

NETGEAR, Inc.(NTGR)

\$18.91 (As of 02/27/20)

Price Target (6-12 Months): **\$16.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 02/10/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:D

Value: C

Growth: D

Momentum: B

Summary

NETGEAR reported decent fourth-quarter 2019 results, wherein both the top line and bottom line declined year over year. The company is facing headwinds in EMEA and APAC that is negatively impacting its revenues. Moreover, the company's decision to split into two independent companies involves a fair amount of risk, which might lead to earnings dilution and lower cash flow in the long term. The Zacks Consensus Estimate for current-year earnings has been revised 42.6% downward over the past year to \$1.71, suggesting negative investor sentiments. Seasonality factors and latent trade war threats remain other headwinds. However, NETGEAR intends to capitalize on technology inflections, create new categories and build recurring service revenues to maintain its market leadership and drive growth in the long run.

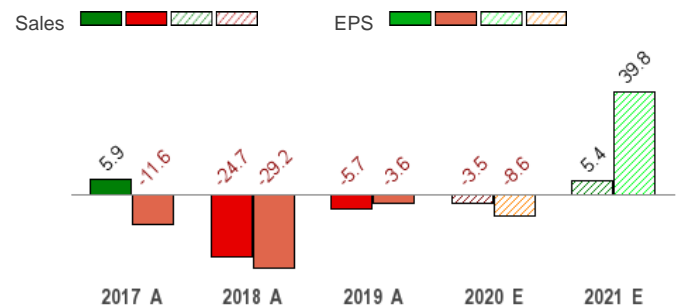
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$37.18 - \$18.08
20 Day Average Volume (sh)	389,406
Market Cap	\$557.0 M
YTD Price Change	-22.9%
Beta	1.57
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computer - Networking
Zacks Industry Rank	Bottom 34% (168 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	17.2%
Last Sales Surprise	3.4%
EPS F1 Est- 4 week change	-34.9%
Expected Report Date	04/22/2020
Earnings ESP	0.0%
P/E TTM	10.1
P/E F1	11.1
PEG F1	NA
P/S TTM	0.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	227 E	232 E	272 E	284 E	1,016 E
2020	208 E	216 E	261 E	278 E	964 E
2019	249 A	231 A	266 A	253 A	999 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.42 E	\$0.48 E	\$0.68 E	\$0.77 E	\$2.39 E
2020	\$0.13 E	\$0.31 E	\$0.51 E	\$0.66 E	\$1.71 E
2019	\$0.60 A	\$0.28 A	\$0.65 A	\$0.34 A	\$1.87 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 02/27/2020. The reports text is as of 02/28/2020.

Overview

Incorporated in January 1996 and headquartered in San Jose, CA, NETGEAR, Inc. is a global telecommunications firm that offers innovative networking and Internet connected products for seamless networking, broadband access and network connectivity. The company's products are built on variety of proven technologies such as wireless (Wi-Fi and LTE), Ethernet and powerline, with a focus on reliability and ease-of-use. These products are available in multiple configurations to address the evolving needs of customers in each geographic region where it operates. Leveraging its technological expertise, high volume manufacturing and engineering infrastructure, NETGEAR designs its products and services to meet the specific needs of consumer, business and service provider markets. The company customizes various elements of the software interface and product design, including component specification, physical characteristics such as casing, design and coloration to meet the individual needs of its clients.

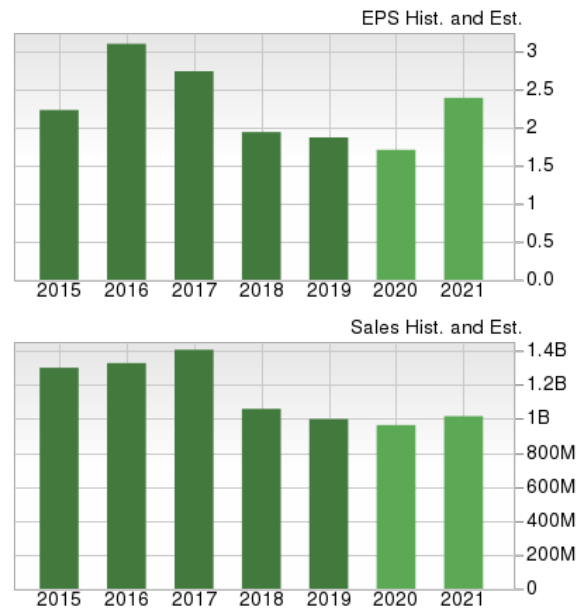
On Dec 31, 2018, NETGEAR completed the spin-off of the Arlo business through a distribution of 62,500,000 shares of Arlo Technologies stock to NETGEAR's shareholders. Prior to that, the company owned approximately 84.2% of Arlo's stock. Following the completion, the company no longer owns any shares of Arlo.

