

VMware, Inc.(VMW)

\$115.74 (As of 03/27/20)

Price Target (6-12 Months): **\$98.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 03/03/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)
5-Strong Sell

Zacks Style Scores:

VGM:F

Value: F

Growth: D

Momentum: C

Summary

VMware shares have underperformed the industry in the past year. Apart from an unfavorable revenue mix, which is expected to hurt license revenues, margins are anticipated to be under pressure due to ongoing investments in hybrid cloud and SaaS portfolio expansions. The company scrapped its first-quarter and fiscal 2021 guidance due to the disruptions caused by the COVID-19 outbreak. The Carbon Black and Pivotal acquisition is also likely to dent operating margin in full fiscal. Moreover, the company is enduring stiff competition. Nevertheless, VMware's widening cloud customer base is driven by partnerships with the likes of AWS, IBM, Microsoft, Google, Oracle and Alibaba. Acquisitions along with a growing Tanzu portfolio are expected to boost recurring hybrid cloud subscription and SaaS revenues in the long haul.

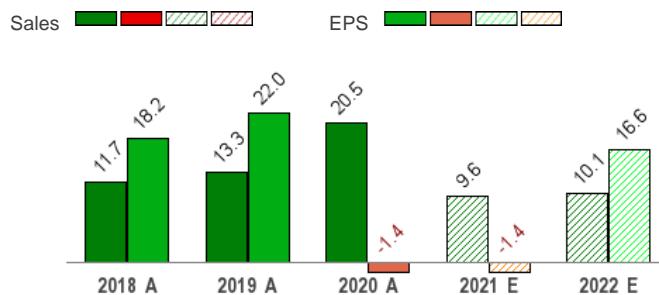
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$206.80 - \$86.00
20 Day Average Volume (sh)	2,375,101
Market Cap	\$47.4 B
YTD Price Change	-23.8%
Beta	0.96
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computer - Software
Zacks Industry Rank	Top 23% (59 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-5.1%
Last Sales Surprise	4.3%
EPS F1 Est- 4 week change	-23.4%
Expected Report Date	NA
Earnings ESP	-4.5%
P/E TTM	17.9
P/E F1	18.8
PEG F1	1.4
P/S TTM	4.6

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	2,961 E	3,182 E	3,223 E	3,751 E	13,047 E
2021	2,684 E	2,872 E	2,914 E	3,336 E	11,850 E
2020	2,266 A	2,439 A	2,456 A	3,073 A	10,811 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.43 E	\$1.74 E	\$1.72 E	\$2.29 E	\$7.17 E
2021	\$1.21 E	\$1.44 E	\$1.46 E	\$1.99 E	\$6.15 E
2020	\$1.32 A	\$1.60 A	\$1.49 A	\$2.05 A	\$6.24 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 03/27/2020. The reports text is as of 03/30/2020.

Overview

Headquartered in Palo Alto, CA, VMware Inc. is a leading provider of virtualization solutions. Its product portfolio addresses the needs of clients, both individuals and organizations. The company specializes in providing virtualization platforms, virtual infrastructure automation and virtual infrastructure management.

VMware's suite of virtualization solutions addresses a range of complex IT problems, including infrastructure optimization, business continuity, software lifecycle management and desktop management.

VMware develops and markets its product and service offerings within three main product groups. These are SDDC or software-defined data center, End-User Computing (EUC) and Hybrid Cloud Computing.

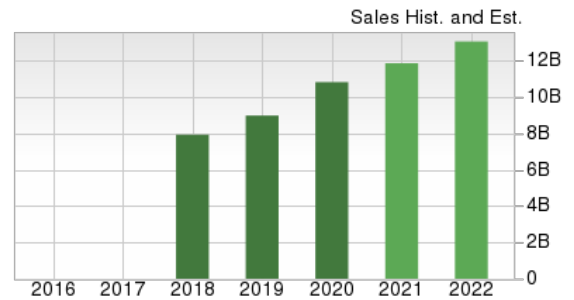
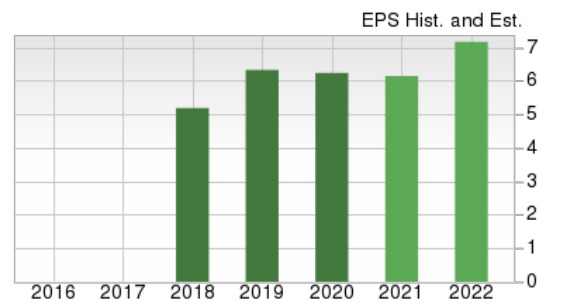
VMware's SDDC architecture consists of four main product categories — Compute, Cloud Management, Networking and Security, and Storage and Availability.

