

Fortinet

4Q preview: expect quarter and guidance weakness; yet already in expectations

Maintain Rating: BUY | PO: 75.00 USD | Price: 66.45 USD

Previewing 4Q results, expect another weak quarter

Fortinet is expected to report 4Q results on 2/6 and we expect the focal point to center on two weak trends. First, we expect 4Q and 1Q billings guidance to be weak and model -5% and -6% YoY declines, respectively. Second, we expect service revenue growth to weaken and model 12% growth for 2024 vs. 29% in 2023. At a high level, both trends are already reflected in Street expectations, yet Street estimates need to decline further, in our view. On the positive side, we expect billings growth to recover and climb from -6% decline in 1Q to +10% in 4Q (see detailed estimates on page 3). We also recently published [an analysis of the historical orders \(see report\)](#), suggesting that historical high orders will be largely digested by the end of 1Q24, supporting our expectations for 2H growth recovery. We maintain our Buy rating and \$75 PO.

Expect FY24 guidance to be below consensus

We believe 4Q buy side expectations are directionally in line with the expected weakness, yet FY24 estimates need to be revised further downward. Consensus calls for 4Q23 to be the trough of billings growth, but in our view 1Q billings faces greater seasonality headwinds and continued tough comps and we model -6% decline in 1Q billings vs. the Street's -3% decline. As a result, our FY billings growth of +3% is roughly 300bps lower than Street estimates, despite our faster sequential recovery in 2H24. Additionally, FY23 slowdown in product growth should impact FY24 service revenues and we model FY24 service revenue growth of 12% versus the Street's 18%.

Buy the stock ahead of a recovery cycle

We model an accelerated QoQ recovery of +800bps in 2Q billings growth compared to the Street's +500bps. We believe the underlying demand for hardware-based Firewalls remains solid, and Fortinet's value proposition of lower pricing and greater feature set/throughput should continue to fuel the growth in the long term. By 2H24 we expect supplies of Fortinet's new ASIC chip, FortiSP5, to improve, potentially driving some replacement with the existing installed base. The new chip offers 17x faster Firewall performance compared to competing products, with 88% lower power consumption. Lastly, we also expect Fortinet's new SASE (secure access service edge) solution to start contributing revenues in 2H24 and ramp more meaningfully in 2025. Fortinet's SASE utilizes its Firewalls for a certain level of local processing, making it a cheaper alternative vs. pure Cloud solutions.

| Estimates (Dec) (US\$) | 2021A | 2022A | 2023E | 2024E | 2025E |
|---------------------------|-------|-------|-------|-------|-------|
| EPS | 0.81 | 1.28 | 1.60 | 1.58 | 1.65 |
| GAAP EPS | 0.73 | 1.07 | 1.28 | 1.07 | 1.16 |
| EPS Change (YoY) | 20.9% | 58.0% | 25.0% | -1.3% | 4.4% |
| Consensus EPS (Bloomberg) | | | 1.56 | 1.68 | 1.93 |
| DPS | 0 | 0 | 0 | 0 | 0 |
| Valuation (Dec) | | | | | |
| P/E | 82.0x | 51.9x | 41.5x | 42.1x | 40.3x |
| GAAP P/E | 91.0x | 62.1x | 51.9x | 62.1x | 57.3x |
| EV / EBITDA* | 59.4x | 43.4x | 36.6x | 37.1x | 33.6x |
| Free Cash Flow Yield* | 2.2% | 2.6% | 3.2% | 2.9% | 4.4% |

* For full definitions of *IQmethod*SM measures, see page 5.

30 January 2024

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Stock Data

| | |
|--------------------------------|-----------------------|
| Price | 66.45 USD |
| Price Objective | 75.00 USD |
| Date Established | 12-Jan-2024 |
| Investment Opinion | B-1-9 |
| 52-Week Range | 44.12 USD - 81.24 USD |
| Mkt Val (mn) / Shares Out (mn) | 55,708 USD / 838.4 |
| Free Float | 82.5% |
| Average Daily Value (mn) | 428.07 USD |
| BofA Ticker / Exchange | FTNT / NAS |
| Bloomberg / Reuters | FTNT US / FTNT.OQ |
| ROE (2023E) | 2,206.9% |
| Net Dbt to Eqty (Dec-2022A) | NA |
| ESGMeter TM | High |

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to ["BofA ESGMeter Methodology"](#).

