Splunk Inc. (SPLK)

$156.53 (As of 01/22/20)

Price Target (6-12 Months): **$180.00**

Long Term: 6-12 Months	**Zacks Recommendation:** **Outperform**
	(Since: 01/21/20)
	Prior Recommendation: Neutral
Short Term: 1-3 Months	**Zacks Rank:** (1-5) **1-Strong Buy**
	Zacks Style Scores: VGM:F
	Value: F	Growth: F	Momentum: F

Summary

Splunk's shares have outperformed the industry in a year's time. The company is expected to benefit from software revenue growth and new customer wins. Moreover, solid demand for cloud-based solutions is anticipated to drive subscription revenues. Management expects cloud contribution to grow significantly over the next few years. Splunk also benefits from the ongoing SIEM replacement cycle. Further, the company's integration with Amazon Web Services (AWS) security Hub to help customers accelerate detection, investigation and response to potential threats within their AWS security environment is a major driver. Moreover, strategic acquisitions are a key catalyst. Further, the successful transition to a renewable model from perpetual license model is expected to drive the top line in the long haul.
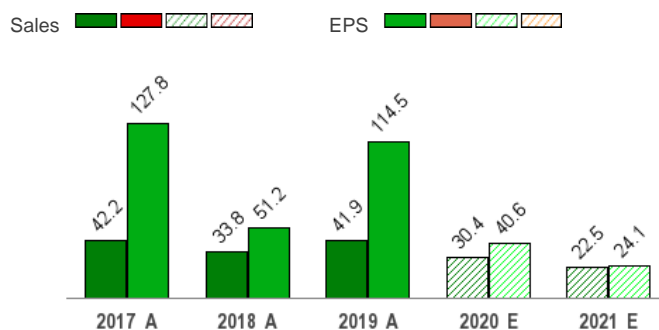
Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$161.49 - $107.16**
20 Day Average Volume (sh)	**1,140,379**
Market Cap	**$24.4 B**
YTD Price Change	**4.5%**
Beta	**2.06**
Dividend / Div Yld	**$0.00 / 0.0%**
Industry	**Internet - Software**
Zacks Industry Rank	**Top 40% (103 out of 255)**
Last EPS Surprise	**11.5%**
Last Sales Surprise	**3.8%**
EPS F1 Est- 4 week change	**0.0%**
Expected Report Date	**02/27/2020**
Earnings ESP	**1.6%**
P/E TTM	**85.5**
P/E F1	**83.7**
PEG F1	**3.0**
P/S TTM	**11.2**

Sales and EPS Growth Rates (Y/Y %)

Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	527 E	637 E	773 E	961 E	2,881 E
2020	425 A	517 A	626 A	784 E	2,352 E
2019	312 A	388 A	481 A	622 A	1,803 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	-$0.03 E	$0.32 E	$0.69 E	$1.29 E	$2.32 E
2020	$0.02 A	$0.30 A	$0.58 A	$0.96 E	$1.87 E
2019	-$0.07 A	$0.08 A	$0.38 A	$0.93 A	$1.33 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/22/2020. The reports text is as of 01/23/2020.

Overview

San Francisco, CA-based Splunk provides software solutions that enable enterprises to gain real-time operational intelligence by harnessing the value of their data. The company's offerings enable users to investigate, monitor, analyze and act on machine data and big data, irrespective of format or source, and helps in operational decision making.

The company's flagship offering, Splunk Enterprise, is primarily a machine data platform. It can collect and index petabytes of machine data on a daily basis. Splunk Enterprise also enables users to interactively explore, analyze and visualize data stored in sources such as Hadoop and Amazon S3.

Splunk Cloud delivers the benefits of Splunk Enterprise deployed and managed reliably and scalably as a service. Splunk Light provides log search and analysis, which are designed, priced and packaged for small IT environments.

The company's premium solutions include Splunk Enterprise Security (ES), Splunk IT Service Intelligence (ITSI) and Splunk User Behavior Analytics (UBA). These solutions address emerging security threats and information and event management (SIEM), monitor health and key performance indicators of critical IT, and detect cyber-attacks and insider threats in business operations, respectively.

EPS Hist. and Est.

Sales Hist. and Est.

Splunk complements the aforementioned services with few add-ons, including Splunk Machine Learning Toolkit (MLTK), Splunk App for AWS, Splunk DB Connect and Cisco Firepower App for Splunk.

Splunk generated revenues of $1.80 billion in fiscal 2019. License revenues contributed 57.1% to total revenues, while maintenance and services revenues accounted for the rest.

