

October 6, 2018

**Symantec: SYMC**

Samantha St.Germain

**Sector: Information Technology**

**Industry: Software**

**Current Price: \$19.46**

**Target Price: \$22.52**

**Company Description:** Symantec is offers digital security solutions in the consumer and enterprise markets. Offering products to protect against information risk, product lines include Norton, Lifelock, and Blue Coat. Symantec offers integrated security solution for desktop, mobile, wireless, and cloud computing.

## Hold

Current Price:	\$19.46
Target Price:	\$22.52
Market Cap:	12.46B
Volume:	5.28
SI/Float	17.6M/2.99%
EPS	\$0.34
Operating Margin	28.1%
Organic Growth	-2%



**Thesis:** Symantec (SYMC) is currently trading far below its 52 week high of \$33.92. The main drop came from an SEC investigation, which is now closed with only minimal changes to past revenue. While the stock has opportunity for growth, the firm faces multiple issues with its current product line, increasing sales cycles, and increasing cost which will limit upside growth.

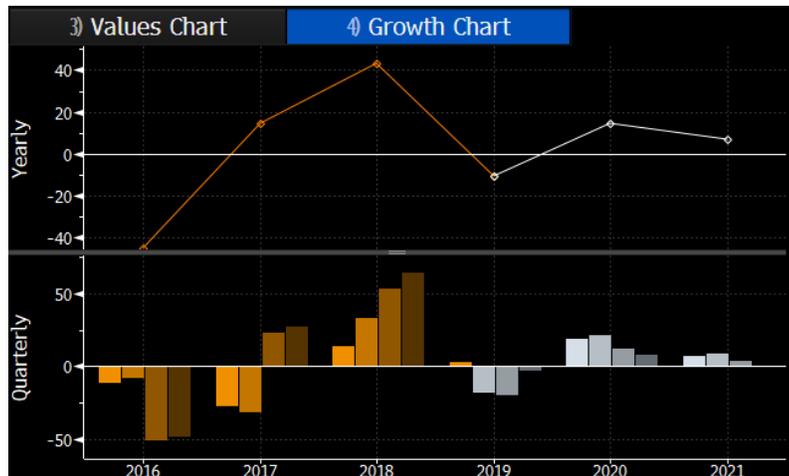
## Catalysts:

- Drop in Demand for Norton Products caused by free alternatives, smaller companies, and a move from PC to mobile options.
- Increase in Sales timeline for Enterprise security decreasing profitability.
- Increasing cost of capital due to debt rating downgrade will make it more expensive to secure funding for new projects.

## Earnings Performance:

For Q1 FY19, Symantec reported \$1.165 billion in revenue and \$0.34 EPS. This reflects revenue contraction of 5% from Q1 FY18. However, EPS was up 3% from \$0.33 the previous year. Operating Margin decreased 260 bps to 28.1% from 30.7%, dropping operating income 13% from \$377 million in Q1 FY18 to

\$327 million in Q1 FY19. Net income did increase to \$671 million from \$664 million the prior year, an increase of 5%. Operating expenses remained about the same.



EPS Growth (Bloomberg)

The Consumer Digital Safety segment, accounting for 51% of revenue, saw 7% growth from Q1 FY19. This can be attributed to the bundle of the LifeLock and Norton product lines. Enterprise Security, accounting for the other 49% of revenue, saw a 16% decrease from Q1 FY18. This decrease can be attributed to longer sales cycles. Trends in both Consumer Digital Safety and Enterprise Security will be discussed in later sections.

	Q1FY19	Q1FY18	Y/Y Growth
<b>Revenues and Earnings Results</b>			
GAAP Revenues	\$1,156	\$1,175	(2%)
Non-GAAP Revenues	\$1,165	\$1,228	(5%)
Diluted GAAP EPS	(\$0.10)	(\$0.22)	(55%)
Diluted non-GAAP EPS	\$0.34	\$0.33	3%
<b>Revenues by Segment - Non-GAAP</b>			
Enterprise Security	\$565	\$669	(16%)
Consumer Digital Safety	\$600	\$559	7%
<b>Expenses and Profitability - Non-GAAP</b>			
Operating expenses	\$652	\$655	(0%)
Operating income	\$327	\$377	(13%)
Operating margin	28.1%	30.7%	(260 bps)
Net income	\$231	\$221	5%
Fully diluted shares outstanding	671	664	1%

Financials from Symantec First Fiscal Quarter 2019 Supplemental Information (Dollars and shares in million)  
[http://s1.q4cdn.com/585930769/files/doc\\_downloads/2018/Q1FY19-Supplemental-Information.pdf](http://s1.q4cdn.com/585930769/files/doc_downloads/2018/Q1FY19-Supplemental-Information.pdf)

