

March, 17, 2017

FORTINET: FTNT

AlexandreTHIAM

Sector: Technology
Industry: Cybersecurity
Current Price: \$37.13
Target Price: \$50.32

Fortinet was founded in early 2000 by Ken Xie in Sunnyvale, California where he also based the headquarters. Ken Xie is said to be a visionary business man that already founded NetScreen. Both of these companies are network security providers mainly focusing on cyber-attacks. Thanks to his long experience within cyber security, Xie built and gathered a solid management team. The company is focusing on “top-rated” network and content security, as well as products that share intelligence via networks. The company count a majority of the fortune 500 as their customers, which proves the reliability of the service provided.

BUY

Current Price:	\$37.13
Target Price:	\$50.32
Market Cap:	\$6.50B
Debt Rating:	No debt
P/E:	42



Thesis:

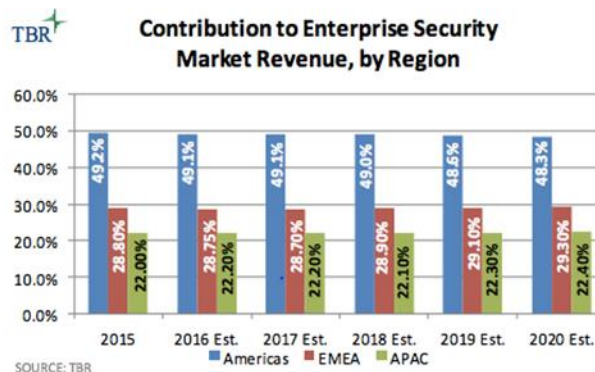
Cyber terrorism was one of the main topic and issue addressed by both Hilary and Trump during their campaign. The candidates said during national debates that counter cyber terrorism and espionage was one of their priorities. This attention benefited most of the industry with stock prices gaining ground. I believe that FTNT is a performing company within booming industry. Therefore I see a lot of upside potential for Fortinet. The company might currently be slightly underpriced, but the upside is about what the company is doing now, and the fact that FTNT is first in line to benefit from a growing industry.

Catalysts:

- Short Term(within the year): Earnings coming next month (strengthened guidance) and the new FortiGate release expected for 2017.
- Mid Term(1-2 years): The stock price would reflect the increasing demand and well-being of the industry being one of the leaders.
- Long Term(3+): Innovation and patent acquisition payoffs would most likely be factored in the stock price in the next 5 years.

Industry Outlook

The cybersecurity industry is gaining ground as well as popularity throughout the years, but still not highly regarded on an investors standpoint. However, the industry outlook looks promising and shows a lot of upside potentials for the market participants. In 2004, the global cybersecurity market was roughly worth \$3.5B and is now worth approximately 35x that amount with \$122.45B. This industry is known as one of the fastest growing one among the tech sector. Cybersecurity business gain in importance and his driven by the increase in security breaches caused attacks and malware viruses. In addition, the growing needs security of Internet of Things as well as Bring Your Own Device caused the users to seek better protection against hack risk. In 2015 the damages were valued at \$3 trillion and is expected to double to \$6 trillion by 2021. The CAGR for the industry, which has been increasing at a fast pace so far, is expected to grow at its highest pace for the period 2016-2021. North America represent the highest proportion of the markets and is expected to remain the major market in a near future due to a large presence of cyber security provider in the area.



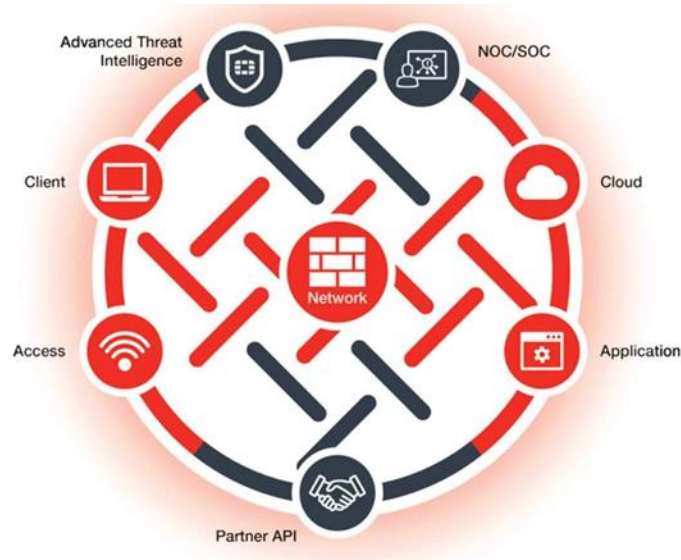
Furthermore, North America represent the region the adopted and endorsed cybersecurity at an early stage. According to Markets and Markets the early adoption is not the only case as “The report also encompasses different strategies, such as mergers & acquisitions, partnerships & collaborations, business expansions, and product developments, adopted by major players to increase their market share.” The Job market in this industry looks promising too, with a forecasted 1.5 million job openings by 2019 up from 1 million last year. Overall, the demand for cybersecurity experts will rise to 6 million. Even more striking, the unemployment rate is currently near 0% and is expected to remain at that level over the next 5 years.