Splunk Enterprise customers pay license fees generally based on their estimated peak daily indexing capacity needs. The company also generates revenues from enterprise adoption agreements (EAAs). Splunk Cloud customers pay an annual subscription fee based on the combination of the volume of data indexed per day and the amount of data stored.

The company faces significant competition from the likes of Oracle, IBM, Intel and Microsoft, among others.
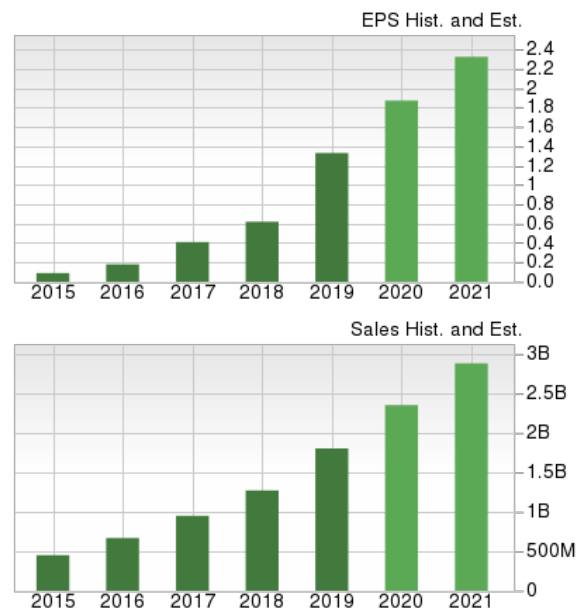
Reasons To Buy:

▲ Splunk's software offerings enables users to have deep insight of their data on a real-time basis, thereby making the operational decision-making process faster. The company's software has a broad range of applications, including security analytics, business analytics and IT operations. The valuable insight into machine and big data is allowing users/enterprises to improve service levels, reduce operational costs, mitigate security risks and maintain compliance. Splunk's customer base is expanding rapidly due to these factors. Notably, the company had 18,000 customers in more than 130 countries as of Apr 30, 2019.

▲ Splunk's software can be deployed in a wide variety of computing environments, from a single laptop to large globally distributed data centers as well as public, private and hybrid cloud environments. The company's top line is benefiting from high demand for its cloud solutions. Splunk's ES solutions also hold promise. Users leverage ES to centralize security management on a single platform and better handle the big data scale of their security operations center. Splunk also benefits from the ongoing SIEM replacement cycle. Further, the company's integration with Amazon Web Services (AWS) security Hub to help customers accelerate detection, investigation and response to potential threats within their AWS security environment is a key catalyst for the long haul.

▲ The company's business transition from perpetual licenses to subscription or renewable model is expected to benefit it in the long run. Splunk has been witnessing an increase in the number of renewable terms contracts, which is a tailwind. Notably, on year-to-date basis, total contract value (TCV) contribution from renewable software is 91% compared with 77% in fiscal 2019. Additionally, cloud ARR was $368 million in third-quarter fiscal 2020. These indicate strong subscription revenue growth for the rest of fiscal 2020.

▲ Splunk's aggressive acquisition strategy has played a pivotal part in developing its business over the last couple of years. The SignalFx acquisition makes the company a leader in cloud monitoring and APM for organizations transitioning to cloud. The VictorOps buyout helps it in addressing the needs of DevOps, which is a rapidly growing domain of software engineering. The acquisition of Phantom Cyber aided in the addition of security orchestration, automation and response to Splunk's portfolio. The buyout of Rocana has strengthened the company's machine data platform. Some of the other acquisitions include SignalSense, Drastin and Caspida, among others. These acquisitions are helping the company not only address the needs of IT operations but also DevOps. Splunk is expected to continue pursuing acquisitions in order to expand its portfolio and increase market share over the long term.

▲ Moreover, the company's strong partner base is a major top-line growth driver. The Splunk Partner+ Program includes more than 1,700 active partners, of which almost 1,000 partners contribute to sales. In fact, these partners are responsible for expanding Splunk's footprint in EMEA, APAC and the U.S. public sector. Further, partnerships with the likes of Cisco Systems, Deloitte and AWS are expected to boost the company's competitive position in the long haul.

> Splunk benefits from a rapidly expanding user base, high demand for cloud solutions, increase in renewable subscription revenues, acquisitions and strong partner base.

Risks

- Splunk's top line over the last couple of years has been negatively impacted by the ongoing business model transition. Moreover, the transition from perpetual licenses to subscription or renewable-based model has severely hurt the company's cash flow generation ability due to lower upfront payment. Although long-term cash yield is expected to return to the mid-20% level, the company is unsure about the time frame.