NETGEAR currently operates and reports under two segments: Connected Home, and Small and Medium Business (SMB).

Connected Home (accounting for 72.7% of net revenues in fourth-quarter 2019): Generating the lion's share of revenues, this segment offers high-performance, dependable and easy-to-use LTE and WiFi Internet networking solutions for consumers.

SMB (27.3%): Focused on small and medium-sized businesses, this segment comprises affordable business networking, storage and security solutions for enterprise-class functionality for small and medium-sized businesses.

The company conducts business across three geographic regions: Americas, Europe, Middle-East and Africa (EMEA) and Asia Pacific (APAC).



Reasons To Sell:

- ▼ NETGEAR is facing headwinds in EMEA and APAC that is negatively impacting its revenues, due to geopolitical factors such as Brexit uncertainty, Yuan depreciation and the unexpected economic slowdown in the China/Hong Kong region. In the last reported quarter, the company generated net revenues of \$253 million, down 12.4% from the previous-year quarter, due to manufacturing inefficiencies and delayed shipments of 5G product offerings. Moreover, the company's decision to split into two independent companies involves a fair amount of risk, which may lead to decline in the top line, earnings dilution and lower cash flow in the long term. The company has incurred high costs related to the separation of the Arlo business from NETGEAR.
- ▼ The Zacks Consensus Estimate for current-year earnings has been revised 42.6% downward over the past year to \$1.71, suggesting negative investor sentiments. NETGEAR operates in a highly competitive and dynamic environment. Hence, its future success depends on its ability to develop new products that have broad market acceptance. In order to differentiate its products, the company has to continually invest in research and development activities, which strain its margins. In addition, high technological obsolescence of its product portfolio has led to lower return on capital.
- ▼ The company functions in a rapidly evolving and fiercely competitive market and expects competition to intensify on price. Furthermore, it depends on a limited number of third-party manufacturers for substantially all of its manufacturing needs, primarily based in low-cost countries like China and Vietnam. With various trade restrictions imposed on China, NETGEAR is likely to lose its cost advantage and products can become pricier. The company's business is highly seasonal. It experiences increased sales in the third and fourth fiscal quarters primarily due to seasonal demand from consumer markets relating to the beginning of the school year and holiday season. This leads to volatility in cash flow and reduces the predictability of earnings.

NETGEAR's business is highly seasonal, which causes volatility in cash flow. The company operates in an intense, competitive and dynamic environment that further strains its margins.

Risks

- NETGEAR continues to capitalize on technology inflections, create new categories and build recurring service revenues to maintain its market leadership position and drive future growth. The company's revenues have been driven by the rapid increase in Internet connected devices such as smart phones, laptops, tablets and the advent of Smart Home and Internet of Things devices, which have boosted the need for robust networking solutions. An increased market demand for Smart Home and Internet-connected products such as Smart TVs, game consoles, HD streaming players, security cameras, thermostats and smoke detectors continues to drive innovations in networking. NETGEAR continues to focus on introducing products into growth areas which form the basis of Smart Homes as it strives to be the provider of industry-leading networking and smart connected products for consumers, business and service provider markets.
 - NETGEAR is confident to retain a competitive edge in new product introductions, based on the Wi-Fi 6 standards. The company is excited to be part of AT&T's commitment to be the first to introduce mobile 5G services in the United States, and intends to launch more 5G related products in 2020. Furthermore, it has released Meural Canvas II. Notably, Meural is the world's leading smart digital canvas. NETGEAR also announced an exciting new Meural content partnership with National Geographic.
 - With an exponential growth in data traffic, consumers, businesses and service providers need a complete set of wired and wireless networking and broadband products that are tailored to their specific needs and budgets. The company's products are designed with an industrial appearance, including metal cases, the ability to mount the product within standard data networking racks as well as unique mounting solutions for other uses and targeting the business market. These products typically include higher port counts, higher data transfer rates and other performance characteristics designed to meet the needs of a business user, providing a competitive edge to outsmart its rivals.
 - The company continues to introduce new products and services that hinge on affordability, reliability and ease of use. In order to capitalize on the increasing demand for cloud-based applications for small and medium-sized enterprises, NETGEAR is introducing next generation commercial products. These include PoE switches, Multi-gigabit Ethernet switches, high capacity local and remote unified storage, small to medium capacity campus wireless LAN, and security appliances. These products are likely to augment the effectiveness and efficiency of its hybrid cloud access network and strengthen its position in the market.
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Last Earnings Report