Business Model

Fortinet’s business model, is based on mass market model with no preferential or differentiation between its customers. In other words the company is targeting, individuals as well as companies. The companies is also not focusing on a particular type of company, and targets from small to large cap as well any different industries (Finance, telecommunications, retail, education etc.). The business model comprehends designing and developing the products and services. Fortinet subcontracts the manufacturing of its products to foreign contract manufacturers including Flextronics International, Adlink Technology, and Taiwan-based manufacturers. Once the products is built, they are delivered to logistics partners located in strategic points in Taiwan or California. In those facilities Fortinet runs = quality-control checking and the packaging takes place.

The company's main components are derived from different suppliers and manufacturers, including CPUs, chips and solid-state drives from Intel, Samsung etc.

The channel of distribution used by Fortinet is rather complex. The company is selling the products offered to distributors using exclusive networks (Ingram Micro, Fine Tec Computer and Arrow Electronics). These distributors resell these products to B2B focused and networking security resellers such as Tech Data and Westcon. From that point the resellers sell the products/services to end-customers, which are mainly enterprises, service providers, and the government. The channel is also encompassing a sales team that aim end customers directly via the website and social Medias.



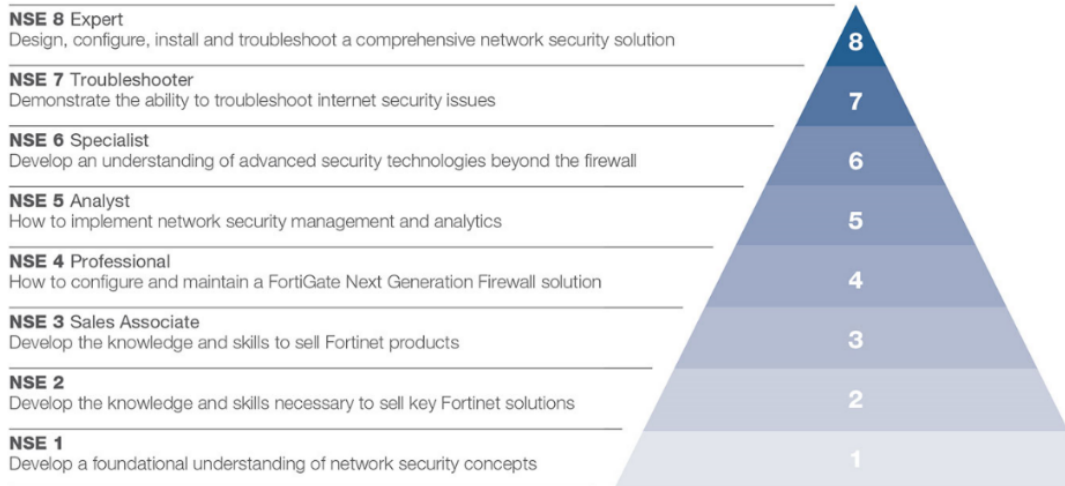
Although the company has a mass market model, Fortinet has key partners that ensure the wellbeing of operations. The company has alliance partners such as IBM, HP, Microsoft, that are helping the company building and developing more efficient solutions. The company also has Managed Security Service Providers such as BAE systems, EarthLink Business, Trustwave etc. that furnish system integrators, platforms, and support as well as selling Fortinet's service to their customers.

Products/Services:

Services- *FortiGuard* security which is a subscription services that offers antivirus, intrusion prevention, web filtering, anti-spam, vulnerability management updates, and application controls.

