# The Owl Fund
William C. Dunkelberg Student Managed Fund

Initiating Coverage Report | 22 February 2023

# Arista Networks, Inc.

## *Can I Add You to My Network?*

| Downside Scenario | Current Price | Price Target | Upside Scenario |
|---|---|---|---|
| $114.00 | $135.53 | $165.00 | $199.00 |
| *(14%)* | | *23%* | *48%* |

- Following a successful year of growing revenue 45.0% YoY, ANET has proven to navigate the current macro environment exceptionally well. The Company is in a prime position to capture growth regardless of the sentiment surrounding the entire Tech sector. The networking equipment industry remains competitive, but ANET has consistently taken market share from its competitors since its IPO in 2014. We believe ANET's portfolio, backed by its networking switches that run on its EOS platform, is like no other in the industry.
- With a goal of growing its TAM to $51 bn by FY'27 from $31 bn, ANET is expanding on all fronts. To do so, the Company has taken the offensive through its Arista 2.0 initiative. This plan includes expanding its offerings to its cloud customers, moving into the campus routing space, and relying on its EOS platform to deliver efficient, easy-to-operate, and low-latency products tailored to its customers' needs.
- Ongoing supply chain issues and increased backlogs have placed additional pressure on margins. Looming concerns also surround the outlook for IT spending, with ANET largely relying on Cloud Titans, META and MSFT, to drive growth. Investors are currently pricing in near-term uncertainty, overlooking its long-term fundamentals and upside.
- Despite ANET's opportunities for revenue growth and TAM expansion across its cloud and enterprise verticals, it trades at 23.2x NTM P/E, a 19.7% discount to its median of 28.9x. Its current multiple gives the fund a prime entry point to a name with substantial potential to generate alpha. Through our DCF and multiples analyses, we see shares having a 23.0% upside with a price target of $165.00/share.

### COMPANY OVERVIEW

Arista Networks, Inc. supplies cloud computing solutions for data center use through ethernet switches and routers. These products are used to achieve efficient connection speeds in local area networks (LANs) and wide area networks (WANs) for user data. Its prime end markets include cloud service providers, financial services companies, government agencies, and media and entertainment companies. Cloud Titans such as META and MSFT rely on ANET for its low latency 100G-400G switches used in data centers. Founded in 2008, the Company has grown to become a leader in cloud computing and networking services. ANET reports in the following segments: Products (81.0% of FY'22 Revenue) & Services (19.0%). Headquartered in Santa Clara, the Company reported FY'22 earnings on February 13th, 2023.

| | |
|---|---|
| Symbol | NYSE: ANET |
| 52-Week Range | $89.12 – 145.12 |
| YTD Performance | 11.26% |
| Market Cap (M) | $42,279 |
| Net Debt (M) | ($4,007) |
| Dividend Yield | N/A |
| NTM P/E | 23.2x |
| NTM EV/EBITDA | 16.9x |
| ROE | 30.5% |
| ROA | 21.6% |
| ROIC | 33.0% |

| FY (Jan) | 2022A | 2023E | 2024E |
|---|---|---|---|
| **EPS (Adj.)** | | | |
| Q1 | 0.88 | 1.16 | 1.41 |
| *YoY Change* | | *32%* | *8%* |
| Q2 | 0.98 | 1.33 | 1.56 |
| *YoY Change* | | *36%* | *17%* |
| Q3 | 1.16 | 1.47 | 1.71 |
| *YoY Change* | | *31%* | *16%* |
| Q4 | 1.69 | 1.59 | 1.86 |
| *YoY Change* | | *(6%)* | *17%* |
| Year | 4.71 | 5.55 | 6.54 |

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## INVESTMENT SUMMARY

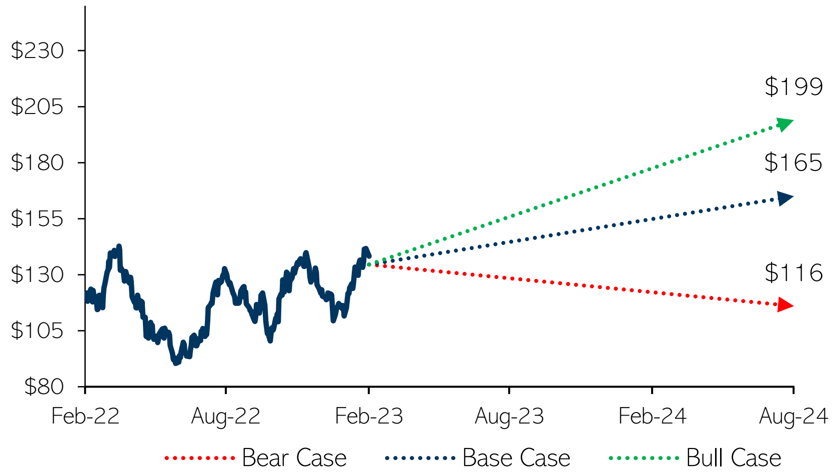
**Headquarters**
Santa Clara, CA

**Chief Executive Officer**
Jayshree Ullal

**Number of Employees**
3,600 (as of FY'22)

**GICS Classification**
Hardware & Equipment

**GICS Sub-Industry**
Communications Equipment




## PRICE TARGET SCENARIOS

**Bull Case Price Target: $199.00**

***12-18 Month Target Return: +48%***

Revenue grows at 28.4% in FY'23, exceeding management's guidance as cloud spending increases much faster than anticipated, and enterprise customers spend as expected. META and MSFT increase their Capex spending to upgrade their switches and invest more into data centers for AI. Supply chain issues resolve quicker than anticipated and ANET can increase its gross margins to 63.0% by the end of FY'23. ANET hits its TAM goal of $41 bn before 2025 and is on pace to exceed a TAM of $51 bn by 2027. With new product releases across switches and its EOS platform, ANET steals more market share from CSCO and can increase its revenue from other Cloud Titans such as GOOG and ORCL.

