Arista

TOP IDEA: Cloud Uncertainty Distracting from Enterprise Oppty; See 17%-22% Growth on Stable to Moderating Cloud Share

Overweight

ANET, ANET US

Price (25 Mar 21): $292.00

Price Target (Dec-21): $365.00

Telecom & Networking Equipment/IT Hardware

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Investor perception is for a strong correlation of Arista's revenue growth to the Cloud vertical, and while that was largely appropriate in recent history, the strong growth trajectory with Enterprises and the increasing relevance of this customer vertical – where there is a lot of upside for market share – has largely been ignored by investors. Recent comments from Arista management in relation to uncertainty relative to (large) Cloud growth in 2021 given timing of large projects and limited opportunity to gain share with Cloud Titans on account of saturated market share has led to a bearish sentiment on the shares, but as we outline in this report, **the bearish sentiment ignores the strong growth in the range of 17% to 22% that Arista can deliver** as Enterprises return to normal spending trends post COVID, even with growth in (large) Cloud ranging between 5% (embedding massive share loss as in the bear thesis) and 18% (maintaining share through the 400G cycle). **Reiterate Overweight rating and our top pick for ANET shares where investors distracted with Cloud growth have failed to appreciate the strong growth sustainable through share gains in the Enterprise vertical alone**.

- **Cloud focus has distracted investors from appreciating the growth in the Enterprise vertical.** Arista's Product revenue has expanded at 30%-40% annually, led by +34% CAGR (2015-18) in Cloud. While Cloud growth overshadowed Enterprise, Arista's Enterprise revenues have expanded at a +32% CAGR, and now accounts for 40% of Product revenue.
- **Saturated share in (large) Cloud, but huge headroom in Enterprise DC and Campus.** Arista's share in the $5 bn Cloud market is already 17%, implying >50% share with top customers (Microsoft and Facebook), leaving less room for higher share. On the other hand, large Enterprise Data Center is $4 bn revenue opportunity and Arista has mid-teens share and limited competition from white-box, and Campus is a $13 bn revenue opportunity with Arista's share ~1%.
- **Forecast +17% CAGR for Large Enterprise DC revenue, and revenue growth of $100-$150 mn annually in Campus.** Arista's gained about 150-200 bps share annually in large Enterprise DC pre-pandemic when the underlying market opportunity expanded at a +20% CAGR. Post-pandemic growth rate is expected to moderate to +7% with adoption of public cloud, but similar pace of share gains will drive +17% revenue CAGR with Enterprise. For Campus, we assume modest share gains each year following the roll-out of a broader portfolio, including $400 mn of revenue in 2023, +70% CAGR off a low-base.
- **17% to 22% growth sustainable despite Cloud uncertainty; expect rebound in valuation premium with growth**. Our math outlines a broad range of outcomes on (large) Cloud revenue growth, from low-end of 5% (assuming significant share loss) to high-end of 18% (maintain share), equate to total revenue growth between 17% and 22%, led by increasing relevance of other verticals. Returns to these growth levels post-pandemic on a sustainable basis will lead to a stronger valuation premium and upward earnings revisions.

Quarterly Forecasts (FYE Dec)

Adj. EPS ($)

	2020A	2021E	2022E
Q1	2.02	2.41	2.66
Q2	2.11	2.50	3.00
Q3	2.42	2.65	3.41
Q4	2.49	2.78	3.63
FY	9.04	10.35	12.70

Style Exposure

Quant Factors	Current %Rank	Hist %Rank (1=Top) 6M	1Y	3Y	5Y
Value	52	53	62	86	78
Growth	66	30	12	8	18
Momentum	61	81	76	9	71
Quality	28	19	4	4	8
Low Vol	31	39	56	73	66
ESGQ	21	26	17	81	-

Sources for: Style Exposure – J.P. Morgan Quantitative and Derivatives Strategy; all other tables are company data and J.P. Morgan estimates.

See page 18 for analyst certification and important disclosures, including non-US analyst disclosures.

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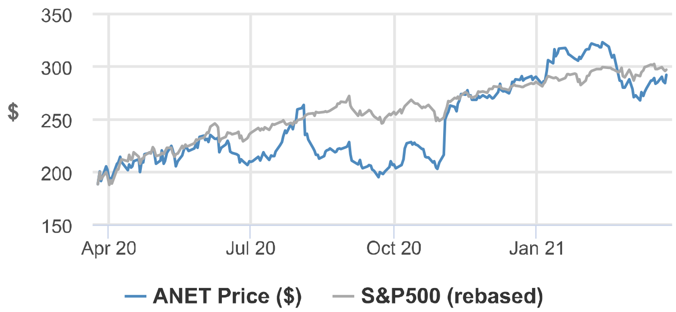
Price Performance



	YTD	1m	3m	12m
Abs	0.5%	4.2%	1.1%	55.0%
Rel	-3.6%	2.1%	-4.5%	-2.9%

Company Data

Shares O/S (mn)	79
52-week range ($)	326.60-185.03
Market cap ($ mn)	23,144.21
Exchange rate	1.00
Free float(%)	73.2%
3M - Avg daily vol (mn)	0.59
3M - Avg daily val ($ mn)	177.0
Volatility (90 Day)	27
Index	S&P 500
BBG BUY|HOLD|SELL	18|11|0

Key Metrics (FYE Dec)

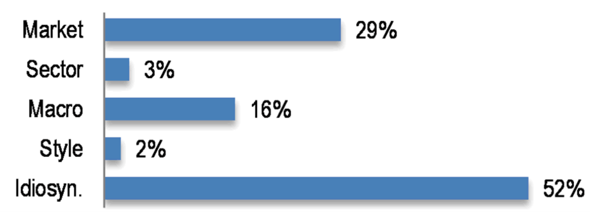
$ in millions	FY20A	FY21E	FY22E
Financial Estimates			
Revenue	2,318	2,700	3,262
Adj. EBIT	875	1,044	1,311
Adj. EBITDA	919	1,079	1,353
Adj. net income	718	829	1,037
Adj. EPS	9.04	10.35	12.70
BBG EPS	8.98	10.09	11.33
Cashflow from operations	735	757	1,033
FCFF	692	727	991
Margins and Growth			
Revenue growth	(3.9%)	16.5%	20.8%
EBIT margin	37.7%	38.7%	40.2%
EBIT growth	(5.2%)	19.3%	25.5%
EBITDA margin	39.7%	40.0%	41.5%
EBITDA growth	(3.8%)	17.4%	25.4%
Net margin	31.0%	30.7%	31.8%
Adj. EPS growth	(7.0%)	14.4%	22.8%
Ratios			
Adj. tax rate	21.0%	21.5%	21.5%
Interest cover	NM	NM	NM
Net debt/Equity	NM	NM	NM
Net debt/EBITDA	NM	NM	NM
ROE	23.1%	22.8%	23.7%
Valuation			
FCFF yield	3.0%	3.1%	4.2%
Dividend yield	-	-	-
EV/Revenue	9.3	8.0	6.6
EV/EBITDA	23.5	20.0	16.0
Adj. P/E	32.3	28.2	23.0

Summary Investment Thesis and Valuation

Our Overweight rating on ANET shares is based on our expectation for a revenue acceleration from the uptick in cloud capex spending from cloud titan customers heading into 2021, and favorable positioning for upside from 400G adoption at hyperscale customers.