In Sep 2016, VMware's parent-company EMC was acquired by Dell for \$67 billion. The new company named Dell Technologies holds approximately 80.5% of VMware shares, as of Feb 1, 2019.

Moreover, VMware revised fiscal calendar effective Jan 1, 2017. The company's first fiscal year under its revised calendar began on Feb 4, 2017 and ended on Feb 2, 2018.

In fiscal 2019, VMware reported revenues worth \$10.81 billion. License, Subscription and SaaS, and Services contributed 29.4%, 17.4% and 53.2% to revenues, respectively.

Region wise, the United States and International accounted for 50% of revenues each.



Reasons To Sell:

- ▼ Intensifying competition from providers of public cloud infrastructure and SaaS-based offerings, including AWS, Microsoft Azure and vendors like Oracle (free server virtualization software) and Cisco (network virtualization technology), are major concerns. Moreover, we also expect increased competition from open source companies that are targeting data center virtualization and private cloud, including Red Hat, now a part of IBM, and Nutanix. The stiff competitive environment hurts VMware's pricing ability, which impacts profitability.
- ▼ Growth in license bookings has been muted for the last few quarters owing to customer delays and macro-economic weakness in some key regions. Though the decline in compute license bookings is slowing down, it can weigh on the financials in the near term.
- ▼ VMware's balance sheet is highly leveraged, which restricts its ability to invest in growth opportunities, including acquisitions. The company's net debt position was \$2.56 billion as of Jan 31, 2020.
- ▼ VMware's frequent acquisitions have escalated integration risks. Moreover, we note that the large acquisitions negatively impacted the company's balance sheet in the form of high level of goodwill and intangible assets, which totaled \$10.50 billion or almost 39.9% of total assets, as of Jan 31.

Intensifying competition, sluggish license bookings and leveraged balance sheet are major headwinds.

Risks

- VMware has placed itself well to benefit from the increasing adoption of cloud-based solutions. Enabling software support on cloud is a positive as many enterprises now prefer public cloud platforms like Amazon Web Services (AWS), Microsoft's Azure and Google Cloud. VMware has partnered AWS to offer an integrated hybrid cloud solution, functioning much like a SDDC. Moreover, VMware and AWS have expanded their partnership that now enables the latter to resell VMware Cloud on the platform. VMware Cloud on AWS is now available in 17 regions globally. Notably, the overall node count increased more than four times in the past year. The company has expanded partnership with IBM to include a new IBM Service offering that will help migrate and extend mission-critical VMware workloads to the IBM Cloud. It also encompasses new integrations to help enterprises modernize applications with Kubernetes and containers. Further, partnerships with Alibaba and Rackspace are expected to drive VCPP growth in the long haul.
 - VMware has been consistently taking initiatives to diversify its product portfolio to include most of the IT infrastructure. The company's offerings in domains like SDDC (vSphere, vSAN, NSX), hybrid cloud (vCloud Air, VMware Cloud Provider Program) and EUC (AirWatch, Horizon) have helped it to gain market share. As a part of its product strategy, the company aims bring SDDC mainstream and vCloud Air as an important hybrid cloud platform, getting an edge to win customers in network architecture (especially in NSX and vSAN) and solidifying its position in the business mobility market.
 - The addition of Carbon Black solutions equips VMware's existing security portfolio to uniquely and radically reduce the attack surface and provide deep protection across infrastructure, applications and endpoints. Post the completion of the acquisition, VMware launched a new security business unit, including Carbon Black and AppDefense offerings. Moreover, Dell is promoting Carbon Black Cloud, along with Dell Trusted Devices and Secureworks, as the preferred endpoint security solution its commercial customers. Customer base also expanded as VMware added more than 5K customers, which doubled Carbon Black's total customer count to more than 10K.
 - Moreover, the Heptio and Pivotal acquisitions combined with the VMware Cloud native offerings make up the Tanzu, a portfolio of products and services designed to transform the way enterprises build, run and manage application software. VMware aims to simplify the use of Kubernetes in a multi-cloud environment by offering this solution. Moreover, the Nyansa acquisition will enable VMware to deliver an end-to-end network visibility monitoring and remediation solution within VMware SD-WAN. Addition of Nyansa's artificial intelligence (AI) & machine learning (ML) capabilities to VMware's existing network and security portfolio will further strengthen the company's ability to enable self-healing networks. These new solutions based on the recent acquisitions are expected to drive the top line in fiscal 2021 and beyond.
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Last Earnings Report