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Timestamp: 30 January 2024 01:00AM EST

iQprofileSM Fortinet

iQmethodSM – Bus Performance*

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|----------------------------|-------|--------|----------|--------|-------|
| Return on Capital Employed | 27.1% | 32.5% | 37.7% | 23.7% | 19.9% |
| Return on Equity | 81.5% | 399.3% | 2,206.9% | 121.9% | 56.3% |
| Operating Margin | 26.2% | 27.4% | 27.3% | 24.4% | 23.8% |
| Free Cash Flow | 1,204 | 1,449 | 1,781 | 1,610 | 2,432 |

iQmethodSM – Quality of Earnings*

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--------------------------|---------|-------|---------|---------|---------|
| Cash Realization Ratio | 2.2x | 1.7x | 1.7x | 1.4x | 1.9x |
| Asset Replacement Ratio | 3.5x | 2.7x | 2.9x | 1.0x | 0.3x |
| Tax Rate | 2.3% | 3.2% | 10.3% | 24.0% | 24.0% |
| Net Debt-to-Equity Ratio | -165.2% | NM | -606.0% | -243.6% | -215.2% |
| Interest Cover | NM | NA | NA | NA | NA |

Income Statement Data (Dec)

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|------------------------------|--------------|--------------|--------------|--------------|--------------|
| Sales | 3,342 | 4,417 | 5,300 | 5,754 | 6,586 |
| % Change | 28.8% | 32.2% | 20.0% | 8.6% | 14.5% |
| Gross Profit | 2,590 | 3,370 | 4,070 | 4,456 | 5,132 |
| % Change | 26.4% | 30.1% | 20.8% | 9.5% | 15.2% |
| EBITDA | 960 | 1,314 | 1,559 | 1,536 | 1,699 |
| % Change | 25.2% | 36.8% | 18.7% | -1.4% | 10.6% |
| Net Interest & Other Income | (22) | 26 | 78 | 170 | 126 |
| Net Income (Adjusted) | 674 | 1,032 | 1,265 | 1,245 | 1,306 |
| % Change | 19.9% | 53.0% | 22.6% | -1.6% | 5.0% |

Free Cash Flow Data (Dec)

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|--|--------------|--------------|--------------|--------------|--------------|
| Net Income from Cont Operations (GAAP) | 610 | 922 | 1,126 | 973 | 1,052 |
| Depreciation & Amortization | 84 | 104 | 113 | 131 | 128 |
| Change in Working Capital | 402 | 233 | 431 | 395 | 1,041 |
| Deferred Taxation Charge | 0 | 0 | 0 | 0 | 0 |
| Other Adjustments, Net | 403 | 471 | 434 | 236 | 254 |
| Capital Expenditure | (296) | (281) | (324) | (126) | (43) |
| Free Cash Flow | 1,204 | 1,449 | 1,781 | 1,610 | 2,432 |
| % Change | 25.7% | 20.4% | 22.9% | -9.6% | 51.1% |
| Share / Issue Repurchase | (742) | (1,991) | (604) | 0 | 0 |
| Cost of Dividends Paid | 0 | 0 | 0 | 0 | 0 |
| Change in Debt | 0 | 0 | 0 | 0 | 0 |