Our Dec 2021 price target of $365 is based on valuing our 2022E EPS of $12.70 at ~29x P/E multiple. We believe a ~29x P/E multiple is appropriate given: 1) modestly above the current NTM multiple; 2) embeds the potential revenue acceleration from cloud capex uptick and ramp of 400G cycle in 2021/22; and 3) represents a modest discount to the longer-term multiple of ~30x on greater volatility in spending with its largest customers, Microsoft and Facebook.

Performance Drivers



Factors	6M Corr	1Y Corr
Market: MSCI US	0.74	0.63
Sect: Technology	0.30	0.20
Ind: Tech Hard Equip	0.19	0.10
Macro:		
US 10yr yield	-0.24	-0.27
Economic Surprise	-0.13	-0.13
Credit Spread	-0.42	0.11
Quant Styles:		
Growth	0.35	0.31
Value	-0.33	-0.28
Momentum	0.37	0.25

Source: J.P. Morgan Quantitative and Derivatives Strategy for Performance Drivers; company data, Bloomberg Finance L.P. and J.P. Morgan estimates for all other tables. Note: Price history may not be complete or exact.

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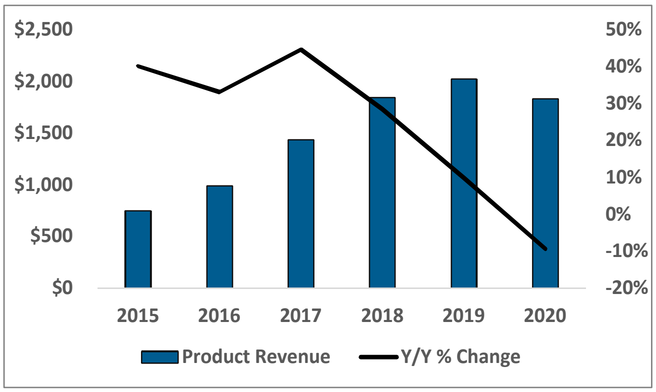
Growth Moderation Led by Cloud Has Distracted Investors from Enterprise Growth

Robust product revenue growth has come under pressure in recent years

As illustrated in Figure 1, Arista's product revenue has grown within a range of +30% to +40% per annum between 2015 and 2018 before moderating to growth of +10% in 2019, led by Cloud customers slowing down infrastructure investments to digest the inventory of capacity built during the period of strong investment as well as an increasing focus on driving efficiencies through higher utilization of technology hardware. Following up the period of slower growth in investments in 2019, expectations were for investments from Cloud to rebound in 2020; however, the push out in new datacenter construction in conjunction with COVID-19 led to a decline of about -9% in 2020 for Arista revenues (closer to -5% excluding deferred revenue, which benefitted 2019).

Figure 1: Arista's Product Revenue

$ in Millions, Y/Y % Change



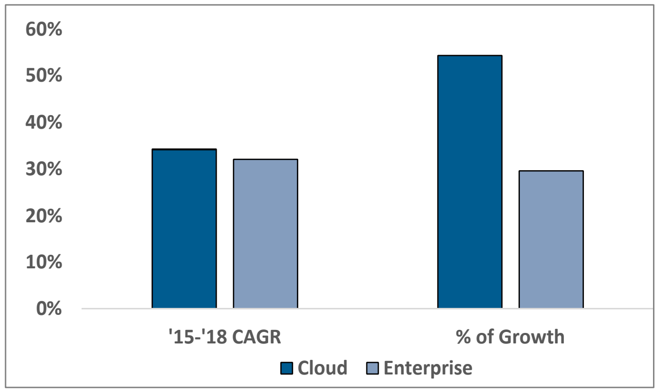
Source: Company reports.

Focus has historically been on Cloud, but Arista would have recorded a +20% CAGR in Product revenue excluding it

Unsurprisingly, following the strong growth that Arista demonstrated between 2015 to 2018, Arista's exposure to Cloud customers increased to as much as 55%-60% of total company revenues in 2018. The majority of revenue and growth coming from Cloud meant that Arista was perceived by investors as a company largely leveraged to Cloud for its growth.

That said, underlying the solid execution in the Cloud vertical has been a gradual improvement in the Enterprise vertical, which has seen the mix improve from ~30% to ~40% of Product revenue, with annual revenue growth rates in the +25% to +35% range. As shown in Figure 2, Enterprise revenues increased at a 32% CAGR between 2015 and 2018, which compares to a 34% CAGR in Cloud revenues; however, contributed 30% of the total growth over that period, which was dwarfed by the growth contribution from Cloud.

Figure 2: Cloud vs. Enterprise Growth Contribution
Y/Y % Change, % of Total



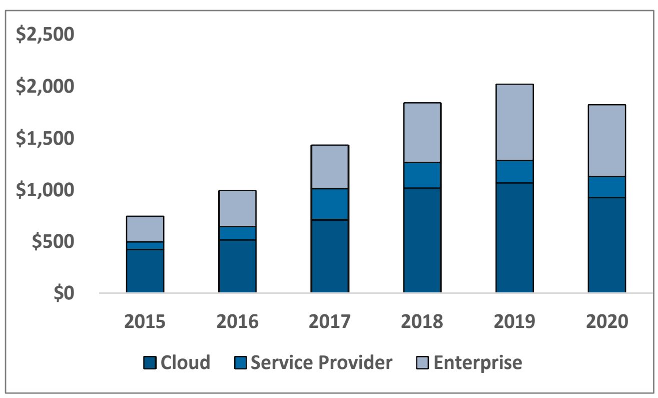
Source: Dell'Oro.

Said differently, if Arista had seen no growth in Cloud revenues between 2015 and 2018 (which ended up growing at a 34% CAGR), **Product revenues** would have expanded at a 19% CAGR instead of the 35% recorded.

