Buy
NUTANIX (NTNX)
Price target USD38.0
Upside 34%

Digital Hyperconverged Infrastructure Services provider

- The company has the most attractive multipliers among the industry, which indicates that it is undervalued;
- The company's sales are growing every year, which indicates its stability in the market and the growth of its services;
- Due to the company's transition to selling exclusively software and expanding its cloud solutions base, the customer base increased by 18% compared to Q2 2020;
- The amount of cash in the company's accounts is really huge and amounts to about $ 1.3 billion, which is higher than the convertible notes, which amount to about $ 995 million.

The financial Justification.

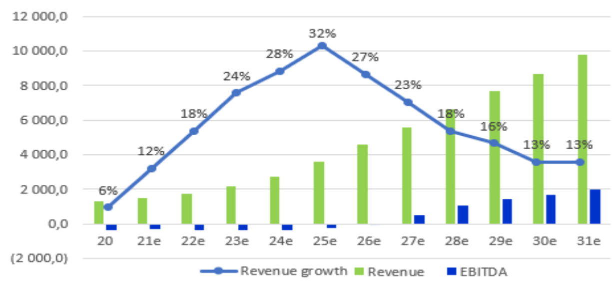
We recommend buying Nutanix with a DCF-based target price of $ 38.0, which represents a 34% increase over the current stock price. Our bullish case assumption assumes a 57% increase. We believe that the company's continued focus on subscription-based revenue and ACV bills will not only lead to more regular and visible financial performance, but will also increase profitability over time. The long-term outlook for the industry is bullish, and Nutanix's new subscription-based operating model will provide a tailwind for revenue growth,

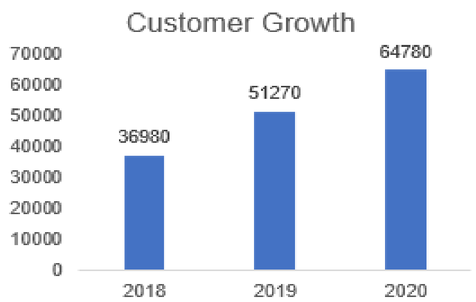
Risks.

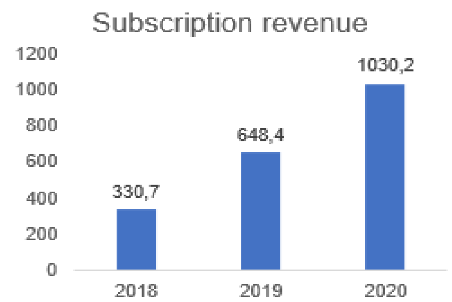
Analyzing the company's operational activities, we were able to draw several parallels that will allow us to identify the most vulnerable points in the Nutanix business. At the moment, the company may fall in price due to changes in market conditions, that is, the entry of new competitors, reputational blows due to the constant absorption of other smaller companies and further aggressive advertising, which significantly reduces its profitability. But the company shows quarterly growth in revenue and customers, demonstrates an excellent strategy, which is expressed in strengthening market share

Financials

	2016	2017	2018	2019	2020
Balance sheet					
Cash/equivalents/STI	185	349	934	908	720
Total assets	412	738	1600	1786	1769
Long-term debt	73	-	430	459	490
Income statement					
Revenue	503	846	1155	1236	1308
Gross Profit	333	519	770	932	1021
gross margin, %	*66%*	*61%*	*67%*	*75%*	*78%*
Net loss	(108)	(380)	(297)	(621)	(873)
Cash flow statement					
Operational Cash flow	4	14	93	42	(160)
Free cash flow	(39)	(36)	30	(76)	(249)
Solvency					
Debt/Assets, %	39.5%	-	26.9%	25.7%	27.7%