FortiCare is a technical support services designed for software updates, Internet access to technical content, and hardware support.

Fortinet is also providing 8 different training courses that aim at forming the employees of the future with the required level of understanding and expertise of cybersecurity.



Products – Fortinet as numerous products, each with a specific allocation. The company offers Firewalls through its *FortiGate* line of products. The firewalls are offering the clients an “End-to-end security across the full attack cycle” over the entire network within which it is deployed. The company sells both high-end and mid-range firewalls adapting its products to the carious demand of customers. The price range for the firewalls is very wide with prices going from \$850 to \$215,000.

The *FortiSandbox* by Fortinet is a top-rated proactive advanced threat and breach detectors. This product is extension of the firewalls offered by the company. In other words, this product is a advance highly performant anti-virus that enhance the threat detection using a flexible easy-to-use deployment. The Sandbox is available as a physical or virtual as well as cloud based form.

Enterprise-class WiFi is a internet router sold by the company that offers a secured wireless LAN solutions to clients. The Fortinet WLAN box is said to be the best-in-class security to protect connected devices and applications.

Innovation:

Being part of a highly innovative industry, Fortinet has to strive in order come up efficient and quality products. Security innovation is a stone pillar of competitiveness within the technology sector. The company reached the milestone of 300 different patents in 2016. The CEO Ken Xie said “When we founded the company 16 years ago, we foresaw the move to IoT, BYOD, and the cloud. Our strong foundation of innovation and unprecedented patent portfolio has enabled us to stay ahead of the ever-evolving threatscape. We were the first to identify the internal segmentation trend two years ago, which is now gaining significant momentum in the market. Our Security Fabric uniquely positions us to address the security challenges faced by enterprise customers today. We will continue to invest in technologies to help power our Security Fabric and that enable our customers to implement innovative security strategies for seamless, comprehensive threat protection across the expanding attack surface.”

The management which has proven efficiencies, are incline to pursue innovation mostly through acquisition (Meru Network, AccelOp etc.) in order to grow the business. The company is currently viewed as the global leader in the high performance cybersecurity solutions and also as a pioneer in innovation creating cost effective, reliable products. The company continues to lead the industry thanks to its broad differentiation base of products or services. One main advantage is that in this particular industry having a broad differentiation model is orienting the company towards a more vertically integrated model. Indeed, Fortinet is in the position to offer a multitude of not only services but also products in completion of a sell. For instance after selling a FortiGate firewall, Fortinet can offer a FortiSandBox (product) for malware detection, and also FortiOS in order to simplify the use of the equipment via one handy application.

Financials/valuation:

As shown in the industry outlook, Fortinet is doing most of its sales in North America with 42.1%. The remaining revenues are generated in the EMEA with 37.4% and Pacific Asia with 20.5%. This is line with the industry expectations of the geography for the industry. The breakdown by segments shows that as of 2016, the company has generated 57.0% (\$727.3 million) of its revenue through services against 43% (\$548.1 million) for the products which represents 262.5% of total revenue. As shown on the table below, the company has a low cost of revenue for the services of \$128.9 million which implies a 82.30% gross margin whereas the cost of products (higher due to costs associated with the production absent for services) were \$209.0 million which shows a 60.10% gross margin

In Millions of USD except Per Share 12 Months Ending	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	FY 2016 12/31/2016
Revenue	433.6 100.0%	533.6 100.0%	615.3 100.0%	770.4 100.0%	1,009.3 100.0%	1,275.4 100.0%
Services	220.3 50.8%	274.0 51.4%	329.7 53.6%	409.8 53.2%	532.5 52.8%	727.3 57.0%
Product	197.4 45.5%	248.9 46.7%	278.0 45.2%	360.6 46.8%	476.8 47.2%	548.1 43.0%
Ratable Product and Services	15.9 3.7%	10.6 2.0%	7.5 1.2%	-	-	-
Cost of Revenue	113.6 100.0%	147.4 100.0%	180.6 100.0%	231.0 100.0%	286.8 100.0%	337.8 100.0%
Product	73.2 64.4%	94.0 63.7%	114.6 63.4%	151.3 65.5%	190.4 66.4%	209.0 61.9%
Services	35.5 31.2%	50.7 34.4%	64.1 35.5%	79.7 34.5%	96.4 33.6%	128.9 38.1%
Ratable Product and Services	4.9 4.3%	2.8 1.9%	1.9 1.1%	-	-	-
Gross Profit	320.0 100.0%	386.2 100.0%	434.7 100.0%	539.4 100.0%	722.5 100.0%	937.6 100.0%
Services	184.8 57.7%	223.4 57.8%	265.6 61.1%	330.1 61.2%	436.1 60.4%	598.5 63.8%
Product	124.2 38.8%	155.0 40.1%	163.4 37.6%	209.3 38.8%	286.4 39.6%	339.1 36.2%
Ratable Product and Services	11.0 3.4%	7.9 2.0%	5.6 1.3%	-	-	-
Gross Margin	-	-	-	-	-	-
Services	83.90	81.50	80.60	80.50	81.90	82.30
Product	62.90	62.30	58.80	58.00	60.10	61.90
Ratable Product and Services	69.10	74.00	74.60	-	-	-

