, Middle East and Africa (EMEA) and the remaining 15% from Asia Pacific (APAC).

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



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## 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. Further, growing cloud of NetApp ONTAP AI aided the company in gaining recognition as a leader in IDC's latest report on scale-out, file-based storage, titled, IDC MarketScape Worldwide Scale-Out File-Based Storage 2019 Vendor Assessment.
- ▲ The company is gaining from robust growth in Public Cloud Services, which recorded annualized recurring revenues of \$178 million in the first quarter of fiscal 2021, up 192% year over year. Adoption of Microsoft Azure NetApp Files is a key catalyst. The company's partnerships with Alphabet's Google Cloud platform and Amazon's Amazon Web Services are expected to bolster adoption of its Cloud Data Services and expand customer base.
- ▲ NetApp is witnessing higher demand for its flash-based solutions. The company boasts of cloud-capable all-flash storage solutions primarily aimed at expanding presence among smaller enterprises looking to manage business across hybrid cloud platforms. The company's all-flash storage portfolio comprises NVMe-based storage systems and new cloud-based services in order to provide hybrid storage architecture. The company continues to launch new products for all segments of the market. 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. During the first quarter of fiscal 2021, the company's All-Flash Array Business annualized net revenue run rate came in at \$2.3 billion, up 34% sequentially.
- ▲ The company has been active on the acquisition front. SolidFire buyout 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. The acquisition boosts NetApp's flash-based storage product portfolio and helps it maintain a dominant position in the flash storage market. Moreover, the acquisition of StackPointCloud, a provider of cloud-based Kubernetes as-a-service (KaaS), has helped expand NetApp's converged infrastructure capabilities. NetApp has also acquired Talon Storage, in a bid to strengthen NetApp Cloud Volumes and Azure NetApp Files offerings, and aid customers to centralize and consolidate IT storage infrastructure to the public clouds to facilitate remote work. Furthermore, the company recently announced the acquisition of CloudJumper, a cloud software company offering virtual desktop infrastructure (VDI) solutions and remote desktop services (RDS) that aid enterprises to accelerate public cloud deployments for work-from-home setup, branch offices and enterprises. We believe that the acquisitions will expand NetApp's customer base and market share driven by higher demand from enterprises.
- ▲ Management execution has been favorable in recent times. Solid net-cash balance, of \$1.14 billion as of Jul 31, 2020, provides the flexibility required to pursue any growth strategy, whether through acquisitions or otherwise. Moreover, the strong balance sheet helps NetApp continue shareholder-friendly initiatives of dividend payouts. In the first quarter of fiscal 2021, NetApp the company returned \$107 million to shareholders through dividend payouts. However, it must be noted that, in the reported quarter, the company has paused share buybacks, and did not make any share repurchases, owing to coronavirus crisis-induced business uncertainty and limited visibility. The company generated net cash from operations of \$240 million and free cash flow was \$188 million during the quarter. The company's ability to generate solid free cash flow is expected to help it sustain current dividend payout (0.55) level at least in the near term.

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.

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## Reasons To Sell:

- ▼ NetApp continues to acquire a large number of companies. While this improves revenue opportunities, it increases integration risks. Notably, large acquisitions negatively impact the balance sheet in the form of high level of goodwill and net intangible assets, which totaled \$2.18 billion or 25.9% of total assets, as of Jul 31, 2020.
- ▼ NetApp faces stiff competition from bellwethers such as HP Inc., Dell, IBM and Oracle. NetApp's competitors are revamping their product lines with faster and efficient products. Notably, Pure Storage is a major competitor in all-flash business and cloud-based storage offerings. Although the Public Cloud Services vertical remains strong, the competitive pressure at the core storage business remains intense and is likely to hurt profitability.
- ▼ NetApp's original equipment manufacturer (OEM) revenues have been declining. The company's OEM revenues declined in two straight fiscals as OEM customers such as IBM, Teradata, Fujitsu, etc., are developing their own product lines or are reacting to the weak demand environment. Coronavirus crisis-induced supply chain constraints, weak demand, and logistical challenges are likely to dampen growth prospects at least in the near term.
- ▼ NetApp is heavily dependent on sales through indirect channels, value-added resellers, systems integrators, distributors, OEMs and strategic business partners, which accounted for 79% of revenues in fiscal 2020. Thus, loss of any key customer, reseller or distributor could affect the company's overall results.
- ▼ Moreover, the company is trading at premium in terms of Price/Book (P/B). NetApp currently has a trailing 12-month P/B ratio of 40.13X. This level compares unfavorably with what the industry witnessed in the last year. Additionally, the ratio is higher than the average level of 31.97X and is near the high end of the valuation range in this period. Consequently, the valuation looks slightly stretched from P/B perspective.