Enterprise now significantly more important for Arista

As shown in Figure 3, following the slower growth from the Cloud vertical (as well as the Service Provider) over the last couple of years, the Enterprise vertical is now significantly more important for the company. As of last year, the Enterprise vertical accounted for ~40% of Product revenues relative to ~30% in 2018.

Figure 3: Arista's Product Revenue Breakdown
$ in Millions



Source: Dell'Oro.

Share Gain Led Opportunity in Enterprise

Arista's Enterprise revenue has been largely limited to datacenter products

While there has been a gradual improvement in the mix of revenue accounted for by Enterprise customers, it has been limited to demand for datacenter products leveraged in that vertical as campus product revenue only began to ramp in 2019. As illustrated in Figure 4, datacenter products accounted for 100% of the enterprise revenue through 2018, and it was not until 2019 in which campus products accounted for a low-single digit percentage of Enterprise revenue, and subsequently increased to a mid-teen percentage of Enterprise revenue in 2020. *Importantly, unlike the rest*

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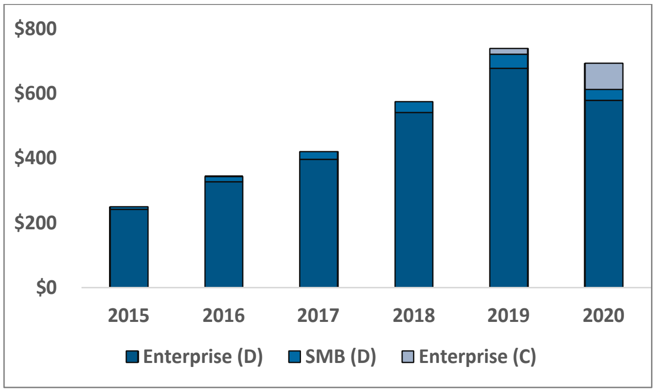
of the portfolio, campus products demonstrated strong growth in 2020, despite COVID-19 headwinds.

Figure 4: Arista's Enterprise Revenue Breakdown
$ in Millions

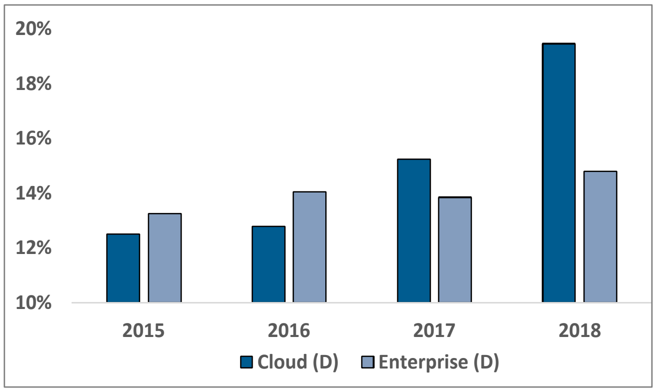


Note: "D" and "C" denotes datacenter and campus, respectively.
Source: Dell'Oro.

Above-peer group growth has been driven by share gains while customer spend towards Networking has increased at a lower rate

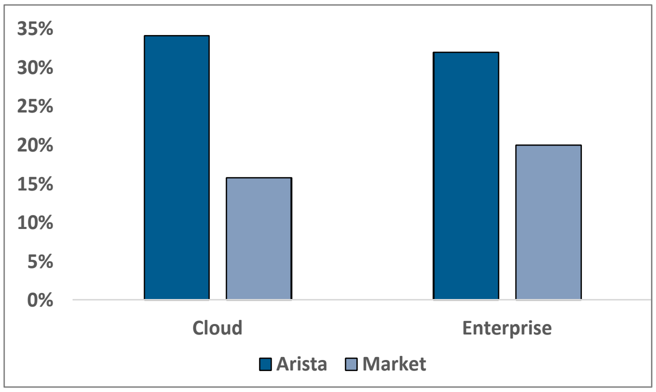
Looking back at the growth CAGR demonstrated by Arista in the 2015-2018 time period, share gains for Arista in both the Cloud and the Enterprise vertical makes it amply clear that the underlying spend from both the customer verticals towards networking equipment was at a much lower rate.

Figure 5: Arista's Cloud and Large Enterprise Market Share
% of Total



Note: "D" and "C" denotes datacenter and campus, respectively.
Source: Dell'Oro.

Figure 6: Arista's Outperformance vs. the Market
Y/Y % Change



Note: "D" and "C" denotes datacenter and campus, respectively.
Source: Dell'Oro.

Saturated share with large Cloud companies to drive focus back to growth with Enterprises

As shown in Figure 7, Arista's share with Cloud companies (for which the datacenter switching revenue opportunity is roughly ~$5 bn) is at ~17%, and is roughly ~22% with large Cloud companies. While on the surface it might appear that there is headroom for share gains, Arista's top customers, Facebook and Microsoft, account for ~41% of total capex spend from Large Cloud companies – Alibaba, Apple, Amazon, Baidu, Facebook, Google, Microsoft and Tencent, which would imply

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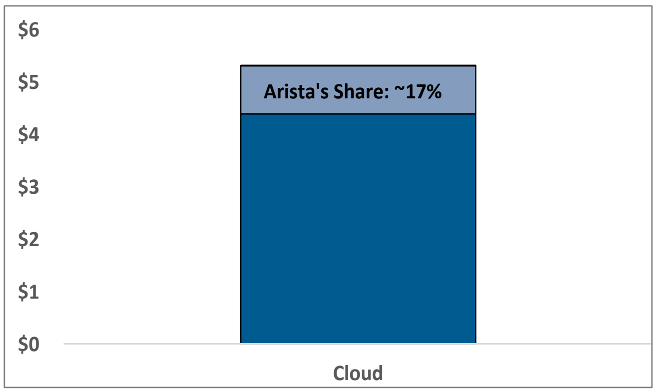
Arista already has more than 50% of the share of the available opportunity near- to medium-term (not withstanding any major strategic changes in use of white box from Google or Amazon).

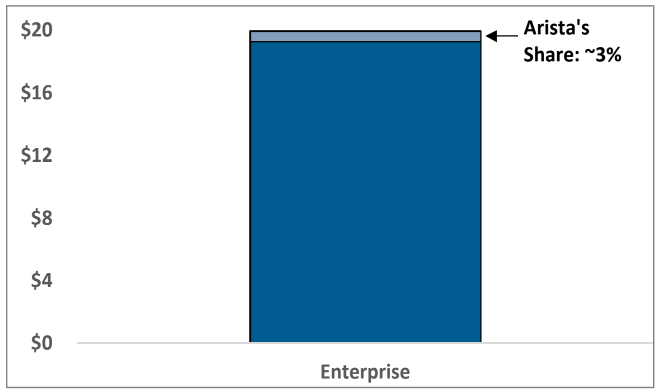
Relative to the $5 bn revenue opportunity for datacenter switching with Cloud providers, the total Enterprise revenue opportunity across both datacenter switching and campus products is about $20 bn and on a combined basis across the two market opportunities, Arista has only a low-single digit share.