Overall the mean of the two margins indicates a company gross margin of 73.5%/. On the other hand, the operating expenses skyrocketed the last three years due to an increase in SG&A and now account for 70.3% of total revenue (SG&A went from 42% to 56%). This bring down the operating margin to 3.2% (73.5% - 70.3%) from 20.5% in 2011. This is explain by the expansion strategy of Fortinet through acquisition of products, which logically increases the SG&A expenses.

Compared to its peers, Fortinet has been showing throughout the years that it was without the shadow of the doubt one of the industry leaders. The mid-cap company (\$6.50 billion) valuations is still showing signs of skepticism on the behalf of investors. Indeed despite being the industry leader the company is still having a rather low P/E of 42.24 against a peer average of 50.15. Yet, the sales growth YoY are at 26.37% way above industry average of 15.58%. The 3 most direct competitors (Palo Alto, Proofpoint, and FireEye) are showing

higher growth which probably encouraging investors doubt. But we further research it appears that these company are capitalizing a prior projects when FTNT is still in the process of focusing on future cash flows generated by new project. This might show a backlog of revenue that the company will catch up a little further down the line. On the other, the EBITDA margin should bring joy to investors as FTNT margin stand at 8.55% against the industry 6.79%. However the direct competitors, PANW, PFPT, and FEYE that had better sales growth all have negative margins with -9.79%, -10.71%, and -40.98% respectively. In line with the high job creation expected in the entire industry over the next 5 years, FTMT 1-yr employee growth is as 16.10% against an average of 5.52%. The R&D / Sales is at 14.35% considerably lower than industry at 21.11%. This is consistent with the ambition of Fortinet to allocate capital in R&D (to innovate) but also acquiring companies and patents. Hence the reason why Fortinet Cash on hand (Cash equivalent) has always been increasing going from \$90 million if 2007 to \$1,085.5 million in 2016. The company has been raising its most liquid assets in order to be able to quickly purchase interesting products or companies if there is a sudden opportunity. All the above figures are shown on the table below.

Equity Valuation	Op Stats	Profitability	Balance Sheet	ESG						
Name (BI Peers)	Sales Growth Yoy (%)	EBITDA Margin (%)	Employees 1 Yr Growth	Revenue 1 Yr Growth	License Revenue 1 Yr Growth	intenance Revenue 1 Yr	Gross Profit 1 Yr Growth	Operating Profit 1 Yr Growth	R&D/Sales	
Average	15.58%	6.79%	5.52%	15.58%	11.99	7.42	16.32	10.74%	21.11%	
100) FORTINET INC	26.37%	8.55%	16.10%	26.37%	14.96	--	29.77	87.90%	14.35%	
101) PROOFPOINT INC	41.48%	-10.71%	30.76%	41.48%	42.21	--	47.18	0.98%	26.23%	
102) PALO ALTO NETWORKS INC	48.54%	-9.79%	43.91%	48.54%	36.16	--	48.20	-47.51%	20.62%	
103) FIREEYE INC	14.63%	-40.98%	-6.45%	14.63%	-29.87	--	13.47	18.63%	39.15%	
104) IMPERVA INC	12.87%	-18.98%	7.58%	12.87%	--	--	12.80	-23.62%	23.60%	
105) SYMANTEC CORP	-9.00%	24.78%	-42.11%	-9.00%	0.78	-9.33	-7.56	86.48%	20.78%	
106) TREND MICRO INC	6.13%	34.52%	--	6.13%	--	--	5.68	10.92%	3.99%	
107) CHECK POINT SOFTWARE ...	6.84%	49.79%	--	6.84%	3.09	3.05	6.86	1.50%	10.24%	
108) MOBILEIRON INC	9.80%	-37.35%	1.30%	9.80%	--	--	10.27	20.79%	41.11%	