Declining OEM revenues and stiff competition remain the headwinds.

## Last Earnings Report

### NetApp Q1 Earnings & Revenues Surpass Estimates

NetApp reported first-quarter fiscal 2021 non-GAAP earnings of 73 cents per share, which surpassed the Zacks Consensus Estimate by 82.5%. Moreover, the bottom line improved 12% from the year-ago quarter. The growth can be attributed to increase in revenue base.

Revenues of \$1.303 billion increased 5% year over year, outpacing the Zacks Consensus Estimate by 13.5%. The improvement was driven by strength in File, Block and Object Software, and Public Cloud Services, which per management "outperformed the market." Nevertheless, unfavorable foreign exchange movement limited growth by "one point."

Region wise, the Americas, EMEA and Asia Pacific accounted for 54%, 29% and 16% of total revenues, respectively.

Direct and Indirect revenues represented 22% and 78%, respectively, of total revenues.

Quarter Ending **07/2020**

Report Date	Aug 26, 2020
Sales Surprise	<b>13.51%</b>
EPS Surprise	<b>82.50%</b>
Quarterly EPS	<b>0.73</b>
Annual EPS (TTM)	<b>4.17</b>

### Top Line Details

**Product** revenues (48.1% of total revenues) decreased 3% year over year to \$627 billion. The decline can be attributed to coronavirus crisis-induced macroeconomic headwinds. Nevertheless, the company witnessed gains from momentum in digital transformation and hybrid cloud projects.

Beginning first-quarter fiscal 2021, the company is now breaking out product revenues into software and hardware, in a bid to provide more visibility in to high-margined software business,. Revenues from products under Hardware grouping were \$316 million, down 7% year over year owing to decline in uptake of spinning disk solutions. Revenues from products under Software grouping amounted to \$311 million, up 2% year over year driven by solid traction witnessed by All-flash FAS products.

**Software Maintenance** revenues (23.1%) were \$301 million, up 20.4% year over year.

**Hardware Maintenance and Other Services** revenues (28.8%) were \$375 million, up 9.6% year over year. Revenues from Hardware Maintenance Support Contracts totaled \$307 million, up 8.1% year over year. Revenues from Professional and Other Services were \$68 million, up 17.2% year over year.

### Key Metrics

During the fiscal first quarter, the company's All-Flash Array Business annualized net revenue run rate came in at \$2.3 billion, up 34% year over year. Moreover, all-flash revenues totaled \$567 million, up 34% on a year-over-year basis.

Public Cloud Services recorded annualized recurring revenues of \$178 million, soaring 192% year over year. Recent acquisitions of Spot, Cloud Jumper and Talon contributed \$44 million in ARR as of the end of the quarter. Excluding the buyouts, Public Cloud Services business grew 120% on a year-over-year basis.

### Operating Details

Non-GAAP gross margin was 68%, which expanded 80 basis points (bps) from the year-ago quarter.

On a non-GAAP basis, Product gross margin of 51.4% contracted 200 bps year over year, owing to higher NAND costs and coronavirus crisis-induced pricing trends. Meanwhile, Software Maintenance gross margin of 95% contracted 100 bps, and Hardware Maintenance and Other Services gross margin expanded 220 bps to 74.1% year over year.

Non-GAAP operating expenses climbed 3% year over year to \$673 million. As a percentage of net revenues, the figure contracted 110 bps on a year-over-year basis to 51.7%.

Non-GAAP operating margin expanded 190 bps to 16.3%.