- Moreover, the maintenance & services segment revenues are slowing down due to the ongoing transition to the cloud. Splunk relies on partners to provide maintenance and professional services (since it's a low-margin business), which is another reason behind the declining growth. This trend is expected to continue as the company projects cloud to account for 50% of total revenues over the next few years.

- Splunk generates a significant portion of revenues (29% in fiscal 2019) from its international operations. Despite its hedging program, the exposure makes the company vulnerable to foreign currency volatility.

- Splunk also faces significant competition across most of its product lines. Its competitors include the likes of BMC Software, CA Technologies, Micro Focus, IBM, Intel, Microsoft and VMware in the security and systems market. In the business intelligence market, Splunk competes with IBM and Oracle. Moreover, in the big data market it faces intensifying competition from the likes of Elastic.

- Splunk is a highly leveraged company. This is indicated by the fact that the ratio of its long-term debt-to-equity is currently 130.1% compared with industry's 25.5%.

Last Earnings Report

Splunk's Q3 Earnings Gain on Cloud and Software Revenues

Splunk reported third-quarter fiscal 2020 non-GAAP earnings of 58 cents per share, which beat the Zacks Consensus Estimate by 11.5% and surged 52.6% year over year.

Revenues soared 30.2% year over year to $626.3 million and comfortably beat the Zacks Consensus Estimate by 4%. The year-over-year upside was driven by greater utilization of Splunk's products by existing customers and new customer wins.

Quarter Ending	10/2019
Report Date	Nov 21, 2019
Sales Surprise	3.80%
EPS Surprise	11.54%
Quarterly EPS	0.58
Annual EPS (TTM)	1.83

Quarter in Details

License revenues (59.7% of revenues) were $373.7 million, up 33.6% year over year. Maintenance & service revenues (40.3% of revenues) rose 25.5% to $252.7 million.

Software revenues jumped 40% from the year-ago quarter to $454 million. Splunk stated that 92% of software bookings were either term or cloud.

Third-quarter remaining performance obligation (RPO) was $1.45 billion, up 52% year over year. The company expects to recognize $862 million (up 42% year over year) of this RPO as revenues over the next 12 months.

RPO bookings grew 42% year over year to $839 million.

Cloud revenues soared 78% from the year-ago quarter to $80 million on the back of increased utilization of cloud-based services. Management expects cloud's contribution to grow 50% over the next few years. In the reported quarter, Cloud ARR was $368 million.

Splunk announced it received FedRAMP authorization from the General Services Administration (GSA) FedRAMP Program Management Office (PMO) at a moderate impact level. Agencies that are eager to remove the barrier between data and action will be able to use Splunk Cloud to turn data into doing.

The company continues its successful transition to a subscription or renewable model, which is evident from the fact that Splunk met its 75% transition rate for fiscal 2020 in fiscal 2019 itself. However, this transition is a headwind for the perpetual business, which is declining rapidly.

Splunk added 450 new enterprise customers in the reported quarter. The company had 134 orders greater than $1 million in total contract value, up 21% from 111 last year.

Splunk unveiled its Data-to-Everything Platform in the third quarter including new products such as Data Fabric Search (DFS), Data Stream Processor (DSP) and Splunk Mission Control.

Additionally, the company also announced new versions of Splunk Enterprise 8.0 and Splunk Enterprise Security 5.0, designed to process massive scale to data in any form.

Operating Details

Non-GAAP gross margin expanded 120 basis points (bps) from the year-ago quarter to 85.7%, driven by large-scale efficiencies in Splunk's cloud business. Cloud delivered a gross margin of more than 50%, marking a milestone achievement, per the company. Splunk's long-term cloud gross margin target is 70% or more.

Operating expenses, as a percentage of revenues, declined 200 bps on a year-over-year basis to 68.9%. Research & development (R&D) expanded 100 bps, while sales & marketing (S&M) expenses decreased 300 bps year over year, respectively.

Non-GAAP operating profit was $105.5 million, up 61.3% from the year-ago quarter. Operating margin expanded 320 bps on a year-over-year basis to 16.8%.

Third Quarter Developments

Splunk announced the acquisition of Omnition, a stealth-mode SaaS company that is innovating in distributed tracing and improving monitoring across micro-services applications.

The company also announced acquisition of the open source distributed messaging leader Streamlio. Management expects that the acquisition will help accelerate Splunk's real-time stream processing.

Balance Sheet & Cash Flow

As of Oct 31, 2019, cash & cash equivalents, including investments, were $873.5 million compared with $1.67 billion reported in the previous quarter.

Cash outflow from operations was $134.8 million due to rapid growth of the multi-year term and cloud contracts.