Conclusion:

All in all, the business and operations of Fortinet are rather easy to understand for a tech company. On top of this the ambitions as well as the direction the company is taking are clear, Fortinet wants to head north. The sales level as well as financials are showing that the company is well managed, therefore stable. The strategy namely the innovation and acquisition clears indicates a real upside potential.

Fortinet, Inc. (FTNT)

CENTER FOR GLOBAL FINANCIAL STUDIES

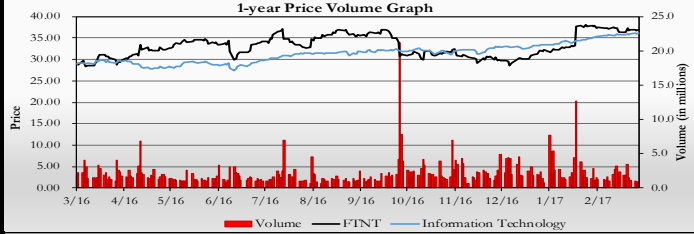
BULLISH

Analysis by Alexandre Thiam
3/17/2017

Current Price: **\$37.13**
Divident Yield: **0.9%**

Intrinsic Value **\$45.17**
Target Price: **\$50.32**

Target 1 year Return: **36.43%**
Probability of Price Increase: **98.8%**

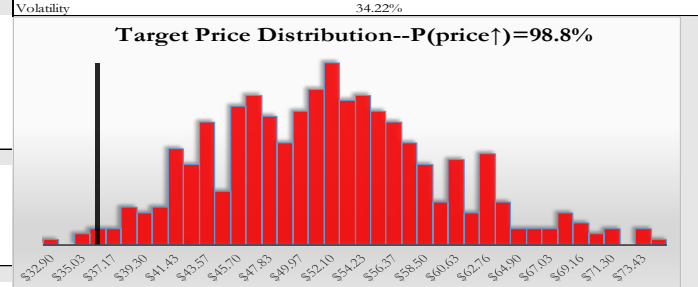


Description	
Fortinet, Inc. provides cybersecurity solutions for enterprises, service providers, and government organizations worldwide.	
General Information	
Sector	Information Technology
Industry	Software
Last Guidance	November 3, 2015
Next earnings date	NM
Estimated Country Risk Premium	2.75%
Effective Tax rate	13%
Effective Operating Tax rate	33%

Market Data	
Market Capitalization	\$6,509.63
Daily volume (mil)	3.09
Shares outstanding (mil)	175.32
Diluted shares outstanding (mil)	176.34
% shares held by institutions	62%
% shares held by investments Managers	53%
% shares held by hedge funds	14%
% shares held by insiders	14.15%
Short interest	2.51%
Days to cover short interest	1.81
52 week high	\$38.33
52-week low	\$27.95
Levered Beta	1.26
Volatility	34.22%

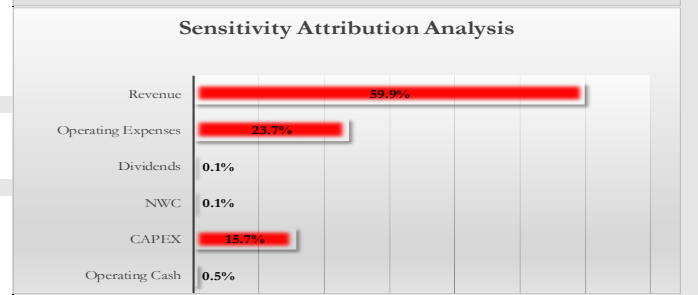
Past Earning Surprises	
Quarter ending	Revenue
12/31/2015	-0.89%
3/31/2016	2.73%
6/30/2016	0.13%
9/30/2016	-1.36%
12/31/2016	4.68%
Mean	1.06%
Standard error	1.1%