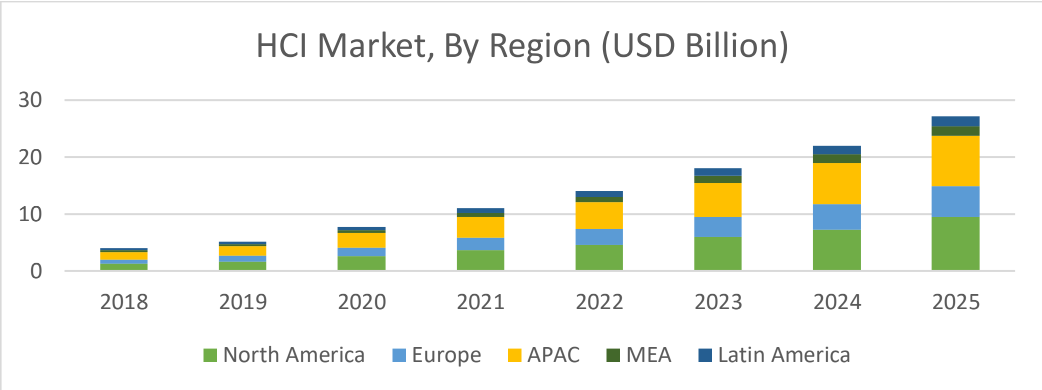




HCI market overview

Hyper-converged infrastructure (HCI) is a single system framework that includes storage, computing, and network resources that help companies to easily deploy and manage with a single user interface. A hyper-converged system allows integrated technologies to be managed as a single system through a common toolset

The global Hyper-Converged Infrastructure (HCI) market size is expected to grow from USD 7.8 billion in 2020 to USD 27.1 billion by 2025, at a Compound Annual Growth Rate (CAGR) of 28.1% during the forecast period. Major growth drivers for the market include several advantages of HCI such as reduced capital expenditure and operational expenditure and disaster recovery capability.



[1]

In terms of the HCI systems' software brand, the main market competitor for Nutanix is VMware, which Market Share for 4Q 2020 was 38.7%

Top 3 Companies, Worlwide Hyperconverged Systems Revenue Attributed to Owner of HCI Software, Q4 2020 (revenue in $M)					
Company	4Q20 Revenue	4Q20 Market Share	4Q19 Revenue	4Q19 Market Share	4Q20/4Q19 Revenue Growth
1. Vmware	$953.1	38,70%	$938.0	40,90%	1,70%
2.Nutanix	$575.1	23,40%	$616.4	26,90%	-6,60%
T3. Huawei	$154.5	6,30%	$87.9	3,80%	75,70%
T3. Dell Technologies	$137.4	5,60%	$87.9	3%	102,40%
Rest of Market	$641.9	26,10%	$583.2	25,40%	10,10%
Total	$2463.1	100,00%	$2293.4	100,00%	7,40%

[2]

[1] Source: MarketsandMarkets research report
[2] Source: IDC Worldwide Quarterly Converged Systems Tracker, March 18, 2021

NUTANIX

Operational key points introduction

The key value of Nutanix products for customers is the simplification and acceleration of processes related to IT infrastructure, and savings on the associated direct and indirect costs

In the modern world, any large company, regardless of the field of its activity, is faced with the need to purchase and maintain a huge amount of IT infrastructure and software to ensure operating processes. Companies have dozens and hundreds of systems that have different functions, which are often not related to each other, are managed separately and require specialized skills to work with them. Nutanix greatly simplifies the interaction between and with IT systems within the company, as well as makes it possible to manage everything within a single software solution.

Nutanix products are used by 60% of the Forbes 100 companies and 40% of the Forbes Global 2000 companies. In total, Nutanix has more than 18 thousand customers and their number is constantly growing at a double-digit rate, the product line has more than 15 positions for various purposes and is constantly expanding[3]

The company's business is very stable from a financial point of view, despite the company's loss-making at the EBITDA level due to the high share of marketing expenses, which is generally typical for companies of the Enterprise Software sector – due to customers pre-payments, and most of the expenses are stock-based compensation, cash flows statement is much more positive than P&L. Nutanix has a growing positive operating cash flow, and net debt is negative and amounts to about -0.3 billion dollars, as there are convertible notes in the liabilities.[4]

Nutanix recently effectively completed a business transformation, moving from selling one-time contracts and hardware to a SaaS business model[5]. This led to a local deterioration in performance, but now almost all of the company's business consists of stable recurring payments, rather than one-time unstable contracts, which significantly increases its potential value. In the long term, this is a positive step for the company, but in the short term it led to a slowdown and even a small local decline, which caused a significant correction in the value of the company's quotations on the stock exchange.

The growth of the company's staff and marketing, which is the main source of expenses, has slowed down significantly. If Nutanix manages to contain the growth of expenses, which previously grew faster than revenue, this will be a positive signal

37% of deals involve at least one emerging product and this value is constantly growing (6% YoY), which is also positive for the business – it allows NTNX to earn more money and reduce the outflow of customers, which is already at a very low level (Retention rate is 97%).[6]

[3] Company's March 2021 Corporate Presentation
[4] Company's 10-Q Quarterly report Mar 04, 2021
[5] Company's Q2 Fiscal 2021 Earnings Presentation
[6] Company's Q2 Fiscal 2021 Earnings Presentation

Risks

After a detailed analysis of the company's operating activities, it can be concluded that the company is increasing revenue due to customer growth. Since Nutanix is one of the leading companies in the field of cloud solutions, the following levels of risk can be distinguished here:

1. Loss of market share (High level of significance);
2. Stagnation in technological solutions (High level of significance);
3. Staff turnover (Average level of significance);
4. Negative cash flow over several reporting periods.