**Base Case Price Target: $165.00**

***12-18 Month Target Return: +23%***

Revenue grows at 26.4% in FY'23, slightly higher than management's guidance, with strength from its enterprise customers. From there on, ANET sees a CAGR of 13.9%, with its services segment seeing growth from new products purchased the previous years. In 2H'23, the supply chain eases, and ANET can increase its gross margin and start to unload some of its inventory. As the macro environment stabilizes, cloud spending from MSFT and META starts to pick up faster than expected and their Capex plans for AI and higher speeds become clear. It is able to reach its goal of $750 mn revenue in the campus routing space, targeting new and existing customers. With the release of its new products and the strength of its existing portfolio, it's clear that ANET is poised to continue to steal market share from CSCO and reach its goal of $41 bn TAM by FY'25.

**Bear Case Price Target: $116.00**

***12-18 Month Target Return: (14%)***

Revenue grows at 21.7% in FY'23, less than management's guidance. Its enterprise customers pull back spending, and its growth from campus switching stagnates due to a softening macro backdrop. META and MSFT cut additional Capex spending as demand slows. Its high concentration in the two Cloud Titans hurts topline expansion. Supply chain issues resolve slower than expected. The Company does not reach its campus routing goal of $750 mn. ANET's margins continue to take a hit, remaining around 60.0%. Because of a slowdown in new product demand, the Company expects to be short of its TAM goal. CSCO defends its market share position.

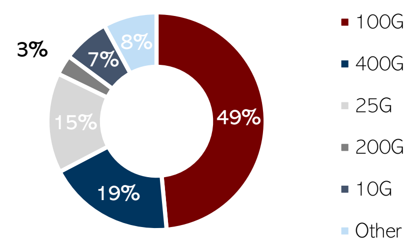
## INDUSTRY OVERVIEW

The outlook for the Networking Communication Equipment industry is positive as demand has been escalated due to increased data center upgrades. Research and Markets estimates that the total market revenue for data center ethernet switching is $15.2 bn with expectations to grow at a 5.2% CAGR reaching $19.9 bn by 2026. The main growth drivers include datacenter buildouts, increased automation, and AI applications. According to 650 Group, enterprise and cloud data center networking is forecasted to grow 8.0% in 2023 to $20.9 bn as it is one of the few industries that is expected to remain resilient within the hardware sub-sector amid the weakening environment.

### More Data More Money

The amount of data generated by internet and software use is increasing rapidly as businesses become more computer-centric. Statista estimates that the global volume of data will grow by 23.1% from ~97 zettabytes in 2022 to ~181 zettabytes by 2025. As more users consume content such as media entertainment and software applications, the flow of data traffic increases, which creates delays and slower speed times because of the congestion in the network. To fix this, companies are investing into more complex data center equipment systems with higher capacities that can achieve lower latency, meaning less delayed times.

**Data Center Revenue By Port Speed**



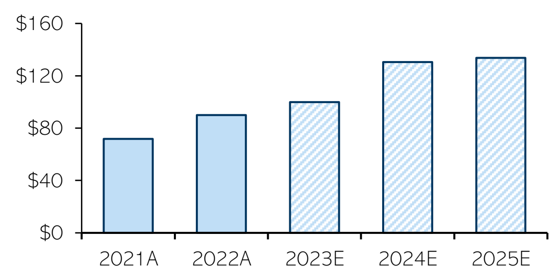

*Source: Bloomberg Intelligence*

### No One Cares if You're a Legacy

To achieve higher profitability, businesses are also moving data, software applications, and IT infrastructure to the cloud. This reduces the costs associated with maintaining on-premise servers. Data centers are filled with networking equipment that facilitates the flow of cloud networks. In 2022, cloud services made up more than $1.3 tn in enterprise IT spending, and it is projected to reach $1.5 tn by 2025. According to Infosys Knowledge Institute, 50.0% of legacy systems are expected to shift to the cloud. This gives perspective on how young the industry is, meaning that networking equipment companies will continue to capitalize from the shift from enterprise to cloud.

Recent interest rate hikes and inflationary headwinds have slowed the adoption of cloud platforms and services. As companies find that it is more profitable and innovative to digitize their operations, they will continue to move and secure their data to the cloud. Cloud Titans such as MSFT and ORCL are adopting the multi-cloud model and developing offerings that provide a competitive advantage. Furthermore, customers will strongly encourage their vendors to satisfy their infrastructure needs.

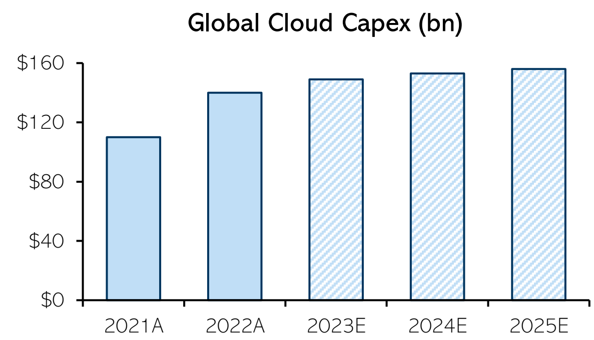
**Global IT Infrastructure Spending (bn)**




*Source: Statista*

- *Enterprise:* Defined as legacy computing infrastructure that serves to connect users and systems to local area networks (LANs) to data centers. As companies continue to reopen and work-from-home trends become more popular, companies are investing in enterprise networking equipment in order to keep up with higher demand stemming from companies' increased need to connect their employees on secure networks. This will drive revenues for networking equipment companies in spite of the recessionary environment. Therefore, companies with exposure to broad campus switches, routers, Wi-Fi, and software portfolios are poised for the most success. Campus systems are defined as networks that connect multiple LANs in one limited geographic area. They are expected to play a significant contribution to the increase in enterprise revenue for the industry. According to Dell'Oro Group, campus switching is projected to achieve record revenue following double-digit growth in 2022. New order levels are expected to fall despite these projections due to a large industry backlog, as the majority of 2023 revenue will come from the unfulfilled orders from 2022.