## SEC Investigation Drops Price:

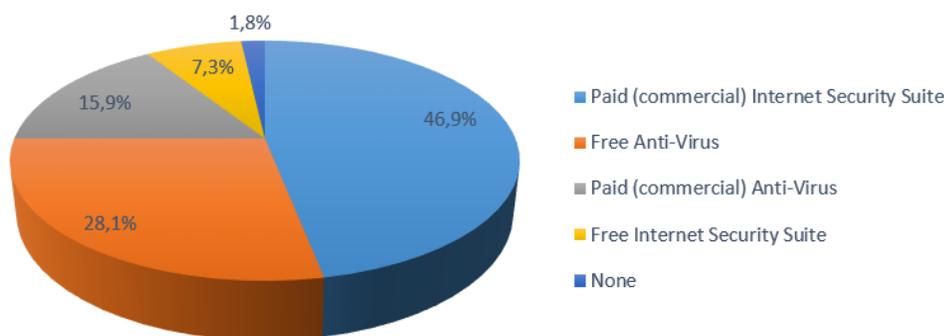
In May 2018, Symantec issued a statement stating that it was currently under investigation by the SEC due to concerns raised by a former employee about the firm's revenue recognition. On May 10<sup>th</sup> the stock closed at \$28.97 and opened on May 11<sup>th</sup> at \$20.02, a 30.89% drop in price. The stock price was dropping prior

to the investigation, already down 14.59% from its 52 week high of \$33.92. While the company could not comment on the investigation in the Q1 FY19 earnings call, CEO Gregory S. Clark did mention that there was “negative press in the market during the quarter”.

On September 24<sup>th</sup>, Symantec issued a statement about the findings of the investigation. The Audit Committee found that \$12 million of revenue from a \$13 million transaction in Q4 2018 should not have been reported until Q1 2019. With the audit investigation complete, the results have been factored into the price by investors and anticipation for the results will no longer be dragging the price of the stock down. However, with the following factors weighing down the price, investors have reason to be wary.

## Competition in Consumer Digital Safety:

In 2017, 62.2% of users used paid security solution for their devices. This is down 5% from the previous year. While Norton is one of the top security solutions, the whole industry faces pressure from free security products such as AVG. Norton products have also faced downward pressure from a decreased demand for PCs, with consumers moving to more mobile options.



Revenue from Norton decrease from \$1,887 in 2015 and \$1,670 in 2016 to \$1,597 in 2017. This translates to an 11.5% drop in sales in 2016 and a 4.4% decrease in 2017. The decline slowed due to transition to a subscription based service.

Graph and Data from 2017 IT Security Survey by AV Comparatives  
<https://www.av-comparatives.org/surveys/it-security-survey-2017/#q4>

Revenue from the Lifelock acquisition equaled \$67 million; making up for some of Norton’s lost sales. Lifelock offers digital security products and fraud protection to its customers, a field of growing importance as the threat of identity theft increases. So while Lifelock will become an integral part of Symantec’s business over the next several years, the threat to Norton will be a drag on growth.

According to Bloomberg, Smaller Endpoint Security Vendors are gaining more traction in the market. While Symantec only saw 2% revenue growth for their endpoint security in 2017, top competitor McAfee saw 10% growth. Firms that only make up 1% of the market also saw higher growth, with CrowdStrike growing 128% in 2017, Cylance growing 47% and Palo Alto Networks growing 33%. Symantec still has the most market share with 22% of the Endpoint Security market, second being McAfee at 17%.

## Increase in Sales Timeline:

A main concern for the Q1 2019 was the increasing sales period in the enterprise system. In the earnings call, CEO Gregory Clark spoke about the how the Integrated Cyber Defense Platform “continues to gain traction with customers, and we continue to close a large number of enterprise deals with multi product platform sales.” It is important to recognize the increased timeline for those sales. In Q1 2018 the duration of projects was 15.5 months compared to Q1 2019 which was 16.5 months.

Due to this increase in sales cycles, Q1 2019 decreased in billing by \$110 million. This decrease equates to 3.8% of billings for FY18. In terms of revenue, this equates to an approximate \$60 million or revenue for FY19. While renewals in products take about 12 months, new and larger sales often take up to 36 months. As deals become larger and more complex, approval time for these deals increases. Overall for Q1 of 2019, sales for the Enterprise Security Segment were down 16% from Q1FY18.

Increasing sales cycles come from two different areas. The first is from security trends. As both technology and cyber threats become more advanced, security measure must also advance. Firms need security more than ever, and with threats becoming more advanced and complex, so do the solutions to protect firms against them. These longer sales cycles will cause revenue recognition to be deferred long than in previous periods, therefore putting downward pressure on sales growth.