NETGEAR's Q4 Earnings Beat Estimates, Decline Y/Y

NETGEAR reported decent fourth-quarter 2019 results, wherein both the top line and bottom line surpassed the respective Zacks Consensus Estimate. However, both earnings and revenues declined year over year.

Net Income

GAAP net loss from continuing operations in the reported quarter were \$420 million or a loss of 1 cent per share compared with net loss of \$535 million or a loss of 2 cents per share in the year-ago quarter. The year-over-year improvement, despite lower revenues, was due to lower operating expenses and lesser provision for income taxes. In 2019, earnings from continuing operations were \$25.8 million or 81 cents per share compared with \$17.3 million or 52 cents per share in 2018.

Non-GAAP net income from continuing operations was \$10.4 million or 34 cents per share compared with \$22.3 million or 68 cents per share in the year-ago quarter. The bottom line beat the Zacks Consensus Estimate by 5 cents. In full-year 2019, non-GAAP net income from continuing operations was \$59.8 million or \$1.87 per share compared with \$64.4 million or \$1.94 per share in 2018.

Revenues

NETGEAR generated net revenues of \$253 million, down 12.4% from the previous-year quarter, due to manufacturing inefficiencies and delayed shipments of 5G product offerings. However, the top line surpassed the consensus estimate of \$245 million. Full-year revenues, too, declined 5.7% to \$998.8 million from \$1,058.8 million in 2018.

Region wise, net revenues from the Americas were \$169.1 million (66.9% of net revenues), down 11.1% year over year due to channel inventory adjustments. EMEA (Europe, Middle East and Africa) revenues were \$50.5 million (20%), down 14.1%, while APAC (Asia Pacific Region) revenues were \$33.4 million (13.2%), down 16.2% due to geopolitical turmoil in the Greater China region. The number of registered app users recorded in the quarter was 4.4 million, exhibiting significant sequential growth from 3.6 million from third-quarter 2019. Notably, NETGEAR ended the quarter with 177,000 paid subscribers.

Segmental Performance

Connected Home, which includes Nighthawk, Orbi, Nighthawk Pro Gaming and Meural brands, generated net revenues of \$183.9 million, down 14.7% year over year. The decline was primarily attributable to lower revenues in the Greater China region and realignment of channel inventory in North America with downfall in service provider business. Markedly, NETGEAR continues to hold about 52% market share in U.S. retail WiFi products, which include mesh, routers, gateways and extenders.

Net revenues from **SMB** declined 5.7% year over year to \$69.1 million due to Brexit-related uncertainties and geopolitical tension in Greater China, its market share being 53%. NETGEAR also launched new PoE+ switches at the beginning of the reported quarter.

Other Details

Adjusted gross margin declined to 27.9% from 31.7% due to lower revenues. Non-GAAP operating margin was 4.4% compared with 9.4% a year ago due to lower operating income.

Cash Flow & Liquidity

During the fourth quarter, NETGEAR generated nearly \$50 million of cash operating activities. As of Dec 31, 2019, the company had \$190.2 million in cash and equivalents with \$298.4 million of current liabilities compared with the respective tallies of \$201 million and \$384 million a year ago. Moreover, it repurchased approximately 721,000 shares at an average price of \$30.49 per share for \$22 million in the reported quarter.

Q1 Guidance Lowered

NETGEAR has lowered outlook for first-quarter 2020. Management anticipates revenues between \$205 million and \$220 million compared with the previous guidance of \$240-\$255 million, due to reduced service provider shipments and realignment of channel inventory toward WiFi 6 offerings in the existing quarter. The company anticipates GAAP operating margin to be in the vicinity of (1.8)-(0.8)% against prior outlook of 0.1-1.1%, and non-GAAP operating margin in the band of 2-3% compared with 4.5-5.5%.