- *Cloud:* Defined as the infrastructure hardware, storage, and network components needed to deliver on-demand computing services. The networking equipment component within the data centers includes network switches, routers, and cables. According to Forbes, traditional on-premise solutions require high maintenance costs compared to cloud computing licensing models. Cloud computing helps companies cut costs and drive increased operational efficiency through automation. The Cloud Titans, Amazon AWS, Google Cloud, IBM Cloud, Microsoft Azure, and Oracle Cloud are known as hyperscalers because of their capabilities to support variable demand on a grand scale using multiple data centers. Given the increasing demand for cloud platforms and solutions, these companies are ramping up their investments in data center buildouts. **Per 650 Group, cloud data-center equipment capital spending is guided to grow 17.0% to $146 bn in 2023 and is expected to maintain a 12.0% CAGR through 2026 to $190 bn.**

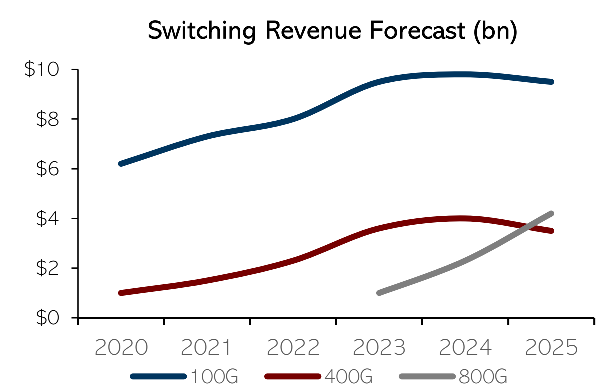


*Source: Analyst Day*

### Routin' n Switchin'

The main products that networking equipment companies sell are switches and routers. A switch connects multiple data centers to create a single network while a router connects multiple switches to form an even larger network and connect with other networks. The networks could be in a single location or across multiple locations. Through deploying ethernet switches, businesses that use data centers can improve capacity and manage high-speed data services. An issue across the industry is the high amount of power that data centers consume, which leads to the overheating of equipment and, consequently, high costs. Roughly 1.0% of global electricity consumption comes from data center operations. As more data is generated and cloud application-use gains traction, customers are switching from the traditional 50G and 100G systems to 400G and 800G systems to achieve reduced energy consumption, as well as higher speeds and lower latency.

Ethernet switch revenues from data center end markets grew 21.7% in 3Q'22 as vendors mitigated supply chain disruptions and fulfilled orders. Though CSCO still holds a 39.4% share of the high-speed data switching market, it is being taken by other players in the space, such as ANET, CIEN, and HPE, that have achieved significant growth in the past few years. Some of the drawbacks in this market include high capital spending and a high level of expertise needed to innovate these systems. Companies that will be successful beyond 2023 will be able to manage costs efficiently, achieve significant partnerships, and uphold pricing power.



*Source: Bloomberg Intelligence*

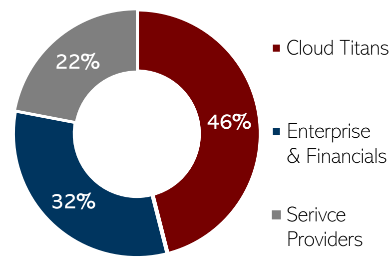
### Supply Chain Not Supplying

In 2022, shortages of chips and competent supplies limited revenues and order fulfillment caused increased backlogs of 2-3x pre-pandemic levels. As the supply chain is expected to rebound in 2023, companies should see elevated backlog levels return to more historical levels. This is a strong industry-wide tailwind as companies will see a boost in sales with the expected healthier supply chain. Another consequence is the inventory buildup: networking companies are currently experiencing 45.0% higher average inventory days outstanding than its pre-pandemic levels. Unloading its inventory as critical components arrive will increase cash levels and drive strong FCF growth. With less cash tied up in inventory, companies will have more opportunities to distribute excess cash flows to shareholders through buybacks in 2023-2024.

## BUSINESS OVERVIEW

With a customer base of 9,000+ organizations, ANET outsources the majority of its production to contract manufacturing partners: FLEX, JBL, LITE, MTSI, NPTN, NVDA, SANM. The Company values working closely with its partners to ensure deliverability and efficiency. Some of its essential components include circuitry and power supply and merchant silicon supplied by vendors such as Broadcom and Intel. As the key components of ANET's products become more advanced, the Company prioritizes innovating its software platforms to make them compatible with these parts and create value for its customers. After the manufacturing process, the products are shipped to ANET's fulfillment facilities for further inspection and adjustments before distribution.

**Revenue By Customer**

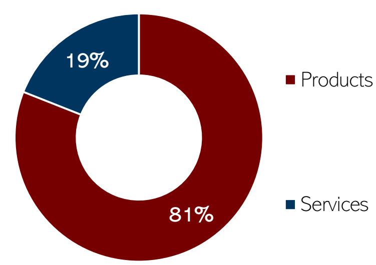



*Source: Bloomberg*

### Products and Technology

All of Arista's products run on its advanced networking operating system called Arista Extensible Operating System (EOS). It's designed to be fully programmable, enabling ANET to expand its software applications to meet the demands of its clients and industry trends, such as cloud networking, data-driven workflow automation, network visibility, analytics, and network detection and response. There are some key benefits that this technology provides to ANET's customers. It allows customers to upgrade switches running in the network using Smart System Upgrade ("SSU") without the entire network collapsing. This is what makes it modular. Moreover, the EOS software is built to offer programmable interfaces, which enables ANET to integrate its cloud networking platform with a wide range of third-party applications. It enables its customers to write their own programming scripts through Application Programming Interfaces (APIs) to customize and optimize their network to their specific needs. EOS provides network managers with a set of tools that proactively monitors, detects, and notifies them if an issue arises.