### Balance Sheet & Cash Flow

NetApp exited the quarter ending Jul 31, 2020, with \$3.773 billion in cash, cash equivalents and investments compared with \$2.882 billion as of Apr 24, 2020. Long-term debt (including current portion) was \$2.63 billion as of Jul 31, 2020, compared with \$1.146 billion as of Apr 24, 2020.

The company generated net cash from operations of \$240 million during the reported quarter compared with \$383 million reported in the fiscal fourth quarter.

Free cash flow was \$188 million compared with \$359 million in the previous quarter.

Further, the company returned \$107 million to shareholders through dividend payouts. In the reported quarter, the company has paused share buybacks, and did not make any share repurchases, owing to coronavirus crisis-induced business uncertainty and limited visibility.

NetApp announced quarterly cash dividend of 48 cents per share to be paid out on Oct 28, 2020, to shareholders of record as of Oct 9, 2020.

### Guidance

NetApp is banking on improvement in adoption of Public Cloud Services offerings.

The company anticipates non-GAAP earnings for second-quarter fiscal 2021 between 66 cents and 74 cents per share. Moreover, net revenues

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are anticipated in the range of \$1.225-\$1.375 billion. For second-quarter fiscal 2021, NetApp expects non-GAAP gross margin in the range of 66-67% and non-GAAP operating margin to be 16%.

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## Recent News

On Aug 26, NetApp announced quarterly cash dividend of 48 cents per share to be paid out on Oct 28, 2020, to shareholders of record as of Oct 9, 2020.

On Jul 22, NetApp announced updates to its Unified Partner Program. The program is more simplified and expanded to deliver faster digital transformation as well as consistent experience to its business partners.

On Aug 4, NetApp made Azure NetApp files available on Microsoft Azure in the government region data centers. This high-performance file storage service will enable federal, state, and local agencies to easily conform with the stringent government security and regulatory compliance requirements.

On Jul 13, NetApp announced that it has concluded acquisition of Israel-based cloud services startup — Spot. The deal is expected to aid NetApp to address the growing demand for efficient and cost-effective cloud infrastructure and boost customer experience.

On Jun 18, NetApp announced the pricing of \$750K in aggregate principal amount of its 1.875% senior notes due 2025, \$550K in aggregate principal amount of its 2.375% senior notes due 2027 and \$700K in aggregate principal amount of its 2.700% senior notes due 2030. The offering is expected to close on Jun 22, 2020.

## Valuation

NetApp's shares declined 27.5% in the year-to-date period and 5.8% over the trailing 12-month period. While stocks in the Zacks sub-industry are down 30%, same in the Zacks Computer & Technology sector are up 27.6% in the year-to-date period. Over the past year, the Zacks sub-industry is down 16% and the sector is up 43.2%.

The S&P 500 index is up 8.2% in the year-to-date period and 19.5% in the past year.

The stock is currently trading at 12.43X forward 12-month earnings compared with 17.24X for the Zacks sub-industry, 27.62X for the Zacks sector and 23.37X for the S&P 500 index.

In the past five years, the stock has traded as high as 23.65X and as low as 9.06X, with a 5-year median of 16.71X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$47 price target reflects 13.3X 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	12.43	17.24	27.62	23.37
	5-Year High	23.65	17.24	27.62	23.37
	5-Year Low	9.06	9.94	16.72	15.25
	5-Year Median	16.71	12.16	19.6	17.58
P/S F12M	Current	1.88	0.94	4.31	3.82
	5-Year High	3.58	1.41	4.31	3.82
	5-Year Low	1.08	0.8	2.32	2.53
	5-Year Median	2.03	1.13	3.14	3.05
EV/Sales TTM	Current	1.52	1.13	5.01	3.42
	5-Year High	3.22	1.71	5.05	3.46
	5-Year Low	0.49	0.55	2.59	2.15
	5-Year Median	1.45	1.33	3.64	2.88