Moving Forward

NETGEAR is confident that it will remain a leader in new product introduction, based on the efforts to realign channel inventory for an accelerated shift toward WiFi 6 and PoE+ in the United States in the first half of 2020. This, in turn, is further likely to drive positive cash flow amid competitive macro environment. The company also launched five PoE switches and Meural Canvas II, and aims to emerge as a pioneer of best-in-class networking technologies like 5G and WiFi 6, thereby benefiting from advanced technological innovations. Moving forward, NETGEAR intends to boost its registered app user base to pay future dividends, thereby continuing to drive the momentum in 2020.

Quarter Ending **12/2019**

Report Date	Feb 05, 2020
Sales Surprise	3.38%
EPS Surprise	17.24%
Quarterly EPS	0.34
Annual EPS (TTM)	1.87

Recent News

On Feb 11, 2020, NETGEAR announced that it has introduced unconventional Audio-Visual over Internet Protocol applications at the Integrated Systems Europe Conference in Amsterdam with M4500 switches. These switches have been specifically designed to meet the high-end requirements of businesses with ultra-low latency connections within 100 gigabit bandwidth. With this launch, the company has also eased ProAV installations with a dedicated Engineering Services team at no additional cost.

On Jan 9, 2020, NETGEAR announced that it has welcomed Laura Durr to join its board of directors. Ms. Durr joins with a valued background in finance and strategy.

On Jan 6, 2020, NETGEAR announced that it has added Nighthawk Mesh WiFi System to its broad portfolio of WiFi 6 solutions. The move has been undertaken to make Nighthawk's line of performance routers more accessible to a broader spectrum of tech enthusiasts, which primarily highlights personalized network settings with flexible WiFi coverage. Equipped with dual-band technology, the innovative mesh system provides seamless and reliable connections with speeds up to 1.8 Gbps to address gaming, streaming and smart home requirements.

On Jan 6, 2020, NETGEAR announced that it has added Orbi 4G LTE WiFi Router to its much acclaimed Orbi portfolio, as it aims to expand network connectivity of all Internet-connected devices within a household. The move has been undertaken to make the Orbi technology more accessible to a broader spectrum of audience. Demonstrated at CES 2020, the high-tech router has been designed to provide uninterrupted WiFi connection with speeds up to 1.2 Gbps and coverage of up to 2,000 square feet. Its expandable mesh architecture is compatible with Orbi AC satellites, which facilitates consistent and flawless 4K streaming and gaming applications. Backed by a robust cellular network, the WiFi router is compatible with major 4G LTE service providers.

Valuation

NETGEAR shares are down 48.2% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 18% over the past year, but stocks in the Zacks Computer and Technology sector are up 16.8% in the same time frame.

The S&P 500 Index is up 10.3% in the past year.

The stock is currently trading at 9.98X trailing 12-month EV/EBITDA, which compares to 9.33X for the Zacks sub-industry, 12.31X for the Zacks sector and 12X for the S&P 500 Index.

Over the past five years, the stock has traded as high as 14.7X and as low as 3.5X, with a 5-year median of 8.3X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$16 price target reflects 17.02X trailing 12-month book value.

The table below shows summary valuation data for NTGR

Valuation Multiples - NTGR					
		Stock	Sub-Industry	Sector	S&P 500
EV/EBITDA TTM	Current	9.98	9.33	12.31	12
	5-Year High	14.67	13.88	12.61	12.87
	5-Year Low	3.54	5	7.68	8.48
	5-Year Median	8.27	7.21	10.54	10.78
P/B TTM	Current	0.94	4.61	5.29	4.51
	5-Year High	3.27	6.16	5.79	4.9
	5-Year Low	0.94	1.84	3.13	2.85
	5-Year Median	1.88	2.53	4.25	3.62
P/S F12M	Current	0.57	3.44	3.48	3.28
	5-Year High	1.58	4.3	3.58	3.43
	5-Year Low	0.57	2.36	2.3	2.54
	5-Year Median	1.02	3.27	3.05	3.01

As of 02/27/2020

Industry Analysis Zacks Industry Rank: Bottom 34% (168 out of 254)