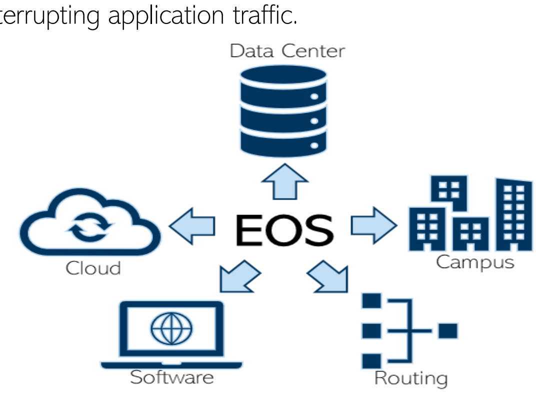
**Revenue By Segment**



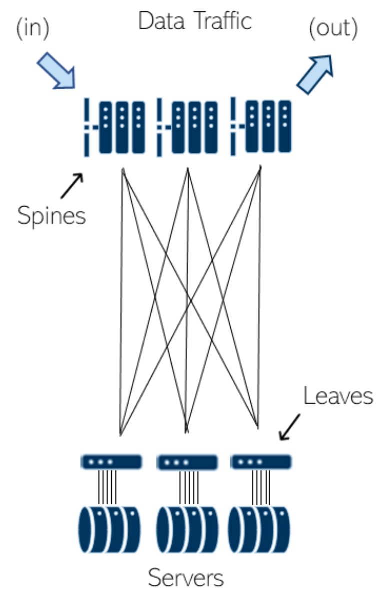

*Source: Company Filings*

*Extensible Operating System:* The core of ANET's cloud networking platform is its data-driven operating system, EOS, which runs on the programming language Linux. Critical data is stored within the EOS and is maintained in a highly efficient, centralized system database. The attributes that set this EOS technology apart are its high availability, programmability, and network visibility. EOS offers its customers a range of applications that enables enhanced networking monitoring and visibility without the need for external monitoring devices. The system is known for its easy software maintenance and ability to be restarted without interrupting application traffic.

ANET offers various Gigabit Ethernet switches at different speeds. These switches transfer data between servers. The Company uses a spine and leaf model for its network communication equipment as opposed to the traditional three-tier architecture. The two-tier spine-leaf architecture creates scalability and quicker east-west traffic (servers communicating directly with other servers). It limits the Spanning Tree Protocol, which typically results in certain pathways being oversubscribed. This means that certain network pathways would experience heavy traffic and therefore result in slower speeds.




*Source: Company Filings*




*Architecture*: The "leaves" connect the data center servers to the spine. The "spine" is the core of the network that connects the system to other servers and devices via the cloud or an enterprise network. The network connection, or routing, selects the best path to reduce the latency (the slowdown at touchpoints) of data traveling from one point to another. The Spline is the smallest possible form of the leaf-spine switch that consists of two switches in a single tier. In this single tier, these two switches combine the roles of the leaf and spine, hence the name "spline." The ANET Spline product attaches directly into a pair of switches connected in a multi-chassis link aggregation.

With a wide product line, its leading industry switching platforms provide high capacity, low latency, and power efficiency to its clients. It differentiates its products by serving core data centers and cloud servers as well as adjacent campus and routing. A campus network is typically a portion of an enterprise network in a single geographic area. This could be a single building or a group of buildings in a smaller region. Conversely, an enterprise or cloud network delivers data to endpoints much further away.

**Electronic Trading**

ANET first achieved success in this business area and established its market presence. The 7130 Series data switching equipment achieves low latency in high-speed trading platforms for financial institutions. This ensures trades can be executed in real-time and provide the most up-to-date stock market information. These networking systems also help manage data traffic efficiently, as there is a substantial amount of market data transferred in and out of these institutions.

**Networking Software and Services**

*CloudEOS:* A cloud-native solution that offers connectivity to the multi-cloud, which gives customers the freedom to use it across public and private clouds. CloudEOS facilitates workflow automation, network visibility, and accessibility for enterprise users, which helps reduce Capex and Opex for customers by simplifying various business operations.

*CloudVision:* A multi-domain management platform built on a subscription-based software model. It provides analytics, automation, telemetry, and provisioning services and allows integration with partner clouds such as ServiceNow, VMWare NSX, and Palo Alto Networks. CloudVision's offerings provide businesses with better visibility of their operations and drives efficient management decisions. It has a wide variety of network solutions that are deployed in data centers, campus networks, WANs, and multi-cloud applications. ANET's cognitive AI/ML platforms use vast amounts of data to provide helpful recommendations and insights for users.

*DANZ Monitoring Fabric (DMF):* Allows IT operators to monitor all traffic by users, devices, IoT, and applications within a network to ensure visibility, observability, and security. ANET's switch platforms are used with the DMF platform to access predictive analytics and track the efficiency of networks through network performance monitoring (NPM). Statistical modeling and machine learning are used to provide analytics. Cloud service providers and enterprises utilize DMF in their data centers, campuses, and 4G/5G networks. The service is accessed through an easy-to-use dashboard and is offered through a license subscription.

*Network Detection and Response (NDR):* ANET's cybersecurity service platform driven by artificial intelligence (AI) and machine learning (ML). NDR analyzes billions of network communications within devices and applications to detect security threats to users. Furthermore, it builds custom models and delivers comprehensive diagnostics to organizations that want to protect their computer-based systems. Autonomous Virtual Assistant (AVA) is a virtual assistant built on AI that drives the technology behind both CloudVision and NDR. It supports the process of analyzing data and producing effective results. Overall, this solution stands out from competing platforms because it mimics the human brain by learning behaviors and patterns over time.

## UNDERVALUATION

### Do You Not Like Growth?

ANET trades at an NTM P/E of 23.2x, a 19.7% discount to its one-year median of 28.9x. The stock outperformed the Nasdaq Composite by 17.9% in 2022 but was not immune to the broader tech sell-off as investors turned to risk-off assets. Investors underappreciate ANET's industry-leading operating model, including its EOS platform and suite of networking switches. **Despite ANET's record year of growing top-line by 45% YoY, its multiple contracted due to IT spending concerns, ongoing supply chain issues, and margin pressures.** We believe these near-term headwinds have caused ANET's mispricing, which ignores its true potential.