VMware Q4 Earnings Lag Estimates, Revenues Rise Y/Y

VMware's fourth-quarter fiscal 2020 non-GAAP earnings of \$2.05 per share missed the Zacks Consensus Estimate by 5.1% but increased 9.6% year over year.

Revenues of \$3.07 billion surpassed the consensus mark by 4.3% and also improved 11.4% on a year-over-year basis.

Strong top-line growth was primarily driven by robust performances in NSX and vSAN product lines. Management stated that it inked 31 deals in the quarter worth more than \$10 million.

Region-wise, U.S. revenues (51.1% of revenues) increased 11.4% to \$1.57 billion. International revenues (48.9%) grew 1.7% from the year-ago quarter to \$1.50 billion.

Services revenues (46.8% of total revenues) rose 9.6% to \$1.44 billion. License revenues (33.6%) inched up 0.7% year over year to \$1.03 billion.

Subscription and SaaS revenues (18.1% of total revenues) jumped 51.5% year over year to \$556 million.

Robust Bookings

The company announced that six of its top 10 customers purchased the entire VMware Cloud Foundation stack in the reported quarter.

NSX adoption was impressive as product bookings (includes Subscription and SaaS, and license bookings, equivalent to license bookings as stated in prior periods) increased more than 20% year over year. Notably, all the top 10 deals in the quarter included NSX.

Furthermore, vSAN product bookings (includes Subscription and SaaS, and license bookings, equivalent to license bookings as stated in prior periods) increased in mid-teens year over year. The product was included in all the top 10 deals.

EUC product bookings (includes Subscription and SaaS, and license bookings, equivalent to license bookings as stated in prior periods) were up more than 30% on a year-over-year basis and included in eight of the top 10 deals. Customers continued to increase their SaaS purchases of Workspace ONE. More than two-thirds of EUC product bookings were sold as SaaS in the reported quarter.

Core SDDC product bookings (includes Subscription and SaaS, and license bookings, equivalent to license bookings as stated in prior periods) decreased in the low-single digits year over year. Total core SDDC bookings were flat year over year.

At the end of the quarter, VMware had license backlog of \$5 million and total backlog of \$18 million.

Notably, remaining performance obligations that capture all of VMware's committed and non-cancelable future revenues, both billed and unbilled, including future revenues related to its growing hybrid cloud subscription and SaaS businesses were \$10.3 billion at the end of the quarter.

Operating Details

Research & development (R&D) expenses as a percentage of revenues slipped 10 basis points (bps) year over year to 17.7%. Moreover, sales & marketing (S&M) expenses as a percentage of revenues decreased 60 bps on a year-over-year basis to 28.7%.

General & administrative (G&A) expenses as a percentage of revenues increased 40 bps to 6.6%.

Non-GAAP operating expenses as a percentage of revenues dipped 30 bps on a year-over-year basis to 52.9%.

Non-GAAP operating margin expanded 20 bps on a year-over-year basis to 34.3% in the reported quarter.

Balance Sheet & Cash Flow

As of Jan 31, 2020, cash & cash equivalents were \$2.92 billion compared with \$2.03 billion as of Nov 1, 2019.

Operating cash flow was \$1.09 billion in the reported quarter while free cash flow was \$1.02 billion. In the previous quarter, operating cash flow was \$810 million and free cash flow was \$760 million.

In the reported quarter, VMware bought back shares worth \$55 million. The company has approximately \$1 billion remaining under its current share repurchase authorization, which extends through the end of fiscal 2021.

Guidance

For fiscal 2021, VMware now expects revenues of \$12.050 billion, suggesting an 11.5% rise from the year-ago reported figure.

Subscription & SaaS and License Revenue are expected to be \$5.860 billion, implying a 15.9% increase from the prior-year reported number. More than 40% of these revenues is expected to come from Subscription & SaaS.

