



JHVEPhoto/iStock Editorial via Getty Images

Investment Thesis

Fortinet, Inc. (NASDAQ:FTNT) delivered strong Q2 2024 results that gave investors precisely what they craved, namely, better revenue growth rates, with substantially better profitability.

Investors cheered, sending this stock to jump more than 15% premarket. Furthermore, I have revised my neutral rating on this stock to a buy, as I believe that paying around 20x next year's non-GAAP operating profits, together with its very strong balance sheet, leaves this stock attractively valued.

Rapid Recap

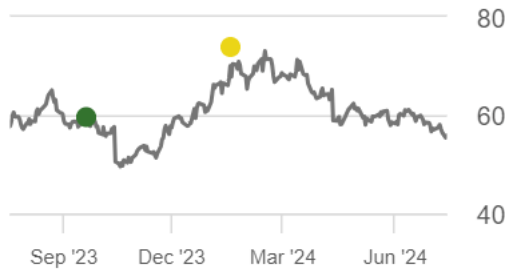
In early February, I soured on Fortinet. This is what I said at the time,

Fortinet has popped 10% on the back of its outlook for 2024. But is there enough here to compel me to bang my fist on the table and call this stock a buy at this point? No, there is not, even though I recognize that turning neutral on a stock that is up nearly 12% premarket reflects an investor that simply "doesn't get it."

To which I retort I strongly believe that in the cybersecurity sector, there are vastly more compelling investments than FTNT.

Stock Covered	FTNT
Analyst's rating at publication	HOLD
Price at publication	\$73.83
Change	-24.41%
S&P 500 change	5.37%

Analyst's rating history



Author's work on FTNT

At the time, that was a tough call to make. I had previously been recommending FTNT and when those results came out, the stock soared. And I looked through its results and decided that the risk-reward wasn't appealing enough for me. Since then, the stock is down more than 10% (including the premarket jump of 15%).

So why am I now bullish? Let's get to it.

Fortinet's Near-Term Prospects

Fortinet is a company that specializes in cybersecurity solutions, offering products and services that help secure networks, data, and applications. These are, to a large extent, hardware solutions.

Furthermore, Fortinet is known for its high-performance FortiOS and FortiASIC technologies, which provide security at low costs.

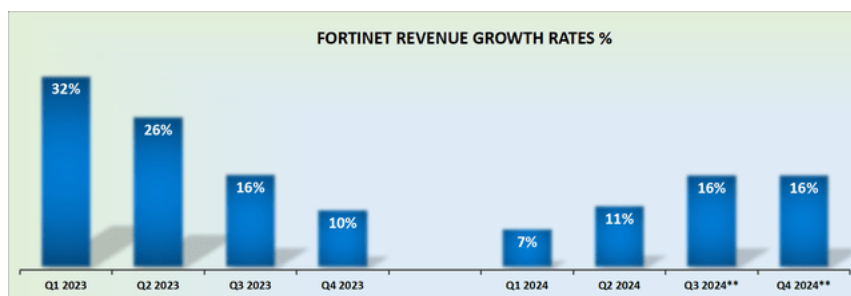
Fortinet's offerings include Unified SASE, a single operating system that integrates several security functions to enhance security operations.

In the near term, Fortinet's prospects look favorable. Fortinet achieved record operating margins and continues to grow its revenue. They are gaining market share in secure networking and investing in fast-growing areas like Unified SASE and Secure Ops. The recent acquisitions of Next DLP and Lacework are expected to expand their market reach and enhance their product offerings, positioning Fortinet well in the fluid cybersecurity market.

And yet, Fortinet also faces challenges. For example, as noted during the earnings call, while the hardware market is showing signs of recovery, a full refresh cycle of firewalls is not expected until 2025, which could delay some revenue growth in the very near term.

Given this balanced background, let's now discuss its improving fundamentals.

Fortinet's Outlook Improves



FTNT revenue growth rates

Fortinet's outlook for 2024 was revised upwards. Looking out to H2 2024, it now appears likely that Fortinet's revenues are going to reaccelerate so that the second half of 2024 could see around 16% y/y increases in both quarters.

Furthermore, given that its comparables into early 2025 are relatively easy, this implies that there's a high likelihood that Fortinet could once more be considered a solid growth business, rather than a firewall company that is potentially facing obsolescence.

All that being said, it's not so much that the outlook improved so dramatically. Rather, it's the combination of lower expectations, together with a slightly raised growth rate, which is the "catalyst" to drive this share price higher.

Given this context, let's now discuss Fortinet's valuation.

FTNT Stock Valuation - 20x Next Year's Operating Income

Fortinet's balance sheet is very strong, with approximately \$2.3 billion of net cash, including marketable securities. This means that approximately 5% of its market cap is made up of cash.

Moreover, consider that previously, investors were eyeing up Fortinet as delivering around \$1.6 billion of non-GAAP operating income. Now, given Fortinet's newly updated guidance, this implies that approximately \$1.9 billion could be on the cards this year.

Naturally, given this progression and improvement, it appears possible that Fortinet could see close to \$2.3 billion of non-GAAP operating income in 2025. Altogether, this leaves Fortinet priced at 20x next year's non-GAAP operating income. A figure that, I believe, is rather compelling.

Incidentally, as a point of reference, note that Fortinet's competitor Juniper Networks, Inc. (JNPR) has recently been acquired at more than 20x forward operating profits, even though its growth rates are decidedly negative. More specifically, Juniper Networks, Inc.'s most recently reported results point to its revenues being down 17% y/y.

The Bottom Line

Paying 20x next year's non-GAAP operating profits for Fortinet strikes me as an attractive valuation due to several compelling factors. First, Fortinet's strong balance sheet, boasting \$2.3 billion in net cash, provides financial stability and the flexibility to invest in growth opportunities. Secondly, the company's revenue growth is poised for acceleration, with an expected 16% y/y increase in the second half of 2024, suggesting robust future prospects.

Compared to its peers, such as Juniper Networks, which was acquired at a similar multiple despite negative growth, Fortinet's valuation appears even more justified.

This combination of growth potential, financial strength, and reasonable valuation makes Fortinet a compelling investment. In sum, Fortinet could be the "fort" you may want in your portfolio.