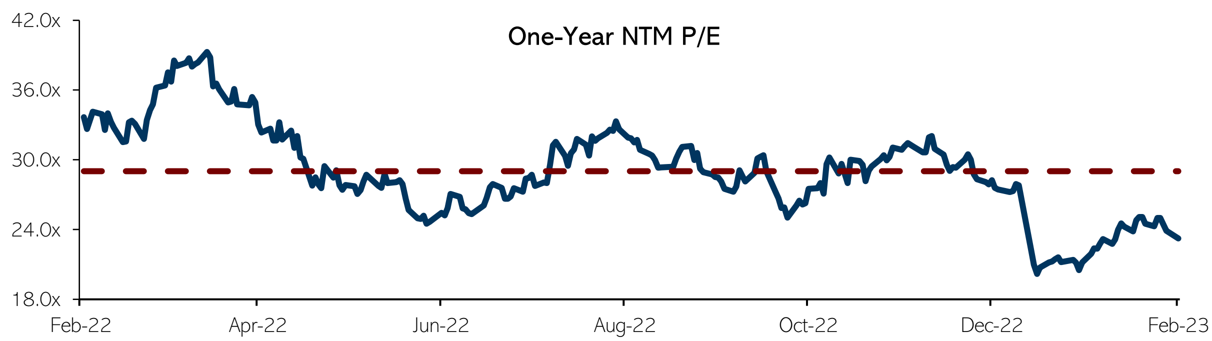
*Are the Clouds Falling?* Its multiple compression mainly starts at the beginning of the year, with analysts citing concerns about the outlook for Big Tech cloud spending in FY'23. In the same week that UBS downgraded MSFT due to risks surrounding its cloud growth, ANET's multiple dropped 35.0% to 20.3x due to shared sentiment across the Street. Given that MSFT makes up 16.0% of its revenue, the concerns are somewhat justified, but a compression of this magnitude was a clear overreaction. For MSFT, a slowdown in Azure does not necessarily correlate to a slowdown in cloud spending as MSFT fends off GOOG and aims to take market share from AWS. Hefty cloud spending is likely to remain as long as the space remains competitive.

- Additionally, on its 4Q'22 earnings call, META announced it would cut Capex by 11.0% to $30-33 bn in the upcoming FY. META currently makes up 25.5% of ANET's revenue. On this news, ANET shares dropped ~4.0% before immediately jumping back up at the market open. While META plans to cut data center construction spending in the near term, its plans to move its investments toward cloud workload for artificial intelligence capabilities which will ultimately benefit ANET.

*Enough with Supply Issues:* No different than other hardware companies, ANET continues to feel the effects that COVID-19 placed on the supply chain over two years ago. These issues have pressured ANET's ability to deliver to its customers. The Company has seen more orders than it has been able to fulfill. ANET does not report backlog numbers, but Piper Sandler estimates that it is around $2 bn or one year's worth, in line with its peers.

- On its 3Q'22 earnings call, management mentioned that the delays relating to the supply chain have largely caused the 75 bp decline in gross margins to 61.2%, which will likely persist through 1H'23. Additionally, with the kind of growth ANET has seen, management explained that margin variability is somewhat expected.
- Margin concerns were reiterated on its 4Q'22 earnings call and that lead times are expected to ease through the second half of 2023. Investors remain focused on the supply side of the equation, ignoring how well ANET has managed its backlog issues and maintained demand to continue to reach its guided goals.

**Our team recognizes ANET's current multiple level as an optimal entry point into a company poised to provide alpha in the Tech Sector. Management reiterated its FY'23 goal of 25.0% YoY revenue growth, driven by data-switching upgrades, expansion into campus routing, and new product offerings. These will help continue its market share growth. The buy recommendation of ANET starts our push to end the semester overweight in Tech and ride the tailwinds of cloud and enterprise network switching.**

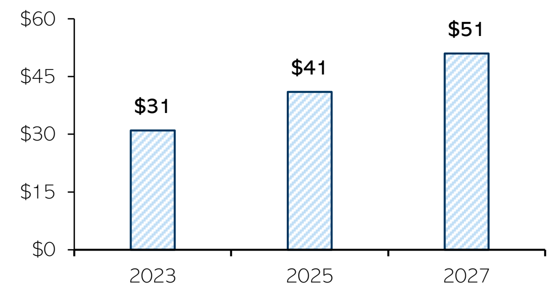



*Source: Bloomberg*

## CATALYSTS & DRIVERS

### Growing on All Fronts

Arista Growth Drivers for TAM (bn)




*Source: Company*

Management has outlined a new vision and strategy starting in 2023 dubbed Arista 2.0: investing in its core products (AI Spine, EOS, and Networking-as-a-Service), expanding its complementary offerings (routing and campus) in adjacent markets, and delivering new SaaS solutions to complement its portfolio of networking equipment solutions. ANET has achieved success in growing its revenues across its verticals, with Cloud Titans being its strongest performer. Its enterprise revenues have seen sustained resilience, and management expects this trend to continue in FY'23. ANET is still in the process of building out its campus vertical. We see this as a key growth driver as ANET implements a go-to-market strategy with its current enterprise customers and eventually develops a path to sales from new mid-market customers.

**With these growth drivers, ANET is expected to experience 25.0%+ revenue growth in FY'23 and is on pace to achieve a 20.0%+ CAGR from FY'20 through FY'25. Complementing its revenue growth, it looks to expand its TAM by 64.5% from $31 bn to $51 bn in FY'27. Its core data center offerings, innovative services, and software implementation into all of its products and services will drive this growth.**

*Cloud Titans*: These revenues have been the driving force for its impressive sales growth, as this segment exhibited 125.0% revenue growth in FY'22. While this growth was profound, management and investors recognize this as a one-off year and expect the Cloud Titan vertical's growth to stabilize. In FY'22, Cloud Titan made up 46.0% of its revenue, with META and MSFT accounting for 25.5% and 16.0%, respectively. GOOG and ORCL made up the remaining 4.5%.

- ANET has been expanding its use-cases for all of its customers, especially its Cloud Titan partners. AI Spine is just the latest new use-case with an increasing TAM by an additional $2-3 bn within the next few years. This is just one of the several internal initiatives, including integrating new security features that ANET is implementing to reach its total TAM target.
- ANET's relationships with META and MSFT are unique, providing the Company an advantage over its competitors as it co-develops its products with them. The Company saw outsized growth because Meta and Microsoft drove their data center buildouts across new regions leading to increased revenue in FY'22.