## Increasing Cost of Capital:

With the acquisitions of Blue Coat Systems for \$4.5 billion and LifeLock for \$2.3 billion, the company issued \$750 of new debt. In addition, Symantec increased buyback authorization to \$1.3 billion. This resulted in a downgraded credit rating by Standard and Poor’s.

While Moody’s kept the credit rating unchanged, Standard & Poor’s dropped the rating to BB+, below investment grade.

Fitch also has rated at BB+. Moody’s released a statement saying:

“The ratings could be downgraded if the company is unable to achieve its aggressive integration and cost cutting plans, if combined organic revenue does not show signs of stabilizing or leverage is not on track to fall towards 3x over the next eighteen months. Given the company's elevated financial leverage, integration risks and turnaround challenges, an upgrade is unlikely in the near term.”

Moody’s put the Baa rating under review in May 2018 pending results of the Audit Committee investigation. Upon the results of the investigation, Moody’s kept Symantec’s rating stable.



This increased credit risk has increased the cost of capital, discounting the value of the company. In the beginning of 2017, the WACC was 5.79%. The WACC currently sits at 8.33%, a 0.44% increase in costs. With the current economic outlook for the company, an upgrade in nowhere in the near future. Symantec's Debt to EBITDA is currently 7.12.

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## **Conclusion:**

Symantec has taken a huge hit in stock price, but this is not necessarily a bad thing. If anything, the decrease in price has brought it in line with value. While the firm should be able to recover some value now that the investigation has concluded, there are multiple factors that weigh on future growth.

Norton and similar products face pressure from multiple lines of competition. From free alternatives to smaller companies outpacing growth of established competitors, Norton is losing market share. Over the past year, the decline of Norton has been slowed by the acquisition of Lifelock, allowing Symantec to bundle products. While this has slowed the decline, it does not fix the core problems with Symantec's products.

The Enterprise Security segment has its own share of battles. The increasing digital threat landscapes give firms like Symantec an opportunity for growth, but the complexity also increases sales timelines due to larger, more complex projects and longer approval times. Symantec faces these increasing timelines hurting their bottom line and will need to balance new, larger deals with a mix of smaller, less time-consuming projects to keep cash flow strong.

As Symantec acquires firms to supplement problems with core products, like the Norton and Lifelock relationship, they will have to increase debt financing. A major concern is their credit rating decreasing, already below investment grade for Standard and Poor's with Moody's stating it is unlikely to increase the rating in the near future. If Symantec wants to finance more projects in the future, they will face higher costs to do so, decreasing the profitability of those products.

**Symantec Corporation**  
**(SYMC)**

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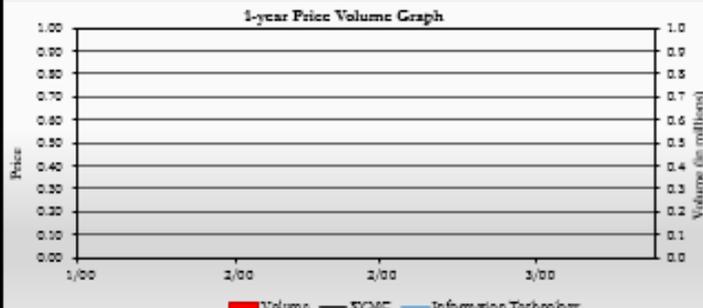
**NEUTRAL**

Analysis by Sam St.Germain  
10/11/2018

**Current Price:** \$19.46  
**Dividend Yield:** 1.5%

**Intrinsic Value:** \$17.19  
**Target Price:** \$22.16

**Target 1 year Return: 15.38%**  
**Probability of Price Increase: 32%**



Description	
Symantec Corporation, together with its subsidiaries, provides cybersecurity solutions worldwide.	
General Information	
Sector	Information Technology
Industry	Software
Last Guidance	May 8, 2018
Next earnings date	October 31, 2018
Market Assumptions	
Estimated Equity Risk Premium	8.16%
Effective Tax rate	20%

Market Data	
Market Capitalization	\$12,368.62
Daily volume (mil)	5.31
Shares outstanding (mil)	621.54
Diluted shares outstanding (mil)	671.75
% shares held by institutions	98%
% shares held by investment Managers	83%
% shares held by hedge funds	9%
% shares held by insiders	1.08%
Short interest	2.85%
Days to cover short interest	2.11
52-week high	\$32.95
52-week low	\$17.81
Volatility	30.88%

Quarter ending	Part Earning Surprises	
	Revenue	EBITDA
6/30/2017	-2.30%	-66.60%
9/29/2017	-2.82%	-63.74%
12/29/2017	-4.43%	117.35%
3/30/2018	2.68%	-39.64%
6/29/2018	0.52%	-59.17%
Mean	-1.27%	-22.36%
Standard error	0.9%	24.3%