Balance Sheet Data (Dec)

| (US\$ Millions) | 2021A | 2022A | 2023E | 2024E | 2025E |
|---------------------------------------|--------------|--------------|--------------|--------------|---------------|
| Cash & Equivalents | 1,319 | 1,683 | 2,401 | 4,011 | 6,443 |
| Trade Receivables | 808 | 1,262 | 940 | 1,067 | 1,219 |
| Other Current Assets | 1,474 | 866 | 1,584 | 1,600 | 1,316 |
| Property, Plant & Equipment | 688 | 899 | 1,155 | 1,149 | 1,064 |
| Other Non-Current Assets | 1,631 | 1,519 | 1,936 | 2,162 | 2,281 |
| Total Assets | 5,919 | 6,228 | 8,017 | 9,989 | 12,324 |
| Short-Term Debt | 0 | 0 | 0 | 0 | 1 |
| Other Current Liabilities | 2,318 | 3,078 | 3,875 | 4,248 | 4,680 |
| Long-Term Debt | 0 | 0 | 0 | 0 | 1 |
| Other Non-Current Liabilities | 2,803 | 3,431 | 3,746 | 4,095 | 4,650 |
| Total Liabilities | 5,121 | 6,510 | 7,621 | 8,343 | 9,333 |
| Total Equity | 798 | (282) | 396 | 1,646 | 2,993 |
| Total Equity & Liabilities | 5,919 | 6,228 | 8,017 | 9,989 | 12,326 |

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Data Networking

Company Description

Fortinet is a pioneer in the Unified Threat Management (UTM) segment of network security solutions. Its security appliances offer the ability to run multiple security functions simultaneously, without a significant drop in throughput, enabled by Fortinet's unique custom-ASIC architecture.

Investment Rationale

We view Fortinet as a strong competitor in the network security space. We believe the company will continue to demonstrate a strong price/performance value proposition due to its custom ASIC products. We see this, along with new product introductions, as driving replacement cycles and opening new opportunities in the high-end data center market given its competitive throughput. Lastly, we highlight Fortinet's strong financial position, a testament to its sustainable business model.

Stock Data

Average Daily Volume 6,441,947

Quarterly Earnings Estimates

| | 2022 | 2023 |
|----|-------|-------|
| Q1 | 0.19A | 0.34A |
| Q2 | 0.24A | 0.38A |
| Q3 | 0.33A | 0.41A |
| Q4 | 0.44A | 0.43E |

Financial highlights

Exhibit 1: BofA vs Consensus – FTNT

We model slightly lower revenues than the Street for both 4Q23E and FY24E and believe numbers will be revised downwards, yet anticipate a swift recovery in growth in 2H24