Figure 7: Arista's Cloud Market Share
$ in Billions, % of Total



Source: Dell'Oro.

Figure 8: Arista's Enterprise Market Share (including Campus)
$ in Billions, % of Total

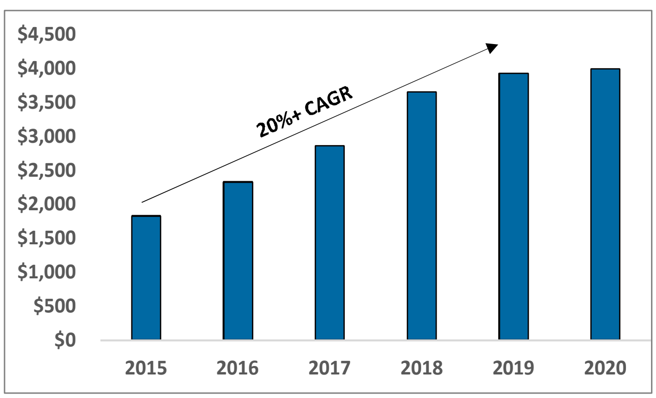


Source: Dell'Oro.

Investors have ascribed to some myths around the Enterprise revenue opportunity, including very modest underlying growth

Investors we speak to consider the Enterprise datacenter market to be one of slower growth, more in line with the growth in Enterprise IT spending in the low-single digit range. On the contrary, a look at the datacenter switching revenue opportunity with Large Enterprises, which are the primary targets for Arista products in the early stages of adoption, have demonstrated roughly +20% growth CAGR over the years pre-pandemic.

Figure 9: Large Enterprise Datacenter Market
$ in Millions



Source: Dell'Oro.

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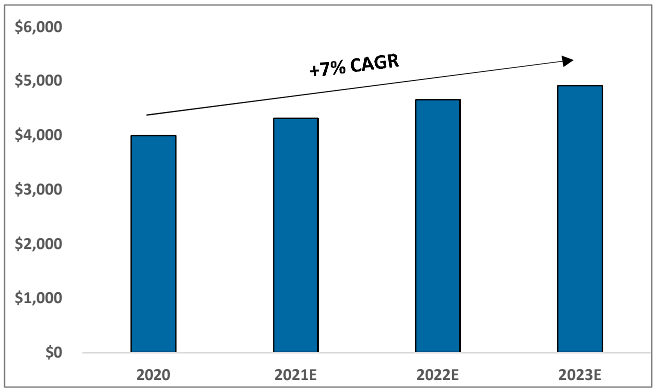
Growth for Large Enterprises is expected to moderate, but to high-single digit level

As shown in the Dell'Oro forecast in Figure 10, the growth in datacenter switching revenue with Large Enterprises is expected to moderate, led partly by adoption of public cloud, but only to a high-single digit level with focus of investments from Large Enterprises remaining towards hybrid cloud infrastructure.

Figure 10: Large Enterprise Datacenter Market

$ in Millions



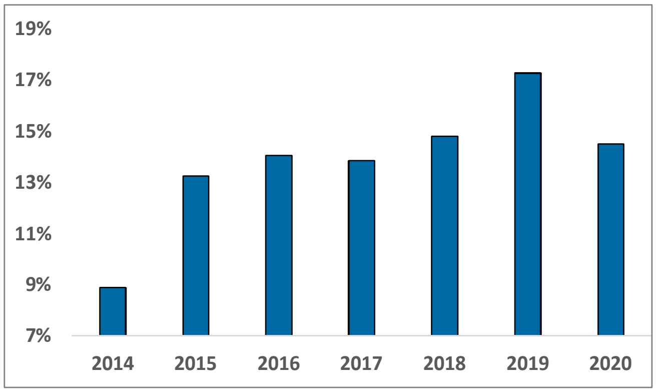
Source: Dell'Oro.

Arista's Enterprise datacenter share has room to run without any threat from white box

As shown in Figure 11, Arista's share in datacenter switching with Large Enterprises has progressed from 9% in 2014 to 17% in 2019 (before moderating with the pull back in conjunction with COVID-19) — or roughly 150-200 bps of share gains per year pre-pandemic.

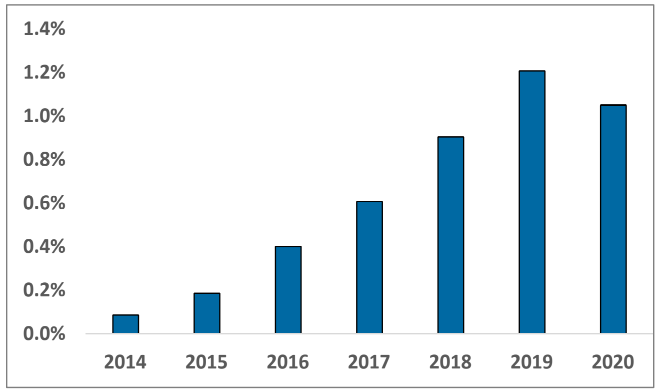
At the same time, Arista's share of in datacenter switching with SMBs has remained modest at 1%. While at the surface, Arista's 17% share with Large Enterprises might appear very similar to its share in large cloud companies, the headroom for share gains is much higher on account of the absence of white box adoption.

Figure 11: Arista's Large Enterprise Datacenter Market Share
% of Total



Source: Dell'Oro.

Figure 12: Arista's SMB Datacenter Market Share
% of Total

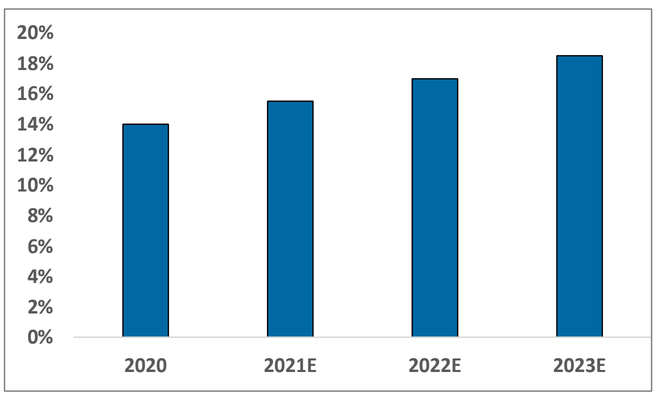


Source: Dell'Oro.