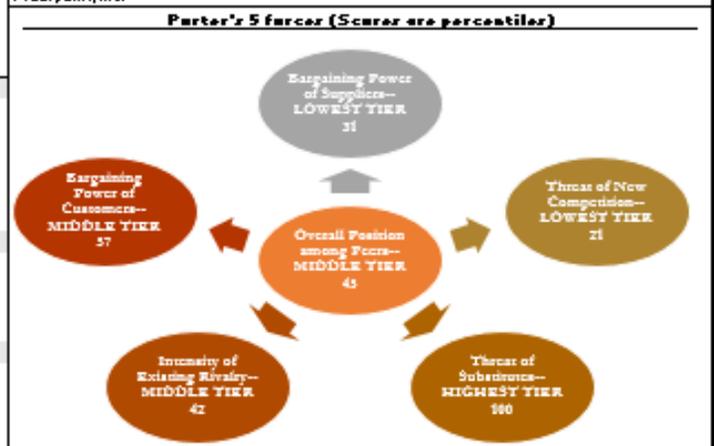
Market and Credit Scores	
Recommendation (STARS) Value--3	
Recommendation (STARS) Description--Hold	
Quality Ranking Value--B	
Quality Ranking Description--Below Average	
Short Score--0	
Market Signal Probability of Default % (Non-Rating)--0.24%	
Credit Model Score (Non-Rating)--bb	

Industry and Segment Information	
<b>LTM Revenue by Geographic Segment</b>	<b>LTM Revenue by Business Segment</b>
EMEA (Europe, Middle East and Africa)--24%	Enterprise Security Implied Billing--53%
APJ (Asia Pacific and Japan)--18%	Consumer Digital Safety Implied Billing--47%
NA (North America)--58%	
NA (North America)--58%	

Management	Paritians	Total Compensation Growth	Stock Price Growth During Tenure
Clark, Gregory	CEO & Director		0% per annum over 0y
Fay, Michael	President & COO		0% per annum over 0y
Naviella, Nicholas	Executive VP & CFO		0% per annum over 0y
Taylor, Scott	Executive VP, General Counsel & Secretary	-100% per annum over 4y	4.81% per annum over 4y
Thompson, Hugh	Chief Technology Officer		
Hipania, Cynthia	Vice President of Investor Relations		

Peers	
Check Point Software Technologies Ltd.	--
Palo Alto Networks, Inc.	--
FireEye, Inc.	--
Fortinet, Inc.	--
Praefix, Inc.	--

Profitability	SYMC (LTM)		Peers' Median (LTM)		
	SYMC Historical	Peers' Median (LTM)	SYMC Historical	Peers' Median (LTM)	
Return on Capital (GAAP)	-1.8%	28.46%	-1.45%	28.46%	
Operating Margin	-6%	27.33%	14.43%	27.33%	
Revenue/Capital (GAAP)	0.31	1.04	-0.10	1.04	
ROE (GAAP)	16.9%	15.5%	8.8%	15.5%	
Net margin	22.0%	23.9%	16.3%	23.9%	
Revenue/Book Value (GAAP)	0.765368225	0.65	0.54	0.65	
Invested Funds	SYMC (LTM)		Peers' Median (LTM)		
	SYMC Historical	Peers' Median (LTM)	SYMC Historical	Peers' Median (LTM)	
	Cash/Capital	25.5%	49.8%	31.8%	49.8%
	NWC/Capital	-14.9%	-30.8%	-12.6%	-30.8%
Operating Assets/Capital	32.1%	30.3%	33.7%	30.3%	
Goodwill/Capital	57.2%	14.4%	42.5%	14.4%	
Capital Structure	SYMC (LTM)		Peers' Median (LTM)		
	SYMC Historical	Peers' Median (LTM)	SYMC Historical	Peers' Median (LTM)	
	Total Debt/Market Capitalization	0.35	0.36	0.26	0.36
	Cost of Debt	4.0%	5.0%	3.8%	5.0%
WACC	8.5%	13.7%	10.2%	13.7%	



Forecast Assumptions	Explicit Period (13 years)		Continuing Period	
	Explicit Period (13 years)	Continuing Period	Explicit Period (13 years)	Continuing Period
Revenue Growth CAGR	7%	4.0%	7%	4.0%
Average Operating Margin	32%	30%	32%	30%
Average Net Margin	28%	23%	28%	23%
Growth in Capital CAGR	8%	4%	8%	4%
Growth in Claims CAGR	2%	4%	2%	4%
Average Return on Capital	8%	7%	8%	7%
Average Return on Equity	12%	8%	12%	8%
Average Cost of Capital	10%	11%	10%	11%
Average Cost of Equity	13%	13%	13%	13%