Non-GAAP operating margin is anticipated to be 28.8%. Non-GAAP earnings are expected to be \$6.55 per share.

Cash flow from operations is expected to be \$4.10 billion. Free cash flow is anticipated to be \$3.76 billion.

Quarter Ending 01/2020

Report Date	Feb 27, 2020
Sales Surprise	4.26%
EPS Surprise	-5.09%
Quarterly EPS	2.05
Annual EPS (TTM)	6.46

For the fiscal first quarter, total revenues are expected to be \$2.73 billion, suggesting 11.4% growth from the year-ago reported figure.

Subscription & SaaS and License Revenues are expected to be \$1.225 billion, hinting at 15.9% growth from the prior-year reported number. More than 45% of these revenues is expected to come from Subscription & SaaS.

Non-GAAP operating margin is anticipated to be 25.1%. Non-GAAP earnings are expected to be \$1.27 per share.

Recent News

On Mar 26, VMware announced the withdrawal of its first-quarter and fiscal 2021 guidance provided on Feb 27. The company cited uncertainty about the impact of the coronavirus spread on its business operations behind the withdrawal.

On Mar 10, VMware announced an expanded portfolio of solutions. VMware Tanzu Portfolio enables enterprises to adopt cloud native technologies and automate the modern application lifecycle on any cloud. Moreover, VMware Cloud Foundation 4 delivers a hybrid cloud platform for modern apps including the native Kubernetes support. Further, new VMware vSphere 7 supports VMware Cloud Foundation Services.

On Jan 21, VMware announced plans to acquire Nyansa, a provider of AI-based network analytics. The addition of Nyansa's AI/ML capabilities to VMware's existing network and security portfolio will make it easier for customers to operate and troubleshoot the Virtual Cloud Network. It will also enhance VMware's ability to enable Self-Healing Networks.

On Dec 30, VMware announced that it has completed the acquisition of Pivotal Software.

Valuation

VMware shares are down 24.7% in the past six-month period and 37.2% over the trailing 12-month period. Stocks in the Zacks sub-industry are up 2.2%, while the Zacks Computer & Technology sector is down 5.6%. Over the past year, the Zacks sub-industry is up 8.5%, while the sector is down 5.5%.

The S&P 500 index is down 13.5% in the past six-month period and 11.8% in the past year.

The stock is currently trading at 18.34X forward 12-month earnings, which compares to 25.52X for the Zacks sub-industry, 19.02X for the Zacks sector and 16.03X for the S&P 500 index.

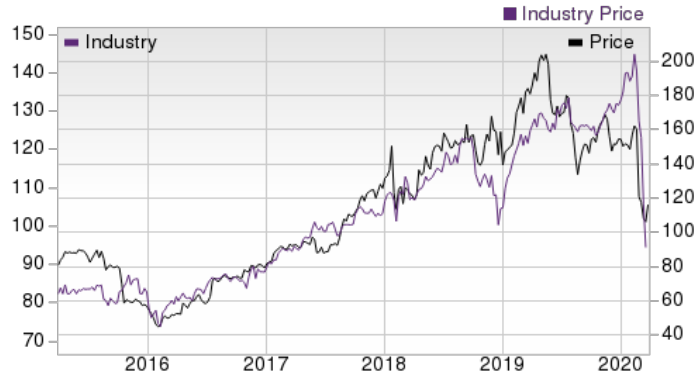
Over the past five years, the stock has traded as high as 40.71X and as low as 12.43X, with a 5-year median of 27.45X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$98 price target reflects 15.53X forward 12-month earnings.

The table below shows summary valuation data for VMW

Valuation Multiples - VMW					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	18.34	25.52	19.02	16.03
	5-Year High	40.71	28.78	22.02	19.34
	5-Year Low	12.43	18.59	16.85	15.18
	5-Year Median	27.45	24.55	19.30	17.42
P/S F12M	Current	3.89	6.41	3.08	2.85
	5-Year High	8.17	7.23	3.58	3.43
	5-Year Low	2.45	3.88	2.30	2.54
	5-Year Median	5.42	5.34	3.07	3.00
EV/Sales TTM	Current	4.72	6.68	3.60	2.65
	5-Year High	9.30	8.13	4.48	3.46
	5-Year Low	1.91	3.19	2.57	2.16
	5-Year Median	5.09	5.40	3.54	2.83