150 bps of market share gains annually can support +17% revenue growth in Enterprise datacenter

Even if the growth rate for the underlying Large Enterprise datacenter switching market were to moderate to high-single digit growth, if Arista continues to expand share by about 150 bps annually – in line with the pace of gains over the 2014-2019 time period – it should be able to able to support a +17% revenue CAGR for Arista in Large Enterprise datacenter switching.

Figure 13: Arista's Large Enterprise Datacenter Market Share
% of Total



Source: Dell'Oro and J.P. Morgan estimates.

Share gains and adoption beyond Large Enterprises in the SMB space can lead to further acceleration in growth

The datacenter switching revenue opportunity with SMB customers is modestly lower than the opportunity in the Large Enterprise market, and amounted to about $3 bn of revenue relative to $4 bn with Large Enterprises. However, Arista's share of the SMB market remains at modest 1% vs. peak of 17% in Large Enterprises. While adoption of Arista's products with SMB customers is likely slower on account of reliance of smaller size customers on traditional solutions from Cisco. Arista's growth with SMB customers will lead to an incremental upside driver for Arista than the above estimated through share gains in Large Enterprises alone.

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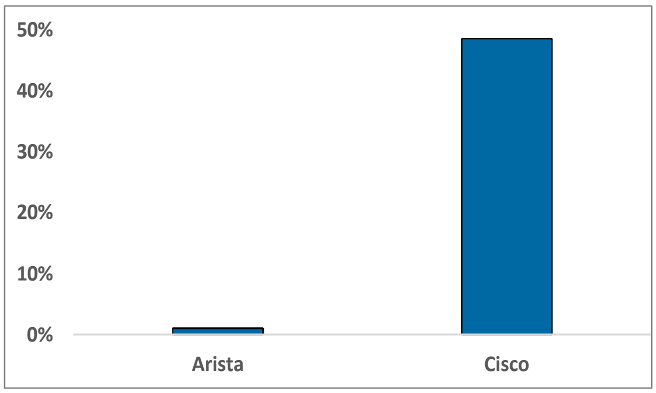
Are share gains with SMB in DC switching realistic?

We believe the primary driver of share gains with SMB customers is providing end-to-end solutions relative to product solutions, as evidenced in the high share that Cisco has in this part of the market. Importantly, Arista has begun to make significant inroads relative to broadening its portfolio, including the expansion of its lineup of campus products, which includes the modular 7300X3 and fixed 7050X3 spline switches (3Q18), 720 and 750 leaf PoE switches (4Q20) as well as Wi-Fi 6 access points (Mojo acquisition in 3Q18).

Figure 14: SMB Enterprise Datacenter Market Share

% of Total



Source: Dell'Oro.

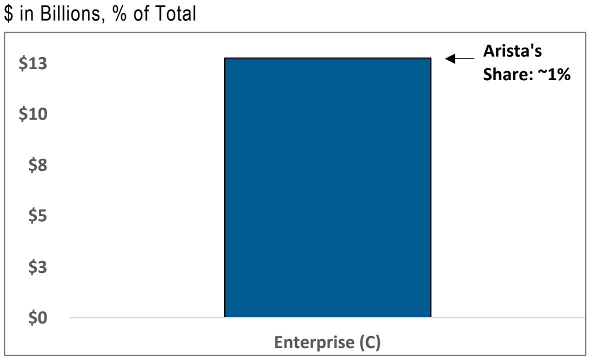
Enterprise Campus Opportunity

Campus represents the over-the-top growth accelerator

Outside of the datacenter switching market opportunity with Enterprise customers (both Large Enterprises and SMB customers), which amounts to $7 bn, the opportunity in relation to the Enterprise campus market is larger as it stand at roughly $13 bn in total. Arista's less than $100 mn of revenue from campus products in 2020 means that Arista has less than 1% share of the market. *Importantly, Arista has disclosed its ambition to increase its share in the campus market to a similar level as in the datacenter market (see report here).*

Figure 15: Arista's Enterprise Campus Market Share

$ in Billions, % of Total



Note: "D" and "C" denotes datacenter and campus, respectively.

Source: Dell'Oro.

Arista targeting strong growth in campus; albeit, from a low base

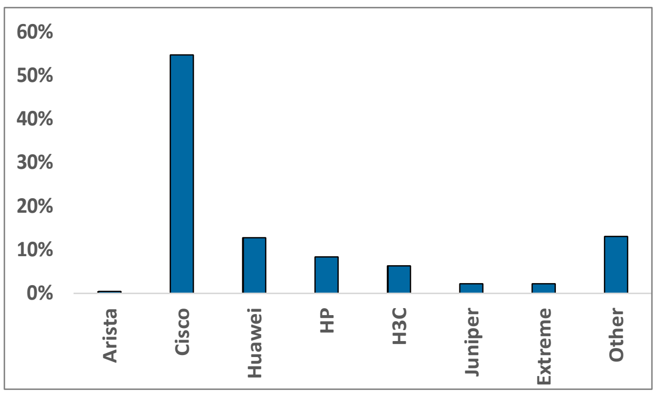
Arista is targeting doubling the run-rate of campus revenues from $100 mn/year to roughly ~$200 mn/year in 2021, implying doubling the run-rate of revenue and share – assuming limited growth in Enterprise campus. While it is unrealistic to expect Arista to double revenues every twelve months going forward, if we assume roughly $100-$150 mn of revenue growth per year, it would imply a $700 mn revenue run-rate by 2025 or only ~4% market share.

Fragmented market share in WLAN and campus switching provides room for modest share gains

As shown in Figure 16 and Figure 17, the WLAN and campus switching market remains fragmented beyond the large market share with Cisco. That leaves opportunity for Arista to gain share modestly from Cisco – whose share has moderated slightly every year historically – but more importantly from the fragmented base of Tier 2 campus suppliers.

Figure 16: Campus Market Share – Arista and Top Six Vendors

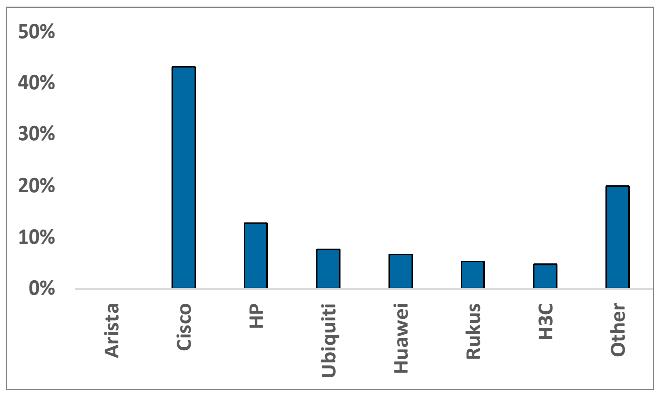
% of Total



Source: Dell'Oro.