Guidance

For fourth-quarter fiscal 2020, Splunk expects revenues of roughly $780 million. Non-GAAP operating margin is likely to be 23%.

Management expects that the elimination of perpetual licenses will increase renewable mix to 99% in the fourth quarter and high 90% for fiscal

2020.

For fiscal 2020, Splunk anticipates revenues of almost $2.35 billion, up from the previous guidance of $2.3 billion. The company maintains its non-GAAP operating margin target of 14%.

The company now expects operating cash outflow for the remainder of the fiscal. Splunk projects operating cash outflow of $300 million for fiscal 2020.

Recent News

On Dec 17, Splunk announced the expansion of its footprint to 11 global innovation hubs in locations spanning Canada, Poland, Singapore, the United Kingdom and the United States.

On Oct 22, Splunk announced the expansion of its data access, Data Fabric Search and Data Stream Processor, which will help customers solve any data problem at any scale.

On Oct 22, Splunk announced that it has enhanced its IT operations portfolio with new versions of Splunk IT Service Intelligence (ITSI) and Splunk App for Infrastructure (SAI) among others.

On Oct 22, Splunk announced the launch of its security solution, Splunk Mission Control modernize and unify the Security Operations Center (SOC).

On Oct 22, Splunk announced that it has received FedRAMP Authorization at a moderate impact level, which will enable Fed agencies to use software from Splunk to solve their IT, security and IoT issues.

On Oct 22, Splunk announced investment in Zonehaven, a cloud-based analytics application designed to help communities improve evacuations and reduce wildfire risk with data.

On Oct 2, Splunk announced that it has completed the acquisition of SignalFx, a SaaS leader in real-time monitoring and metrics for cloud infrastructure, microservices and applications.

Valuation

Splunk shares are up 11.8% in the six-months period and 30.5% over the trailing 12-month period. Stocks in the Zacks sub-industry is down 4% while the Zacks Computer & Technology sector is up 15.1% in the six-months period. Over the past year, the Zacks sub-industry and the sector are up 17.2% and 33.8%, respectively.

The S&P 500 index is up 10.8% in the six-months period and 24.9% in the past year.

The stock is currently trading at 8.51X forward 12-month sales, which compares to 6.49X for the Zacks sub-industry, 3.75X for the Zacks sector and 3.56X for the S&P 500 index.

Over the past five years, the stock has traded as high as 16.78X and as low as 4.65X, with a 5-year median of 7.84X. Our Outperform recommendation indicates that the stock will perform better than the market. Our $180 price target reflects 9.79X forward 12-month sales.

The table below shows summary valuation data for SPLK

Valuation Multiples - SPLK		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	8.51	6.49	3.75	3.56
	5-Year High	16.78	15.61	3.75	3.56
	5-Year Low	4.65	3.03	2.3	2.54
	5-Year Median	7.84	5.31	3.01	3
EV/Sales TTM	Current	10.43	7.05	4.41	3.33
	5-Year High	17.35	11.57	4.41	3.33
	5-Year Low	4.48	3.01	2.56	2.16
	5-Year Median	8.94	5.98	3.46	2.8
P/B TTM	Current	13.37	7.25	5.62	4.54
	5-Year High	16.58	8.17	5.62	4.55
	5-Year Low	4.66	2.28	3.13	2.85
	5-Year Median	10.85	5.16	4.22	3.61

As of 01/22/2020

Industry Analysis Zacks Industry Rank: Top 40% (103 out of 255)

Top Peers

Check Point Software Technologies Ltd. (CHKP)	Neutral
Citrix Systems, Inc. (CTXS)	Neutral
FireEye, Inc. (FEYE)	Neutral
F5 Networks, Inc. (FFIV)	Neutral
Fortinet, Inc. (FTNT)	Neutral
Okta, Inc. (OKTA)	Neutral
Palo Alto Networks, Inc. (PANW)	Neutral
Proofpoint, Inc. (PFPT)	Neutral