*Enterprise*: ANET has increased momentum from its enterprise segment, which made up 32.0% of its FY'22 revenue. Driving this strong demand is the availability of ANET's EOS across all of its customers' enterprise and campus products. **Its ability to incorporate its EOS platform for all of its enterprise customers is a strong driver that will increase its TAM by another $3-4 bn.** EOS enables its customers to utilize different products and platforms across a common operating system, providing a consistent and cohesive experience. Looking ahead, management expects enterprise revenues to make up 21-22% of its FY'23 revenues. Its customers are looking for consolidation of their data centers, and with ANET products, they have many operational advantages, including, but not limited to, better automation, telemetry, and consolidation throughout their enterprise data centers.

- ANET is able to manage its customers' existing enterprise systems through its Network-as-a-Service (NaaS), where it can handle the purchase and installation of the complex process. The Company is simplifying the process, so its customers do not need to worry about which switch to buy, which slot in the rack it plugs into, and which cables and configurations it needs. ANET has boasted a 21.0% growth in its enterprise vertical, and its demand has only continued to grow as it reaches more enterprise customers. Management has noted an opportunity to gain many new customers has come from cross-selling opportunities with campus. Both of these segments are expected to drive strong growth and propel each other moving forward.

*Campus*: This vertical experienced the most significant supply chain constraints in FY'22. Its orders exceeded $400 mn, but its revenues fell short of management's guidance due to shortages, missing only a few key components. It is going implement redesigning for some of its products with components that are more available and improve its supplier partnerships to hit its revenue targets for FY'23. ANET's Network-as-a-Service, Edge-as-a-Service, and cognitive campus solutions, are being embraced well by its campus customers. Its current go-to-market strategy has targeted its ~9,000+ existing customers as primary enterprise customers. ANET expects to develop a mid-market strategy targeting acquiring new customers from its channel partners. **Based on management's guidance, we expect the Company to achieve $750 mn in revenue by FY'25.**

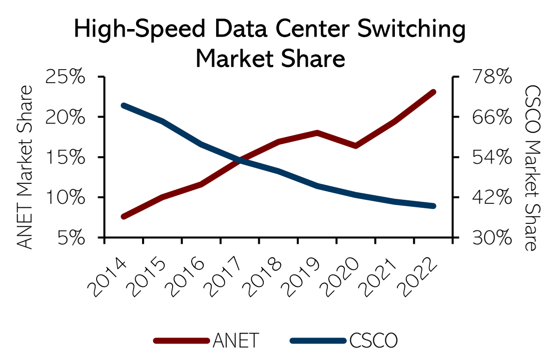
### Products Switching Lanes

ANET continues to innovate its products and services to meet the needs of enterprises and cloud service providers. Over the past year, the Company achieved significant breakthroughs in advancing its software offerings, network switching products, routing systems, and cybersecurity solutions. Most recently, the expansion of two business segments provide tailwinds for the Company that will contribute to capturing market share.

- *Continuous Integration (CI) Pipeline:* This is a suite of solutions built on the Company's core platform, EOS Net DataLake, that helps its customers simplify the management of their operations. It allows enterprises to acquire a modern network operating model, which is typically difficult for companies to achieve on their own because it requires a significant amount of expertise to develop. This model leverages data to manage networks and business operations faster and more efficiently. Furthermore, it helps businesses cut costs. Expected to deploy in FY'23, these offerings will create value for enterprise customers aiming to stay competitive. **The opportunity to reduce expenses and expedite decision-making processes will attract new customers for ANET.**
- *Network Switching:* A surge in data generation and cloud utilization is driving enterprise and hyperscale players to shift from 25G and 50G systems to the more complex 100G and 400G switches. This allows for more advanced cloud computing and the processing of larger AI and machine learning workloads. In December 2022, ANET announced two notable developments in its networking equipment portfolio. The 7050X4 and 70605 Series are new switches that are able to achieve higher network speeds, manage larger workloads, and support investment protection for customers. The significance of this breakthrough is that these each of these devices has the ability to manage a network that traditionally requires two devices, and it can process networks faster. ANET's data center customers will favor this opportunity to reduce Capex, Opex, and used storage space. **Upon deployment in 1Q'23, these products will expand the growth of ANET's 400G and 800G customers.**

### Puffin' That Cisco Pack

CSCO has, for a long time, been a dominant force in the ethernet switch industry. However, ANET's innovation and strong customer base have allowed it to steal market share since 2017. **The Company has grown to attain 45.0% of the market, which includes 100G-400G switch ports, as well as 23.0% of the high-speed data center switching market.** ANET has an advantage over CSCO because it can effectively tailor its software platforms and other solutions to its customers' needs. Furthermore, its switching products simply focus on achieving higher speeds and executing network tasks, while systems offered by competitors often include supplemental features that drive up prices. Customers prefer ANET's products because they are efficient, suited to their needs, and cheaper than those of competitors. It's also important to consider the expertise needed to utilize equipment from CSCO and its competitors, whereas ANET's technology is easier to deploy and configure. Also, the Company works closely with clients to implement its products. Through innovating its products and services, it will continue to take market share from CSCO and other competitors in the future.




*Source: Bloomberg Intelligence*

## RISKS TO INVESTMENT THESIS

### Lost in the METAverse

ANET's biggest risk in FY'23 surrounds investments and spending in the networking and data center industry. If the macro environment becomes weaker and the recession is more severe than expected, we are likely to see more Capex cuts from Big Tech companies. Companies may hold back upgrading its switches if they expect a slowdown.

ANET's revenue is dependent on Cloud Titans such as META and MSFT, a pause in their data center investments would slow the Company's growth, as 46.0% of its revenue comes from Cloud Titans.

- *Mitigant:* ANET's goal of expanding its TAM to $51 bn directly combats its high concentration risk. With the rollout of its new products, the Company will be able to diversify its revenue streams in the next few years. Additionally, after a record year for product revenues, growth in its service segments will help provide a buffer in the event product revenue does slow.
- Despite many Tech names seeing downward earnings revisions and slashed growth targets, ANET's outlook has only been revised upwards. Even in a recession, spending will remain resilient as the race to control the cloud continues. Big Tech names have no choice but to continue to invest in networking equipment.