| | 4Q23E | | | FY24E | | |
|-------------------------------------|-------------------|-------------------|--------------|-------------------|-------------------|--------------|
| | BofA | Consensus | % Diff | BofA | Consensus | % Diff |
| Total billings (mn's) | \$1,630.20 | \$1,625.95 | 0.3% | \$6,342.20 | \$6,507.50 | -2.5% |
| YoY%Chg | -5.2% | -5.4% | -4.5% | 2.9% | 5.6% | -49.2% |
| Total product revenue (mn's) | \$493.85 | \$497.69 | -0.8% | \$1,953.84 | \$1,936.56 | 0.9% |
| YoY%Chg | -8.6% | -7.9% | 9.1% | 19.7% | 0.0% | 98575.9% |
| Total service revenue (mn's) | \$916.48 | \$915.19 | 0.1% | \$3,800.10 | \$4,000.26 | -5.0% |
| YoY%Chg | 23.4% | 23.2% | 0.8% | 12.9% | 18.9% | -31.8% |
| Total revenue (mn's) | \$1,410.33 | \$1,411.70 | -0.1% | \$5,753.95 | \$5,943.84 | -3.2% |
| YoY%Chg | 9.9% | 10.0% | -1.1% | 8.6% | 12.1% | -29.2% |
| Cost of goods sold | 337.91 | 344.7 | -2.0% | 1,298.34 | 1,401.7 | -7.4% |
| Total gross profit | 1,072.42 | 1,070.3 | 0.2% | 4,455.61 | 4,469.7 | -0.3% |
| Gross margin | 76.0% | 75.9% | 0.1% | 77.4% | 76.5% | 1.3% |
| Sales & Marketing | 485.30 | 524.54 | -7.5% | 2,187.35 | 2,302.23 | -5.0% |
| Research & Development | 145.80 | 157.48 | -7.4% | 658.07 | 727.39 | -9.5% |
| General & Administrative | 49.25 | 55.97 | -12.0% | 204.99 | 250.99 | -18.3% |
| Operating Income / (Loss) | 392.07 | \$332.25 | 18.0% | 1,405.19 | \$1,258.21 | 11.7% |
| Operating margin | 27.8% | 23.4% | 18.7% | 24.4% | 21.3% | 14.7% |
| Interest income (expense) | 15.60 | 22.26 | -29.9% | 170.24 | 88.03 | 93.4% |
| Taxes | 69.31 | 43.63 | 58.8% | 330.84 | 182.95 | 80.8% |
| Net Income | 338.37 | \$309.62 | 9.3% | 1,244.59 | \$1,185.71 | 5.0% |
| Non-GAAP EPS | \$0.43 | \$0.43 | 0.2% | \$1.58 | \$1.50 | 5.4% |
| Total share count | 785,029 | 785,029 | 0.0% | 787,154 | 787,154 | 0.0% |
| Margin Analysis | | | | | | |
| Gross margin | 76.0% | 75.9% | 0.1% | 77.4% | 76.5% | 1.3% |
| Sales & Marketing | 34.4% | 37.2% | -7.4% | 38.0% | 38.7% | -1.9% |
| Research & Development | 10.3% | 11.2% | -7.3% | 11.4% | 12.2% | -6.5% |
| General & Administrative | 3.5% | 4.0% | -11.9% | 3.6% | 4.2% | -15.6% |
| Operating Expenses | 48.2% | 52.3% | -7.7% | 53.0% | 55.2% | -3.9% |
| Operating Income / (Loss) | 27.8% | 23.4% | 18.7% | 24.4% | 21.3% | 14.7% |
| Net Income | 24.0% | 21.9% | 9.4% | 21.6% | 19.9% | 8.4% |

Source: BofA Global Research estimates, company report

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Price objective basis & risk

Fortinet (FTNT)

Our \$75 PO is based on roughly 35x 2025E EV/FCF. Our multiple is slightly below the hardware peer group average multiple of 30-40x and a discount to software peers as well. We believe the slightly below multiple to the hardware peer group is appropriate at this stage given the current business environment despite some recent share gains, shift to more recurring software, and expansion into adjacent security markets. New market tailwinds, such as software defined wide area networking (SD-WAN) should drive further market share gains.

Upside risks to our price objective are growth of non-FortiGate products, which could support high growth and acceleration from current levels and could result in more SaaS-like multiples and drive up the valuation.

Downside risks to our price objective are 1) product convergence leading to a shrinking market with larger competitors, 2) exposure to public spending and EMEA, 3) reputation risk if major threats missed and 4) early ordering that occurred during CY21/CY22 creates tough comps heading in CY23

Analyst Certification

I, Tal Liani, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Telecom and Data Networking Equipment Coverage Cluster