But based on the latest data provided by the company, the marketing strategy looks as attractive as possible from the entire market. That is, the company provides very high-quality solutions due to really low prices for services, and aggressive marketing allows you to capture new niches.

In addition, the company is engaged in the acquisition of smaller companies in order to expand and further promote their services in the field of cloud solutions. Therefore, the company is currently successfully leveling the above risks and in the future will become even more attractive from the point of view of investment.

Risk	The essence of risk	Mitigation	Impact level
1. Market risk	The risk of losses due to unfavorable changes in market prices for stock values.	Market risk insurance; The use of futures/options for the purpose of fixing and hedging the market rate.	medium
2. Credit risk	The risk of losses arising as a result of non-performance, late or incomplete performance of the company's financial obligations in accordance with the terms of the agreement.	Application of statistical models in decision-making, pricing; Independent risk assessment; Diversification of the loan portfolio.	high
3. Operational risk	The risk of losses due to the unreliability of the company's operational processes.	Development of the organizational structure, internal rules and procedures for performing operations; Insurance of operations up to full coverage.	high
4. Strategic risk	The risk of adverse changes in the company's results of operations due to erroneous decisions made in the company's management process.	To study the market structure in detail in order to determine who is the main target audience; Conduct scheduled meetings with top management to determine strategic plans; Build a long-term development trajectory for the company.	low
5. Liquidity risk	The inability of the company to finance its activities, that is, to ensure the growth of assets and meet obligations as they become due without incurring losses in an amount that threatens the financial stability of the company.	Asset diversification; Making a careful budget with a certain cash sweep; A more detailed review of the covenant in order to select the most suitable ones.	high

VALUATION

DCF and EV/Revenue are preferred valuation tools; We recommend to Buy NTNX with a target price of USD38.0, implying 34% upside from the current share price.

Our primary valuation method is a DCF model as we believe it best captures the company's long-term growth potential. We forecast the FCF for the coming 10 years (2021-31e), followed by a terminal value at the end of the forecast period.

The company's growing recurring revenue stream reflects customer loyalty to Nutanix's solution, which improves visibility of revenue growth trajectory; subscription recurring revenue increased 58,8% year-over-year to $1030 million, representing 78,8% of total revenue. Moreover, expanding customer base will continue to drive top-line growth. Nutanix has been consistently growing its customer base from 1168 in 2015 to 18770 in 2021 at a CAGR of 48,7%. During 2 quarters fiscal 2021, the company added 1410 new customers, 18% y/y growth. Besides, its transition to software-only sales is expected to significantly boost and maintain gross margin.

We believe the company's continued focus on subscription-based revenue and ACV billings will not only drive more recurring and visible financials, but profitability will improve over time. The long-term industry outlook is bullish and Nutanix's new subscription-based operating model will provide tailwinds for revenue growth, profitability, and ultimately valuation.

We see Nutanix's EBITDA turning positive in 2027e and FCF turning positive in 2028e on the back of increased billings and higher operating cash flow. We don't expect it to happen earlier because of the management's long-term growth strategy based on high Sales&Marketing and R&D expenses. The EBITDA margin should improve to 9,3% in 2027e and FCF as a percentage of revenue to 10%.

The results of the DCF model are supported by the comparables method for which we used VMware as the most similar comparison on the market.

DCF Valuation

Nutanix is considered a pioneer of hyper converged infrastructure (HCI) market, which is projected to grow rapidly in the long term. We expect the revenue growth rate to increase up to 32% in 2026 boosted by the new business model and the company's strong market position. Thus, revenue CAGR will be 21% in 2021-2026, which is in line with the overall HCI market. Thereafter we expect revenue growth rate to slow down up to 13% in 2031 as the company will enter a phase of maturity. Gross margin is expected to stabilize at 86% since 2026 comparative to current 81% margin as the company will focus on software-only sales and subscription-based business model.

Company plans to maintain high investments in research and development and sales and marketing teams. However, we expect the share of OPEX in revenue to decline gradually to 0.83 in 2031 from the current value of 1.41.