As of 03/27/2020

Industry Analysis Zacks Industry Rank: Top 23% (59 out of 254)



Top Peers

Microsoft Corporation (MSFT)	Outperform
Adobe Systems Incorporated (ADBE)	Neutral
Amazon.com, Inc. (AMZN)	Neutral
Cisco Systems, Inc. (CSCO)	Neutral
Hewlett Packard Enterprise Company (HPE)	Neutral
International Business Machines Corporation (IBM)	Neutral
Nutanix Inc. (NTNX)	Neutral
Oracle Corporation (ORCL)	Neutral

Industry Comparison Industry: Computer - Software				Industry Peers		
	VMW Underperform	X Industry	S&P 500	CSCO Neutral	IBM Neutral	NTNX Neutral
VGM Score	F	-	-	C	D	F
Market Cap	47.44 B	1.44 B	17.63 B	164.63 B	95.97 B	3.30 B
# of Analysts	11	4	13	12	7	11
Dividend Yield	0.00%	0.00%	2.41%	3.61%	6.00%	0.00%
Value Score	F	-	-	C	C	F
Cash/Price	0.05	0.13	0.07	0.18	0.11	0.29
EV/EBITDA	13.45	14.75	10.81	8.78	8.03	-6.09
PEG Ratio	1.41	2.04	1.69	2.28	1.51	NA
Price/Book (P/B)	8.16	4.15	2.35	4.63	4.56	NA
Price/Cash Flow (P/CF)	17.81	17.81	9.47	11.28	5.47	NA
P/E (F1)	18.82	25.67	14.74	12.30	8.27	NA
Price/Sales (P/S)	4.64	3.70	1.89	3.19	1.24	2.64
Earnings Yield	5.31%	3.83%	6.73%	8.14%	12.09%	-17.31%
Debt/Equity	0.63	0.16	0.70	0.41	2.58	-9.13
Cash Flow (\$/share)	6.50	1.20	7.01	3.44	19.75	-2.48
Growth Score	D	-	-	C	D	D
Hist. EPS Growth (3-5 yrs)	14.59%	11.15%	10.85%	8.60%	-3.50%	NA
Proj. EPS Growth (F1/F0)	-1.50%	12.92%	2.89%	1.80%	1.96%	-94.34%
Curr. Cash Flow Growth	23.44%	11.31%	5.93%	6.95%	2.09%	121.11%
Hist. Cash Flow Growth (3-5 yrs)	12.60%	9.27%	8.55%	3.53%	-3.76%	NA
Current Ratio	0.58	1.50	1.23	1.81	1.02	1.64
Debt/Capital	38.53%	20.16%	42.57%	28.97%	72.05%	90.20%
Net Margin	62.27%	7.06%	11.64%	21.44%	12.23%	-68.13%
Return on Equity	48.29%	11.82%	16.74%	36.40%	62.27%	-650.18%
Sales/Assets	0.54	0.64	0.54	0.55	0.53	0.68
Proj. Sales Growth (F1/F0)	16.14%	5.68%	2.37%	-3.80%	-0.57%	8.20%
Momentum Score	C	-	-	D	C	D
Daily Price Chg	-7.20%	-0.47%	-3.35%	-4.34%	-4.31%	-3.92%
1 Week Price Chg	-2.00%	-9.48%	-16.96%	-5.42%	-11.64%	-0.21%
4 Week Price Chg	-14.66%	-17.31%	-18.79%	-3.05%	-18.84%	-27.34%
12 Week Price Chg	-25.64%	-21.87%	-25.68%	-19.83%	-20.23%	-46.89%
52 Week Price Chg	-34.98%	-7.94%	-17.12%	-27.25%	-22.79%	-53.73%
20 Day Average Volume	2,375,101	126,287	4,286,768	49,381,880	9,238,134	5,543,311
(F1) EPS Est 1 week change	-9.52%	0.00%	-0.15%	-2.02%	-2.21%	-2.41%
(F1) EPS Est 4 week change	-23.44%	-0.07%	-2.28%	-3.08%	-2.24%	-4.43%
(F1) EPS Est 12 week change	-23.44%	-0.52%	-3.22%	-2.52%	-1.07%	-4.43%
(Q1) EPS Est Mthly Chg	-28.96%	-0.41%	-1.60%	-8.08%	-8.08%	-15.38%

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	F
Growth Score	D
Momentum Score	C
VGM Score	F

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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