| Investment rating | Company | BofA Ticker | Bloomberg symbol | Analyst |
|---------------------|-----------------------------------|-------------|------------------|--------------------|
| BUY | | | | |
| | Akamai | AKAM | AKAM US | Madeline Brooks |
| | Amdocs | DOX | DOX US | Tal Liani |
| | Arista Networks | ANET | ANET US | Tal Liani |
| | Check Point Software Technologies | CHKP | CHKP US | Tal Liani |
| | Ciena | CIEN | CIEN US | Tal Liani |
| | CrowdStrike Holdings Inc. | CRWD | CRWD US | Tal Liani |
| | CyberArk | CYBR | CYBR US | Tal Liani |
| | Fastly | FSLY | FSLY US | Madeline Brooks |
| | Fortinet | FTNT | FTNT US | Tal Liani |
| | Gen Digital, Inc. | GEN | GEN US | Jonathan Eisensohn |
| | InterDigital, Inc. | IDCC | IDCC US | Tal Liani |
| | Motorola Solutions | MSI | MSI US | Tomer Zilberman |
| | Qualcomm | QCOM | QCOM US | Tal Liani |
| | Zscaler | ZS | ZS US | Tal Liani |
| NEUTRAL | | | | |
| | Cellebrite | CLBT | CLBT US | Tal Liani |
| | Cisco Systems | CSCO | CSCO US | Tal Liani |
| | Palo Alto Networks | PANW | PANW US | Tal Liani |
| | SentinelOne, Inc. | S | S US | Tal Liani |
| UNDERPERFORM | | | | |
| | Cloudflare | NET | NET US | Madeline Brooks |
| | CommScope | COMM | COMM US | Tal Liani |
| | F5 Inc | FFIV | FFIV US | Tal Liani |
| | Okta Inc | OKTA | OKTA US | Madeline Brooks |
| | SecureWorks | SCWX | SCWX US | Tal Liani |

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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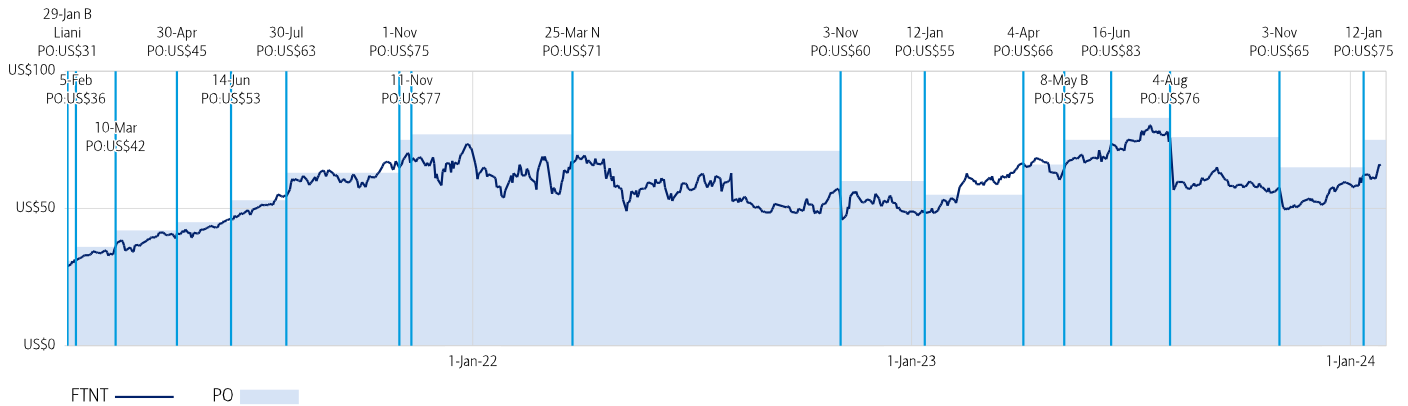
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Disclosures

Important Disclosures

Fortinet (FTNT) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Equity Investment Rating Distribution: Telecommunications Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 57 | 51.82% | Buy | 43 | 75.44% |
| Hold | 27 | 24.55% | Hold | 17 | 62.96% |
| Sell | 26 | 23.64% | Sell | 12 | 46.15% |

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

| Coverage Universe | Count | Percent | Inv. Banking Relationships ^{R1} | Count | Percent |
|-------------------|-------|---------|--|-------|---------|
| Buy | 1895 | 53.62% | Buy | 1083 | 57.15% |
| Hold | 832 | 23.54% | Hold | 454 | 54.57% |
| Sell | 807 | 22.84% | Sell | 383 | 47.46% |

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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| Investment rating | Total return expectation (within 12-month period of date of initial rating) | Ratings dispersion guidelines for coverage cluster ^{R2} |
|-------------------|---|--|
| Buy | ≥ 10% | ≤ 70% |
| Neutral | ≥ 0% | ≤ 30% |
| Underperform | N/A | ≥ 20% |

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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