***In our bear case, we modeled in lower revenue growth, reflecting the result of ANET missing its 25.0% YoY revenue growth target caused by more Capex cuts from META and MSFT and a slowdown in the demand for lower latency networking switches in a tougher than expected macro environment.***

### Stuck in Limbo

In the past year, supply chain issues have been the main drag on ANET's full growth potential. Demand continues to outpace the speed at which the Company produces under the current market constraints. Compared to its competitors, ANET has more capital tied up in its inventory, with days in inventory being almost double than it was in 2019. If the supply chain eases slower than expected, margins will continue to contract.

- *Mitigant:* Fortunately for ANET, its competitors all face the same issue. On its 4Q'22 earnings call, management expects supply chain issues to bottom out in 1Q'23. From there, we should see marginal improvement. The fact that ANET could still hit its original revenue guidance and much higher margins than competitors amidst a stagnating supply chain shows its resilience and effective management.

***In our bear case, we modeled a gross margin of 60.0% to reflect higher supply chain costs throughFY'23 and slower normalization of product backlogs, placing increased pressure on margins.***

### If You're Not First, You're Last

While ANET continues to take market share from CSCO in the network switching market, there is a concern that more companies will adopt white box solutions. White box solutions refer to non-branded switches available off the shelf. These solutions are cheaper for data centers to implement. Additionally, ANET is still a fairly new company in the industry. CSCO has years of reputational history in the space, helping it to fight off competitors like ANET.

- *Mitigant:* ANET has a clear competitive advantage over its white box competitors. The Company has strong relationships with META and MSFT. ANET communicates with its cloud customers to deliver exactly what they want in a networking switch. Its networking switches are not one-size-fits-all. For example, some switches in its 7060x Series are specifically tuned to META's needs. Additionally, it's unlikely the performance of a white box system would suffice the needs of Big Tech because they are generally slower and less customizable.
- Versus CSCO, ANET comes out on top in terms of product quality. CSCO's products allow for little flexibility compared to the full hardware and cloud functionality of ANET's switches.

***In our bear case, we modeled a ~10.5% revenue CAGR through FY'27 to illustrate ANET losing customers to CSCO and white box products in the long run.***

## PEER GROUP ANALYSIS

Ciena Corp. is a telecommunications networking equipment and software service provider that specializes in optical connectivity. The Company also provides routing, analytics, automation, and other IT solutions. Its segments include Networking Platforms (76.5% of FY'22 Revenue), Global Services (13.8%), Platform Software & Services (7.6%), and Blue Planet Automation Software & Services (2.1%).

Cisco Systems, Inc. (CSCO) designs, manufactures, and distributes Internet Protocol-based networking products and services for telecommunications and information technology applications. It also delivers cloud and security solutions for a variety of industries. The Company reports revenue through the following segments: Secure, Agile Networks (46% of FY'22 revenue), Services (26.3%), Internet for the Future (10%), and Other (17%).

Hewlett Packard Enterprise Co. (HPE) is a global edge-to-cloud company that provides IT solutions, cloud services, financial technology services, and enterprise hardware for data center switching and local area network (LAN) management. HPE's business segments include Compute (44% of FY'21 Revenue), Storage (16%), Intelligent Edge (13%), and Other (27%).

Juniper Networks, Inc. (JNPR) designs, develops, and provides products and services for service and cloud providers, governments, enterprises, and other organizations. Some of its key products include routers, switches, network management software, and network security solutions. JNPR's segments include Automated WAN Solutions (35.2% of FY'21 Revenue), Hardware Maintenance & Professional Services (31.9%), AI-Driven Enterprise (17.5%), and Cloud-Ready Data Centers (15.4%).

Nokia Corp. (NOK) provides network infrastructure, technology, and software services. It services communication providers & enterprises with Radio Access Network (RAN) technologies, Microwave Radio Links (MWR), and cloud and network services. NOK derives its FY'21 revenues from the following segments: Networks (44%), Network Infrastructure (35%), Cloud & Network Services (14%), and Other (7%).

| Primary Peer Group | | | | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Market | Enterprise | Sales | | EPS | | EBITDA Margin | | Profit Margin | | EBITDA | | Sales | | Price / Earnings | | |
| | Ticker | Cap | Value | LTM | 2022E | LTM | 2022E | LTM | 2022E | LTM | 2022E | LTM | 2022E | LTM | 2022E | LTM | 2022E |
| Arista Networks, Inc. | ANET | $40,724 | $37,821 | 48.6% | 24.4% | 62.4% | 32.1% | 36.3% | 41.5% | 30.9% | 32.8% | 23.8x | 16.7x | 8.8x | 6.9x | 31.9x | 22.8x |
| Cisco Systems, Inc. | CSCO | 194,149 | 184,267 | 3.0% | 5.7% | 3.0% | 25.8% | 30.3% | 35.9% | 22.0% | 26.7% | 11.3x | 9.4x | 3.6x | 3.4x | 17.3x | 13.3x |
| Juniper Networks, Inc. | JNPR | 10,085 | 10,848 | 11.9% | 8.6% | 88.2% | 15.4% | 14.3% | 20.4% | 8.9% | 13.1% | 13.4x | 9.2x | 2.1x | 1.9x | 21.9x | 13.3x |
| Ciena Corporation | CIEN | 7,204 | 7,207 | 0.3% | 17.2% | (68.7)% | 1.0% | 10.9% | 15.0% | 4.2% | 9.1% | 17.4x | 11.3x | 2.0x | 1.7x | 49.5x | 18.7x |
| Hewlett Packard Enterprise Company | HPE | 21,073 | 31,540 | 2.6% | 2.3% | (74.4)% | 44.1% | 16.8% | 18.6% | 3.0% | 9.0% | 6.2x | 5.8x | 1.1x | 1.1x | 25.2x | 8.0x |
| Nokia Corporation | NOKIA | 24,276 | 20,726 | 12.2% | 3.4% | 155.3% | (41.1)% | 15.3% | 15.8% | 17.1% | 9.7% | 5.5x | 5.1x | 0.8x | 0.8x | 5.9x | 9.7x |
| High | | 194,149 | 184,267 | 12.2% | 17.2% | 155.3% | 207.1% | 30.3% | 35.9% | 22.0% | 26.7% | 17.4 | 11.3x | 3.6x | 3.4x | 49.5x | 18.7x |
| Mean | | 51,357 | 50,918 | 6.0% | 7.4% | 20.7% | 82.8% | 17.5% | 21.1% | 11.0% | 13.5% | 10.8 | 8.2x | 1.9x | 1.8x | 23.9x | 12.6x |
| Median | | 21,073 | 20,726 | 3.0% | 5.7% | 3.0% | 60.7% | 15.3% | 18.6% | 8.9% | 9.7% | 11.3 | 9.2x | 2.0x | 1.7x | 21.9x | 13.3x |
| Low | | 7,204 | 7,207 | 0.3% | 2.3% | (74.4)% | (41.1)% | 0.1x | 15.0% | 3.0% | 9.0% | 5.5x | 5.1x | 0.8x | 0.8x | 5.9x | 8.0x |