Figure 17: WLAN Market Share – Arista and Top Six Vendors

% of Total



Source: Dell'Oro.

Forecast for $400 mn and $700 mn in Campus revenue by 2023 and 2025, respectively

We believe Arista achieving $700 mn in campus revenue by 2025 is a conservative forecast given that it implies the company is capturing less than $1 of campus spend from their customers relative to $1 of spend on datacenter switching. By comparison, given the market size between Enterprise datacenter and campus, the typical enterprise customer spends slightly more than $3 on campus products ($2 on switching and $1 on WLAN) for every $1 of spend on datacenter switching.

Uncertainty around Cloud, But Growth Can Be Driven by Enterprise

Recent comments from Arista management has led investors to be concerned about the sustainability of strong growth

Arista management has recently communicated: 1) uncertainty relative to Cloud revenue growth in 2H21 given the likelihood of slippage of timing for large projects; and 2) limited opportunity for share gain with Cloud Titans on account of the saturated share with the large cloud companies that are willing to leverage branded equipment vendors.

The tone had led to concerns from investors that Arista might be challenged in driving growth with Cloud, as well as overall strong top-line growth with uncertainty persisting around growth in the Cloud.

However, as we outline in the scenarios below, we believe Arista can sustain a strong top-line growth even in absence of strong growth with Cloud, although growth would accelerate if growth with Cloud comes in strong.

Scenario 1: Cloud Hyperscale Revenue Growth Lower than Industry; But Double-digit – Implies +19% Revenue CAGR for Arista

As shown in Table 1, we assume:

1. Arista's revenue growth with Cloud Titan customers over the next three years is below the +18% growth CAGR expected for datacenter switching revenues with large Cloud customers.

2. Arista's revenue growth with Large Enterprises at a mid-teens CAGR on account of increasing share at ~150 bps annually.

3. Revenues from campus hardware sales of roughly $400 mn, with about $100 mn increase per year.

4. Services growth ahead of Product revenue growth with increasing revenue mix from Enterprises.

Table 1: Arista Revenue Forecast by Customer Vertical

$ in Billions

Customer Vertical	2020	2023E	CAGR	Market Growth
Cloud Titans	$0.7	$0.9	10%	18%
Tier-2 Cloud	$0.3	$0.4	20%	19%
Service Provider	$0.2	$0.3	12%	12%
Enterprise Datacenter	$0.6	$0.9	17%	7%
SMB Datacenter	$0.0	$0.0	-17%	-28%
Enterprise Campus	$0.1	$0.4	70%	4%
Services	$0.5	$0.9	24%	N/A
Total	**$2.3**	**$3.9**	**19%**	**N/A**

Source: Dell'Oro and J.P. Morgan estimates.

The implied share in the different customer verticals on assuming the above growth are:

Table 2: Arista Market Share Assumption by Customer Vertical

% of Total

Customer Vertical	2020	2023E
Cloud Titans	22%	18%
Tier-2 Cloud	11%	11%
Service Provider	23%	23%
Enterprise Datacenter	14%	19%
SMB Datacenter	1%	2%
Enterprise Campus	1%	3%

Source: Dell'Oro and J.P. Morgan estimates.

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Scenario 2: Cloud Hyperscale Revenue Growth in Line with Industry – Implies +22% Revenue CAGR for Arista

As shown in Table 3, we assume:

1. Arista's revenue growth with Cloud Titan customers over the next three years is in line with the +18% growth CAGR expected for datacenter switching revenues with large Cloud customers.

2. All other assumptions remain same as Scenario 1.

Table 3: Arista Revenue Forecast by Customer Vertical

$ in Billions

Customer Vertical	2020	2023E	CAGR	Market Growth
Cloud Titans	$0.7	$1.1	18%	18%
Tier-2 Cloud	$0.3	$0.4	20%	19%
Service Provider	$0.2	$0.3	12%	12%
Enterprise Datacenter	$0.6	$0.9	17%	7%
SMB Datacenter	$0.0	$0.0	-17%	-28%
Enterprise Campus	$0.1	$0.4	70%	4%
Services	$0.5	$1.0	27%	N/A
Total	**$2.3**	**$4.2**	**22%**	**N/A**

Source: Dell'Oro and J.P. Morgan estimates.

The implied share in the different customer verticals on assuming the above growth are:

Table 4: Arista Market Share Assumption by Customer Vertical

% of Total

Customer Vertical	2020	2023E
Cloud Titans	22%	22%
Tier-2 Cloud	11%	11%
Service Provider	23%	23%
Enterprise Datacenter	14%	19%
SMB Datacenter	1%	2%
Enterprise Campus	1%	3%

Source: Dell'Oro and J.P. Morgan estimates.

Scenario 3: Cloud Hyperscale Revenue Growth Well Below Industry at Mid-single Digit – Implies +17% Revenue CAGR for Arista

As shown in Table 5, we assume:

1. Arista's revenue growth with Cloud Titan customers over the next three years is well below the +18% growth CAGR expected for datacenter switching revenues with large Cloud customers.

2. All other assumptions remain same as Scenario 1

Table 5: Arista Revenue Forecast by Customer Vertical

$ in Billions

Customer Vertical	2020	2023E	CAGR	Market Growth
Cloud Titans	$0.7	$0.8	5%	18%
Tier-2 Cloud	$0.3	$0.4	20%	19%
Service Provider	$0.2	$0.3	12%	12%
Enterprise Datacenter	$0.6	$0.9	17%	7%
SMB Datacenter	$0.0	$0.0	-17%	-28%
Enterprise Campus	$0.1	$0.4	70%	4%
Services	$0.5	$0.9	22%	N/A
Total	**$2.3**	**$3.7**	**17%**	**N/A**

Source: Dell'Oro and J.P. Morgan estimates.

The implied share in the different customer verticals on assuming the above growth are:

Table 6: Arista Market Share Assumption by Customer Vertical

% of Total

Customer Vertical	2020	2023E
Cloud Titans	22%	16%
Tier-2 Cloud	11%	11%
Service Provider	23%	23%
Enterprise Datacenter	14%	19%
SMB Datacenter	1%	2%
Enterprise Campus	1%	3%

Source: Dell'Oro and J.P. Morgan estimates.