We derive the cost of equity for the US, based on a risk-free rate of 1,6% and ERP of 4,7% (with a beta of 0,91). We also took into account the company's specific risk of 5%, in which we incorporated its aggressive strategy. Nutanix operates in the intensely competitive enterprise infrastructure market and if its extensive investment program does not meet investors' expectations, the price of common stock may decline, potentially significantly.

We assume a 0% cost of debt (which is the interest rate of Nutanix's corporate bonds) and a target debt-to-equity ratio of 6,55% to arrive at our WACC. We use a WACC for the US of 10,23% for the DCF calculation. A TV growth rate is 2,3%.

(USD MLN)	2020	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E
Revenue	**1 308**	**1 465**	**1 728**	**2 143**	**2 732**	**3 593**	**4 563**	**5 590**	**6 596**	**7 651**	**8 646**	**9 770**
GP	**1 021**	**1 186**	**1 452**	**1 822**	**2 323**	**3 054**	**3 924**	**4 807**	**5 673**	**6 580**	**7 436**	**8 402**
OPEX	1 850	2 036	2 376	2 850	3 415	4 132	4 928	5 355	5 871	6 504	7 263	8 109
NOPAT	**(847)**	**(860,5)**	**(936,7)**	**(1 029)**	**(1 093)**	**(1 078)**	**(1 004)**	**(548)**	**(198)**	**55**	**125**	**211**
Adjustments:												
D&A	94	131	135	139	145	154	166	176	188	201	215	228
Stock-based compensation expense	352	395	432	493	574	672	776	894	1 055	1 178	1 297	1 446
Changes in WC:	(202)	19	37	59	83	122	137	145	142	149	141	159
Net cash (used in) provided by operating activities	(134)	(352,7)	(406,9)	(455)	(458)	(374)	(199)	377	903	1 285	1 496	1 726
CAPEX	(89)	(100)	(118)	(147)	(187)	(246)	(312)	(382)	(451)	(523)	(591)	(668)
FCF	**(223)**	**(452,8)**	**(525,1)**	**(602)**	**(644)**	**(619)**	**(511)**	**(5)**	**452**	**762**	**905**	**1 058**
Discount factor	1,00	0,95	0,91	0,86	0,82	0,78	0,75	0,71	0,68	0,65	0,61	0,59
Terminal												**1082,5**

[7]

DISCOUNT RATE CALCULATION	
Risk-free rate	1,6%
Matket risk premium (S&P 500)	4,7%
Levered beta	0,91
Beta unlevered	0,87
Target D/E	6,55%
Company specific remium	5%
Cost of equity	**10,9%**
Cost of debt	**0%**
Share of equity	**93,9%**
WACC	**10,23%**

DCF RESULTS	
PV of DCFs	(856)
Terminal period growth rate	0,023
TV	7989
Cash	720
Debt	490
Equity value	7 363
No of shares	194
DCF-based target price	38

Comparables valuation

Nutanix's competitors fall into the following categories:

- software providers, such as VMware, Inc. that offer a broad range of virtualization, infrastructure and management products to build and operate enterprise and hybrid clouds;
- traditional IT systems vendors, such as Cisco Systems, Inc. that offer integrated systems that include bundles of servers, storage and networking solutions, as well as a broad range of standalone server and storage products;
- traditional storage array vendors, such as NetApp, Inc., which typically sell centralized storage products;
- providers of public cloud infrastructure and SaaS-based offerings, such as Amazon.com, Inc., Google Inc. and Microsoft Corporation.

[7] Company's 10-Q Quarterly report Mar 04, 2021 and team analysis

We have chosen VMware's EV/Revenue multiplier as a benchmark for valuating Nutanix, since we consider this company the most similar in terms of business model.

Nutanix's EV/Revenue is 5,5, It's almost equal to our 5,65 benchmark. Using this value as the second valuation tool, we justified our DCF valuation results and BUY rating

COMPARABLES VALUATION

	VMware	Cisco	NetApp	Splunk
Selected EV / LTM Revenue	**5,65**	4,4	2,96	9,0
LTM Revenue	1307,7	1 308	1307,7	1 308
(Implied Enterprise Value	7388,5	5740,8	3870,8	11808,5
Cash	719,7	720,7	719,7	719,7
Debt	490,2	490,2	490,2	490,2
Equity Value	7618,0	5971,3	4100,3	12038,0
Shares Outstanding	193,5	193,5	193,5	193,5
Value per share	**39,4**	30,9	21,2	62,2

Scenario analysis

Our bull case with a 10,5% WACC and a 22% Revenue CAGR suggests 57% upside

Revenue growth is a key for Nutanix. They need to prove that their aggressive investments in growth and transition toward a subscription-based model will lead to better financial results.