Industry Comparison Industry: Internet - Software / Industry Peers

	SPLK Outperform	X Industry	S&P 500	FFIV Neutral	FTNT Neutral	PANW Neutral
VGM Score	F	-	-	B	B	F
Market Cap	24.41 B	693.00 M	24.65 B	8.04 B	20.15 B	23.88 B
# of Analysts	16	5	13	9	13	17
Dividend Yield	0.00%	0.00%	1.77%	0.00%	0.00%	0.00%
Value Score	F	-	-	C	F	F
Cash/Price	0.07	0.11	0.04	0.12	0.10	0.12
EV/EBITDA	-362.62	-1.88	13.98	11.60	45.88	51.94
PEG Ratio	3.01	2.63	2.05	1.76	3.10	2.12
Price/Book (P/B)	13.37	5.27	3.38	4.52	16.79	15.74
Price/Cash Flow (P/CF)	NA	35.50	13.60	14.05	58.71	48.22
P/E (F1)	83.71	58.24	19.07	12.90	43.46	49.19
Price/Sales (P/S)	11.15	4.44	2.69	3.59	9.84	7.92
Earnings Yield	1.19%	0.77%	5.24%	7.75%	2.30%	2.03%
Debt/Equity	1.06	0.10	0.72	0.00	0.00	1.20
Cash Flow ($/share)	-0.47	-0.01	6.94	9.42	2.01	5.05
Growth Score	F	-	-	D	A	C
Hist. EPS Growth (3-5 yrs)	NA%	16.72%	10.60%	15.32%	91.94%	NA
Proj. EPS Growth (F1/F0)	40.69%	14.46%	7.53%	-1.03%	12.52%	-9.09%
Curr. Cash Flow Growth	-25.40%	3.33%	13.90%	2.02%	128.85%	119.25%
Hist. Cash Flow Growth (3-5 yrs)	-1.16%	14.22%	9.00%	9.12%	36.70%	69.30%
Current Ratio	2.33	1.55	1.22	1.37	1.84	1.78
Debt/Capital	51.52%	19.79%	42.99%	0.00%	0.00%	54.51%
Net Margin	-14.24%	-14.19%	11.21%	19.07%	19.23%	-3.42%
Return on Equity	-11.03%	-12.09%	17.16%	31.79%	25.46%	2.43%
Sales/Assets	0.47	0.66	0.55	0.72	0.62	0.48
Proj. Sales Growth (F1/F0)	30.43%	17.63%	4.08%	4.02%	14.82%	19.43%
Momentum Score	F	-	-	A	A	D
Daily Price Chg	-0.36%	0.00%	-0.04%	-2.04%	0.15%	0.21%
1 Week Price Chg	1.40%	2.22%	2.29%	1.37%	2.77%	1.77%
4 Week Price Chg	4.11%	7.39%	2.05%	-4.55%	9.32%	5.15%
12 Week Price Chg	29.93%	7.50%	6.92%	-7.99%	42.60%	7.38%
52 Week Price Chg	31.05%	0.35%	21.50%	-17.14%	64.83%	18.48%
20 Day Average Volume	1,140,379	238,087	1,518,423	443,534	832,842	767,423
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-0.05%	0.34%	0.00%
(F1) EPS Est 12 week change	2.27%	-0.09%	-0.23%	0.36%	15.09%	-146.67%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.33%	0.00%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Value Score	F
Growth Score	F
Momentum Score	F
VGM Score	F

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.

Disclosures

This report contains independent commentary to be used for informational purposes only. The analysts contributing to this report do not hold any shares of this stock. The analysts contributing to this report do not serve on the board of the company that issued this stock.The EPS and revenue forecasts are the Zacks Consensus estimates, unless indicated otherwise on the reports first page. Additionally, the analysts contributing to this report certify that the views expressed herein accurately reflect the analysts personal views as to the subject securities and issuers. ZIR certifies that no part of the analysts compensation was, is, or will be, directly or indirectly, related to the specific recommendation or views expressed by the analyst in the report.

Additional information on the securities mentioned in this report is available upon request. This report is based on data obtained from sources we believe to be reliable, but is not guaranteed as to accuracy and does not purport to be complete. Any opinions expressed herein are subject to change.

ZIR is not an investment advisor and the report should not be construed as advice designed to meet the particular investment needs of any investor. Prior to making any investment decision, you are advised to consult with your broker, investment advisor, or other appropriate tax or financial professional to determine the suitability of any investment.This report and others like it are published regularly and not in response to episodic market activity or events affecting the securities industry.

This report is not to be construed as an offer or the solicitation of an offer to buy or sell the securities herein mentioned. ZIR or its officers, employees or customers may have a position long or short in the securities mentioned and buy or sell the securities from time to time.ZIR is not a broker-dealer.ZIR may enter into arms-length agreements with broker-dealers to provide this research to their clients.Zacks and its staff are not involved in investment banking activities for the stock issuer covered in this report.

ZIR uses the following rating system for the securities it covers. **Outperform-** ZIR expects that the subject company will outperform the broader U.S. equities markets over the next six to twelve months. **Neutral-** ZIR expects that the company will perform in line with the broader U.S. equities markets over the next six to twelve months. **Underperform-** ZIR expects the company will underperform the broader U.S. equities markets over the next six to twelve months.

No part of this report can be reprinted, republished or transmitted electronically without the prior written authorization of ZIR.