EBITDA	
12/31/2015	-61.28%
3/31/2016	-80.77%
6/30/2016	-86.39%
9/30/2016	-64.09%
12/31/2016	-17.37%
Mean	-61.98%
Standard error	12.1%



Management	
Xie, Ken	Founder, Chairman and Chief
Xie, Michael	Co-Founder, President, Chief
Del Matto, Andrew	Chief Financial Officer
Whittle, John	Vice President of Corporate
Jensen, Keith	Chief Accounting Officer, Vi
Perche, Patrice	Senior Executive Vice Presid

Total compensations growth	
37.53% per annum over 5y	6.23% per annum over 5y
40.91% per annum over 5y	6.23% per annum over 5y
-37.52% per annum over 1y	1.66% per annum over 1y
33.92% per annum over 5y	6.23% per annum over 5y
N/M	N/M
N/M	N/M



Profitability	
ROIC	24.8%
NOPAT Margin	12%
Revenue/Invested Capital	1.99
ROE	11.3%
Adjusted net margin	12%
Revenue/Adjusted Book Value	0.93

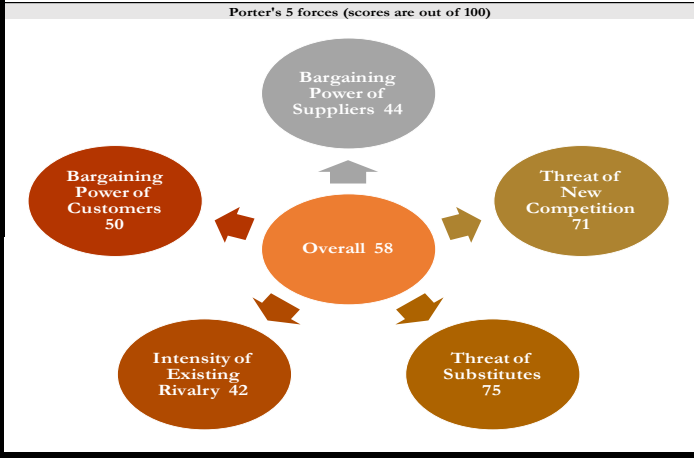
FTNT (5 years historical average)	
255.01%	12.61%
29.04%	17.5%
8.78	0.72
27.32%	13.88%
28.82%	15.5%
0.95	0.90

Valuation	
NOPAT margin	12.4%
ROIC/WACC	3.35
12/31/2017	30.3%
12/31/2018	29.8%
12/31/2019	30.5%
12/31/2020	29.0%
12/31/2021	26.9%
12/31/2022	25.5%
12/31/2023	24.0%
12/31/2024	22.6%
12/31/2025	21.2%
12/31/2026	19.9%
Continuing Period	18.5%

Invested Funds	
Total Cash/Total Capital	61.2%
Estimated Operating Cash/Total Capital	24.3%
Non-cash working Capital/Total Capital	-21.2%
Invested Capital/Total Capital	49.2%

FTNT (5 years historical average)	
58.4%	53%
20.6%	N/A
-19.8%	-2.9%
38.4%	66%

Net Claims	
Base Year	-\$604.15
12/31/2017	-\$987.61
12/31/2018	-\$1,463.75
12/31/2019	-\$1,997.98
12/31/2020	-\$2,536.83
12/31/2021	-\$3,177.51
12/31/2022	-\$3,680.86
12/31/2023	-\$4,175.00
12/31/2024	-\$4,649.70
12/31/2025	-\$5,093.50
12/31/2026	-\$5,514.64
Continuing Period	-\$5,514.64



Revenue growth	
Base Year	26.4%
12/31/2017	15.5%
12/31/2018	12.7%
12/31/2019	12.2%
12/31/2020	11.8%
12/31/2021	9.3%
12/31/2022	8.4%
12/31/2023	7.5%
12/31/2024	6.6%
12/31/2025	5.7%
12/31/2026	4.9%
Continuing Period	4.0%

Invested Capital	
Base Year	\$34.50
12/31/2017	\$136.26
12/31/2018	\$250.38
12/31/2019	\$465.93
12/31/2020	\$639.73
12/31/2021	\$872.88
12/31/2022	\$1,158.29
12/31/2023	\$1,449.61
12/31/2024	\$1,759.31
12/31/2025	\$2,099.54
12/31/2026	\$2,453.85
Continuing Period	\$2,453.85