Our base case derives a target price of USD38.00 and is based on the assumption of the CAGR for the Revenue reaching 19% in 2021-30e and WACC of the 10,2%.

We conclude that, if the revenue reaches 10500 in 2030 (22% CAGR comparing to HCI market CAGR of 18-20, there may be 57% or even 72% upside (depends on WACC) to the share price, translating to an equity value per share of USD44.9-49.1. However, with a 6500 revenue in 2030 and 11% WACC, there may be 34% downside to current price.

Revenue

WACC, %	6 500,00	7 500,00	8 500,00	9 500,00	10 500,00	11 500,00
12,5%	13,8	19,0	24,2	29,5	34,7	39,9
12,0%	15,3	20,9	26,5	32,1	37,7	43,3
11,5%	17,0	23,0	29,0	35,1	41,1	47,1
11,0%	18,9	25,4	31,9	38,4	**44,9**	51,4
10,5%	21,0	28,0	35,1	42,1	**49,1**	56,2
10,0%	23,4	31,1	38,7	46,4	54,0	61,6

[8]

[8] Source: Big 4 estimates

Revenue

WACC, %	6 500,00	7 500,00	8 500,00	9 500,00	10 500,00	11 500,00
12,5%	-52%	-33%	-15%	3%	22%	40%
12,0%	-46%	-27%	-7%	13%	32%	52%
11,5%	-40%	-19%	2%	23%	44%	65%
11,0%	-34%	-11%	12%	35%	**57%**	80%
10,5%	-26%	-2%	23%	48%	**72%**	97%
10,0%	-18%	9%	36%	63%	89%	116%

[9]

Financial summary

Income statement

(USDm)	2018	2019	2020	2021e	2022e
Total revenue	**1 155,4**	**1 236,2**	**1 307,7**	**1 465**	**1 728**
Total cost of sales	**386**	**304,1**	**286,7**	**278,3**	**277,5**
Gross profit	**769,4**	**932,0**	**1 021,0**	1 186	1 452
Sales & Marketing	649,6	909,7	1 160,4	1221,5	1425,9
Research and development	313,8	500,7	554,0	610,8	712;9
General and administrative	86,4	119,6	135,5	203,6	237,6
Total operating expense	**1 049,8**	**1 530,0**	**1 849,9**	**2035,8**	**2376,4**
Operating loss	**(280,4)**	**(598,0)**	**(828,9)**	**(849,5)**	**(924,6)**
Other income and expense	(9,3)	(15,1)	(26,3)	-	-
Income before income taxes	**(289,7)**	**(613,1)**	**(855,2)**	**(849,5)**	**(924,6)**
Income taxes	7,5	8,1	17,7	11	12,1
Net loss	**(297,2)**	**(621,2)**	**(872,9)**	**(860,5)**	**(936,7)**

Balance sheet

(USDm)	2018	2019	2020	2021e	2022e
Cash, cash equivalents and shortterm investments	934,3	908,8	719,8	675	606
Current assets	1263,1	1275,2	1094	1080	1068
Total assets	**1599,9**	**1786**	**1768,6**	**1676,7**	**1781**
Deferred revenue (current and non-current portion)	631,2	910	1183,4	1476	1517
Operating liabilities	311,1	599,3	760,2	891	958
Long-term debt	429,6	458,8	490,2	490,2	490,2
Total stockholders' (deficit) equity	**326,8**	**186,9**	**(274,9)**	**(524,9)**	**(466,6)**

Cash flow statement

(USDm)	2018	2019	2020	2021e	2022e
Net cash flow from operating activities	**101,8**	**57,3**	**(133,6)**	**(352,7)**	**(406,9)**
Capex	(62,4)	(118,5)	(89,4)	(100,1)	(118,2)
Changes in investments	(150,2)	(253,4)	(202,2)	18,7	37,3
Net cash from investing activities	**(503,5)**	**(16,9)**	**24,6**	**(81,4)**	**(80,9)**
Dividends paid	NA	NA	NA	NA	NA
Net borrowings	578,6	67,1	57,8	500,5	225
Other financing activities	-	-	-	-	-
Net cash from financing activities	578,6	67,1	57,8	500,5	130,3
Net change in cash	**167,6**	**92,4**	**(77,5)**	**66,4**	**(-262.8)**
Cash at beginning	139,5	307,1	399,5	322,0	388,4
Cash at the end	**307,1**	**399,5**	**322,0**	**388,4**	**125,6**

[9] Source: Big 4 estimates