Valuation Premium Mirrors Growth

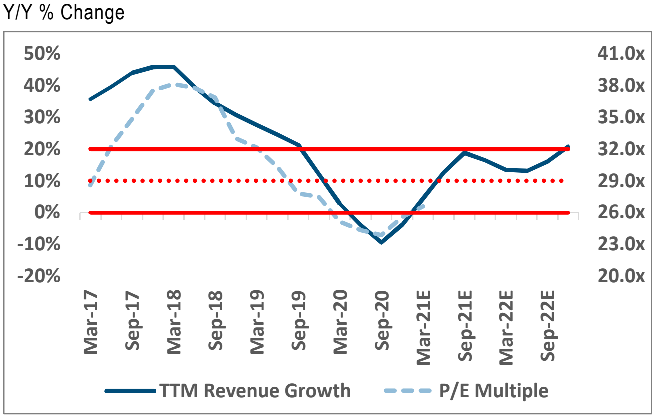
Return to strong top-line growth to drive premium multiple

As illustrated in Figure 18, Arista's revenue growth has a strong correlation to the P/E multiple at which investors are willing to value the shares, with periods of strong top-line growth driving a higher earnings multiple.

We expect Arista's revenue rebound to mid- to high-teens growth in 2021, followed by growth in the high-teens to low-20% growth in 2022/23 to lead to a premium multiple on the earnings power in the out-year — where we expect positive revisions to sell-side estimates.

Figure 18: Arista's TTM Revenue Growth vs. P/E Multiple

Y/Y % Change



Source: Company reports, Bloomberg Finance L.P. and J.P. Morgan estimates.

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Limited track record and scarcity of high-growth hardware companies makes it difficult to predict an appropriate earnings multiple

The most obvious investor question has been the appropriate earnings multiple to pay for the shares of a company that is positioned to expand top-line at a +20% pace, given the limited peer group in hardware with similar credentials as well as limited track record of Arista in delivering consistent growth.

However, we expect the valuation multiples to increase from the current levels (28x NTM P/E) and reflect the improving revenue growth trajectory.

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Investment Thesis, Valuation and Risks

Arista Networks Inc. *(Overweight; Price Target: $365.00)*

Investment Thesis

Our Overweight rating on ANET shares is based on our expectation for a revenue acceleration from the uptick in cloud capex spending from cloud titan customers heading into 2021, and favorable positioning for upside from 400G adoption at hyperscale customers.

Valuation

Our Dec 2021 price target of $365 is based on valuing our 2022E EPS of $12.70 at ~29x P/E multiple. We believe a ~29x P/E multiple is appropriate given: 1) modestly above the current NTM multiple; 2) embeds the potential revenue acceleration from cloud capex uptick and ramp of 400G cycle in 2021/22; and 3) represents a modest discount to the longer-term multiple of ~30x on greater volatility in spending with its largest customers, Microsoft and Facebook.

ANET P/E Based Price Target Analysis

$ mns, except per share data

	NTM Qtrs 1-4	2022E
JPM Net Income	**829**	**1037**
JPM EPS	$10.34	$12.70
P/E Multiple	28.2x	
JPM P/E Multiple		29x
Implied Equity Value	**23,144**	**29,823**
Average Diluted Share Count	79	82
Implied Share Price	**$292.0**	**$365.0**
Current Value per Share	$292.00	$292.00
Upside vs. Current		25%
Memo:		
(-) Net Cash/(Debt)	2,873	4,210
Enterprise Value	20,271	25,613
JPM EBITDA	1,079	1,353
Implied EV/EBITDA	*18.8x*	*18.9x*

Source: Company reports and J.P. Morgan estimates.

Risks to Rating and Price Target

Industry Downside Risks

Adoption of white box solutions remains a threat. While it is difficult to drive superior performance using white box solutions (non-branded switches available off-the-shelf) relative to switches from established technology leaders like Arista or

Cisco, the improving capabilities of the white box solutions over time could drive customers to use them for parts of the network with lower performance requirements. Faster than expected adoption of white box solutions could imply downside to our Arista earnings forecasts and price target.

Company-Specific Downside Risks

Faster than expected shift toward disaggregated software solutions from datacenter customers could challenge Arista. Arista delivers industry-leading switching technology through a combination of hardware and software, although a significant portion of the value-add is driven by software. While Arista has already started to offer disaggregated software products to its customers, these do not account for a significant portion of revenues yet. A faster than expected shift from customers toward proprietary software and generic hardware could create competitive challenges for Arista.

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Arista: Summary of Financials

Income Statement - Annual	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	**2,411**	**2,318**	**2,700**	**3,262**	**-**
COGS	(851)	(812)	(942)	(1,135)	-
Gross profit	**1,559**	**1,506**	**1,758**	**2,127**	**-**
SG&A	(227)	(232)	(267)	(301)	-
Adj. EBITDA	**956**	**919**	**1,079**	**1,353**	**-**
D&A	(33)	(45)	(35)	(42)	-
Adj. EBIT	**923**	**875**	**1,044**	**1,311**	**-**
Net Interest	51	35	12	12	-
Adj. PBT	**974**	**910**	**1,056**	**1,322**	**-**
Tax	(187)	(191)	(227)	(285)	-
Minority Interest	-	-	-	-	-
Adj. Net Income	**787**	**718**	**829**	**1,037**	**-**
Reported EPS	9.73	9.04	10.35	12.70	-
Adj. EPS	**9.73**	**9.04**	**10.35**	**12.70**	**-**
DPS	**-**	**-**	**-**	**-**	**-**
Payout ratio	-	-	-	-	-
Shares outstanding	81	79	80	82	-

Income Statement - Quarterly	1Q21E	2Q21E	3Q21E	4Q21E
Revenue	**644**	**658**	**687**	**711**
COGS	(228)	(230)	(238)	(246)
Gross profit	**416**	**428**	**449**	**465**
SG&A	(66)	(66)	(68)	(68)
Adj. EBITDA	**250**	**260**	**277**	**292**
D&A	(8)	(9)	(9)	(9)
Adj. EBIT	**242**	**251**	**268**	**283**
Net Interest	3	3	3	3
Adj. PBT	**245**	**254**	**271**	**286**
Tax	(53)	(55)	(58)	(61)
Minority Interest	-	-	-	-
Adj. Net Income	**192**	**200**	**213**	**224**
Reported EPS	2.41	2.50	2.65	2.78
Adj. EPS	**2.41**	**2.50**	**2.65**	**2.78**
DPS	**-**	**-**	**-**	**-**
Payout ratio	-	-	-	-
Shares outstanding	80	80	80	81