Top Peers

Seagate Technology PLC (STX)	Outperform
Allot Communications Ltd. (ALLT)	Neutral
Cisco Systems, Inc. (CSCO)	Neutral
Dell Technologies Inc. (DELL)	Neutral
Digi International Inc. (DGII)	Neutral
Infinera Corporation (INFN)	Neutral
Radcom Ltd. (RDCM)	Neutral
Extreme Networks, Inc. (EXTR)	Underperform

Industry Comparison Industry: Computer - Networking				Industry Peers		
	NTGR Underperform	X Industry	S&P 500	CSCO Neutral	EXTR Underperform	INFN Neutral
VGM Score	D	-	-	A	B	D
Market Cap	556.97 M	116.91 M	21.35 B	169.80 B	602.02 M	1.22 B
# of Analysts	4	2	13	12	1	8
Dividend Yield	0.00%	0.00%	2.02%	3.50%	0.00%	0.00%
Value Score	C	-	-	B	B	F
Cash/Price	0.30	0.16	0.04	0.14	0.19	0.06
EV/EBITDA	7.90	7.53	12.70	9.07	21.95	-18.64
PEG Ratio	NA	2.46	1.84	2.10	NA	NA
Price/Book (P/B)	0.94	1.58	2.92	4.78	11.82	2.85
Price/Cash Flow (P/CF)	12.61	12.18	11.89	11.64	8.79	110.67
P/E (F1)	10.84	14.65	16.90	12.29	12.39	NA
Price/Sales (P/S)	0.56	1.66	2.39	3.29	0.59	0.94
Earnings Yield	9.04%	2.84%	5.90%	8.14%	8.07%	-0.74%
Debt/Equity	0.04	0.15	0.70	0.41	8.00	0.90
Cash Flow (\$/share)	1.50	0.18	6.94	3.44	0.58	0.06
Growth Score	D	-	-	C	C	C
Hist. EPS Growth (3-5 yrs)	-7.39%	-1.66%	10.85%	8.60%	-10.04%	NA
Proj. EPS Growth (F1/F0)	-8.69%	30.01%	6.79%	5.08%	17.14%	92.29%
Curr. Cash Flow Growth	102.04%	1.22%	5.92%	6.95%	-31.93%	-123.33%
Hist. Cash Flow Growth (3-5 yrs)	-24.73%	16.42%	8.38%	3.53%	5.33%	32.06%
Current Ratio	2.49	2.24	1.23	1.81	0.99	1.47
Debt/Capital	4.01%	14.59%	42.53%	28.97%	88.89%	47.45%
Net Margin	4.01%	-0.45%	11.57%	21.44%	-8.31%	-29.77%
Return on Equity	2.58%	3.13%	16.80%	36.40%	6.55%	-28.35%
Sales/Assets	4.88%	0.90	0.54	0.55	1.16	0.85
Proj. Sales Growth (F1/F0)	1.03	0.00%	4.07%	-1.78%	0.00%	9.48%
Momentum Score	B	-	-	A	C	C
Daily Price Chg	-5.92%	-1.54%	-3.99%	-5.03%	-8.30%	-3.29%
1 Week Price Chg	0.59%	0.00%	-0.94%	-1.44%	-2.02%	2.52%
4 Week Price Chg	-27.63%	-11.73%	-9.83%	-15.24%	-16.86%	-11.73%
12 Week Price Chg	-22.44%	0.61%	-6.79%	-8.00%	-25.29%	13.02%
52 Week Price Chg	-47.25%	-2.86%	2.79%	-22.66%	-38.20%	32.49%
20 Day Average Volume	-47.25%	21,463	2,169,477	25,031,664	1,374,487	2,198,402
(F1) EPS Est 1 week change	389,406	0.00%	0.00%	0.00%	-53.33%	0.00%
(F1) EPS Est 4 week change	0.00%	-10.00%	-0.09%	0.58%	-80.56%	0.00%
(F1) EPS Est 12 week change	-34.88%	-2.38%	-0.24%	0.58%	-80.56%	0.00%
(Q1) EPS Est Mthly Chg	-34.88%	-30.75%	-0.72%	0.19%	NA	-47.71%
	-189.29%					

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	C
Growth Score	D
Momentum Score	B
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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