As of 08/27/2020

## Industry Analysis Zacks Industry Rank: Bottom 4% (241 out of 252)



## Top Peers

Company (Ticker)	Rec	Rank
Dell Technologies Inc. (DELL)	Neutral	3
Netlist, Inc. (NLST)	Neutral	2
Pure Storage, Inc. (PSTG)	Neutral	4
Qumu Corporation (QUMU)	Neutral	4
Seagate Technology PLC (STX)	Neutral	3
Teradata Corporation (TDC)	Neutral	2
Quantum Corporation (QMCO)	Underperform	5
Super Micro Computer, Inc. (SMCI)	Underperform	5

Industry Comparison Industry: Computer- Storage Devices				Industry Peers		
	NTAP	X Industry	S&P 500	PSTG	SMCI	TDC
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Underperform	Neutral
Zacks Rank (Short Term)	4	-	-	4	5	2
VGM Score	A	-	-	B	C	B
Market Cap	9.75 B	793.84 M	23.67 B	3.90 B	1.36 B	2.65 B
# of Analysts	10	4	14	10	1	4
Dividend Yield	4.37%	0.00%	1.64%	0.00%	0.00%	0.00%
Value Score	B	-	-	F	A	C
Cash/Price	0.31	0.19	0.07	0.29	0.15	0.19
EV/EBITDA	8.35	8.35	13.33	-41.26	9.57	16.59
PEG Ratio	1.16	2.26	3.05	3.27	NA	1.24
Price/Book (P/B)	34.31	5.14	3.18	5.14	1.27	7.64
Price/Cash Flow (P/CF)	9.56	9.56	12.81	NA	NA	12.57
P/E (F1)	13.78	13.20	21.68	66.35	12.95	20.50
Price/Sales (P/S)	1.78	1.44	2.50	2.31	0.41	1.44
Earnings Yield	7.45%	4.89%	4.43%	1.49%	7.72%	4.89%
Debt/Equity	9.26	0.19	0.74	0.77	0.01	1.57
Cash Flow (\$/share)	4.59	-0.07	6.94	-0.17	-0.58	1.94
Growth Score	B	-	-	A	D	C
Hist. EPS Growth (3-5 yrs)	27.41%	-7.13%	10.41%	NA	NA	-28.79%
Proj. EPS Growth (F1/F0)	-19.31%	-7.51%	-4.94%	-23.45%	-27.08%	13.10%
Curr. Cash Flow Growth	-17.99%	-37.62%	5.22%	-37.62%	-131.56%	-7.74%
Hist. Cash Flow Growth (3-5 yrs)	1.04%	1.04%	8.50%	11.70%	NA	-17.98%
Current Ratio	1.62	1.62	1.35	3.12	2.25	1.06
Debt/Capital	90.25%	43.38%	43.86%	43.38%	0.53%	61.12%
Net Margin	14.47%	-1.49%	10.25%	-11.25%	2.52%	6.07%
Return on Equity	240.01%	3.31%	14.66%	-13.64%	12.59%	12.92%
Sales/Assets	0.71	0.93	0.50	0.74	1.81	0.89
Proj. Sales Growth (F1/F0)	-6.09%	0.00%	-1.43%	1.11%	1.46%	-6.15%
Momentum Score	A	-	-	A	B	A
Daily Price Chg	4.03%	-0.02%	0.43%	-2.13%	0.62%	-1.06%
1 Week Price Chg	-0.75%	0.00%	-1.45%	2.94%	1.69%	1.58%
4 Week Price Chg	2.47%	1.24%	3.75%	-15.54%	-12.04%	18.20%
12 Week Price Chg	-2.98%	-1.49%	3.95%	-13.86%	-5.77%	11.95%
52 Week Price Chg	-8.33%	-5.12%	2.75%	-7.88%	33.56%	-20.35%
20 Day Average Volume	4,005,681	407,186	1,887,168	4,772,631	525,489	1,240,183
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-0.88%	-16.00%	0.79%	0.00%	-35.34%	87.50%
(F1) EPS Est 12 week change	-2.21%	-5.55%	3.43%	-1.85%	NA	80.18%
(Q1) EPS Est Mthly Chg	1.03%	-1.30%	0.00%	0.00%	-89.83%	173.33%

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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	<b>B</b>
Growth Score	<b>B</b>
Momentum Score	<b>A</b>
VGM Score	<b>A</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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