Balance Sheet & Cash Flow Statement	FY19A	FY20A	FY21E	FY22E	FY23E
Cash and cash equivalents	1,116	893	1,434	2,234	-
Accounts receivable	392	390	474	557	-
Inventories	244	480	493	526	-
Other current assets	1,720	2,075	2,083	2,106	-
Current assets	**3,472**	**3,837**	**4,484**	**5,424**	**-**
PP&E	39	32	17	8	-
LT investments	4	8	8	8	-
Other non current assets	670	861	861	861	-
Total assets	**4,185**	**4,739**	**5,371**	**6,301**	**-**
Short term borrowings	0	0	0	0	-
Payables	92	134	119	152	-
Other short term liabilities	505	634	653	712	-
Current liabilities	**597**	**768**	**772**	**864**	**-**
Long-term debt	0	0	0	0	-
Other long term liabilities	694	650	650	650	-
Total liabilities	**1,291**	**1,419**	**1,422**	**1,514**	**-**
Shareholders' equity	2,895	3,320	3,949	4,787	-
Minority interests	-	-	-	-	-
Total liabilities & equity	**4,185**	**4,739**	**5,371**	**6,301**	**-**
BVPS	**37.93**	**43.70**	**52.32**	**63.90**	**-**
y/y Growth	*32.3%*	*15.2%*	*19.7%*	*22.1%*	-
Net debt/(cash)	(1,116)	(893)	(1,434)	(2,234)	-
Cash flow from operating activities	**963**	**735**	**757**	**1,033**	**-**
o/w Depreciation & amortization	33	45	35	42	-
o/w Changes in working capital	5	(165)	(126)	(105)	-
Cash flow from investing activities	**(284)**	**(609)**	**(20)**	**(33)**	**-**
o/w Capital expenditure	(16)	(15)	(20)	(33)	-
as % of sales	*0.7%*	*0.7%*	*0.8%*	*1.0%*	-
Cash flow from financing activities	**(218)**	**(346)**	**(200)**	**(200)**	**-**
o/w Dividends paid	-	-	-	-	-
o/w Net debt issued/(repaid)	0	0	0	0	-
Net change in cash	**461**	**(220)**	**537**	**800**	**-**
Adj. Free cash flow to firm	**906**	**692**	**727**	**991**	**-**
y/y Growth	*98.6%*	*(23.6%)*	*5.1%*	*36.3%*	-

Ratio Analysis	FY19A	FY20A	FY21E	FY22E	FY23E
Gross margin	64.7%	65.0%	65.1%	65.2%	-
EBITDA margin	39.6%	39.7%	40.0%	41.5%	-
EBIT margin	38.3%	37.7%	38.7%	40.2%	-
Net profit margin	32.6%	31.0%	30.7%	31.8%	-
ROE	31.2%	23.1%	22.8%	23.7%	-
ROA	21.7%	16.1%	16.4%	17.8%	-
ROCE	29.4%	22.2%	22.5%	23.5%	-
SG&A/Sales	9.4%	10.0%	9.9%	9.2%	-
Net debt/equity	NM	NM	NM	NM	-
P/E (x)	30.0	32.3	28.2	23.0	-
P/BV (x)	7.7	6.7	5.6	4.6	-
EV/EBITDA (x)	22.6	23.5	20.0	16.0	-
Dividend Yield	-	-	-	-	-
Sales/Assets (x)	0.7	0.5	0.5	0.6	-
Interest cover (x)	NM	NM	NM	NM	-
Operating leverage	140.6%	134.5%	117.1%	122.9%	-
Revenue y/y Growth	12.1%	(3.9%)	16.5%	20.8%	-
EBITDA y/y Growth	17.0%	(3.8%)	17.4%	25.4%	-
Tax rate	19.2%	21.0%	21.5%	21.5%	-
Adj. Net Income y/y Growth	22.3%	(8.7%)	15.4%	25.1%	-
EPS y/y Growth	22.3%	(7.0%)	14.4%	22.8%	-
DPS y/y Growth	-	-	-	-	-

Source: Company reports and J.P. Morgan estimates.

Note: $ in millions (except per-share data).Fiscal year ends Dec. o/w - out of which

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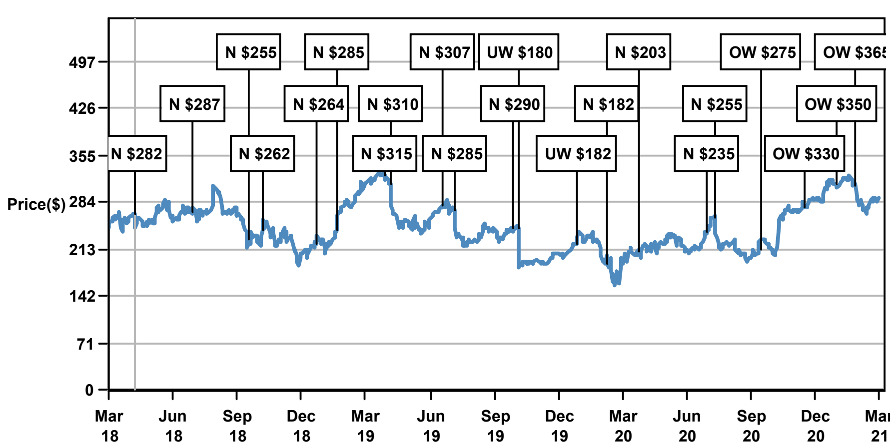
Arista (ANET, ANET US) Price Chart



Source: Bloomberg Finance L.P. and J.P. Morgan; price data adjusted for stock splits and dividends.
Initiated coverage May 13, 2016. All share prices are as of market close on the previous business day.
Break in coverage Oct 13, 2017 - May 03, 2018.

Date	Rating	Price ($)	Price Target ($)
03-May-18	N	265.46	282
23-Jul-18	N	268.84	287
11-Oct-18	N	225.79	255
02-Nov-18	N	240.96	262
18-Jan-19	N	221.03	264
15-Feb-19	N	240.78	285
22-Apr-19	N	323.38	315
03-May-19	N	310.85	310
16-Jul-19	N	277.64	307
02-Aug-19	N	272.22	285
22-Oct-19	N	243.84	290
01-Nov-19	UW	244.57	180
21-Jan-20	UW	221.87	182
04-Mar-20	N	191.75	182
19-Apr-20	N	210.02	203
24-Jul-20	N	239.30	235
04-Aug-20	N	260.51	255
08-Oct-20	OW	211.99	275
11-Dec-20	OW	276.37	330
25-Jan-21	OW	311.21	350
19-Feb-21	OW	308.85	365

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