| Company | | General Statistics | | | Returns Analysis | | | 2021A Leverage Analysis | | | 2021A Coverage Analysis | | | Liquidity Profile | | Credit Profile | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | Total Debt / | | | | | | | | | |
| | | | | Dividend | | | | | | | EBITDA / | (EBITDA - | EBIT / | Quick | Current | | |
| | Ticker | Tax Rate | Beta | Yield | ROIC | ROE | ROA | Cap | EBITDA | Equity | Int. Exp. | Capex)/Int. | Int. Exp. | Ratio | Ratio | S&P | Outlook |
| Arista Networks, Inc. | ANET | 14.5% | 1.26 | 0.0% | 30.7% | 30.5% | 15.3% | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 3.1x | 4.3x | 0 | 0 |
| Cisco Systems, Inc. | CSCO | 18.4% | 0.95 | 3.2% | 26.8% | 27.7% | 9.3% | 0.2x | 0.6x | 0.3x | 45.9x | 44.6x | 39.0x | 1.2x | 1.4x | AA- | Stable |
| Juniper Networks, Inc. | JNPR | 11.4% | 0.93 | 2.8% | 8.8% | 10.7% | 3.7% | 0.3x | 2.3x | 0.4x | 13.9x | 12.1x | 9.2x | 1.1x | 1.7x | BBB | Stable |
| Ciena Corporation | CIEN | 16.2% | 0.93 | 0.0% | 7.4% | 5.3% | 3.2% | 0.3x | 2.8x | 0.4x | 9.0x | 7.0x | 5.5x | 2.2x | 3.3x | BB+ | Stable |
| Hewlett Packard Enterprise Company | HPE | 0.9% | 1.20 | 2.9% | 7.5% | 4.3% | 2.5% | 0.4x | 2.8x | 0.7x | 19.0x | 7.0x | 8.8x | 0.6x | 0.9x | BBB | Stable |
| Nokia Corporation | NOKIA | N/A | 0.63 | 2.8% | N/A | 21.7% | 4.0% | 0.2x | 1.4x | 0.3x | 31.0x | 26.1x | 21.7x | 1.3x | 1.6x | BBB- | Stable |
| High | | 18.4% | 1.20 | 3.2% | 26.8% | 27.7% | 9.3% | 0.4x | 281.0% | 68.6% | 45.9x | 44.6x | 39.0x | 2.2x | 3.3x | | |
| Mean | | 11.7% | 0.93 | 2.3% | 12.6% | 14.0% | 4.6% | 0.3x | 198.6% | 41.2% | 23.8x | 19.4x | 16.8x | 1.3x | 1.8x | | |
| Median | | 13.8% | 0.93 | 2.8% | 8.1% | 10.7% | 3.7% | 0.3x | 227.3% | 41.4% | 19.0x | 12.1x | 9.2x | 1.2x | 1.6x | | |
| Low | | 0.9% | 0.63 | 0.0% | 7.4% | 4.3% | 2.5% | 0.2x | 63.9% | 25.8% | 9.0x | 7.0x | 5.5x | 0.6x | 0.9x | | |

## VALUATION ANALYSIS

### Model Assumptions

In our FY'23 base case, we assume revenue grows slightly above management projections, with strength coming from its enterprise customers. We modeled lower margins in 1H'23 as the supply chain continues to weigh on COGS. Our revenue projections align with most analysts, and our average projected CAGR reflects the Company's continued steady growth in the years beyond what the Street projects. Our team weighted ANET's valuation on a DCF exit multiple and an NTM P/E method. As the Company trades at a premium to peers, we used an EV/EBITDA exit multiple of 17.0x. It currently trades at 16.9x NTM EV/EBITDA. For NTM P/E, we used its one-year multiple of 29.4x to factor out the inflated multiple it had as investors poured money into tech during 2021. Most banks use an NTM P/E multiple to value the Company, but others use a 4.0 – 5.0% PGR in the DCF. However, we found this to be a rash assumption and chose to remain more realistic. Our team is slightly more bullish than the Street, with our assumptions and PT, closely reflecting management guidance and our intuition about the networking equipment space.

| Discounted Cash Flow | 2020 | 2021 | 2022 | 1Q23e | 2Q23e | 3Q23e | 4Q23e | 2023e | 2024e | 2025e | 2026e | 2027e |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | $2,317.5 | $2,948.0 | $4,381.3 | $1,197.4 | $1,333.1 | $1,442.4 | $1,563.6 | $5,536.5 | $6,195.6 | $6,883.5 | $7,670.3 | $8,416.1 |
| EBITDA | 744.3 | 975.1 | 1,589.8 | 435.6 | 499.9 | 547.5 | 590.9 | 2,073.8 | 2,419.1 | 2,741.2 | 3,130.0 | 3,435.7 |
| EBIT | 699.7 | 924.7 | 1,527.1 | 418.6 | 482.5 | 529.7 | 572.4 | 2,003.2 | 2,340.1 | 2,650.2 | 3,029.8 | 3,324.4 |
| Income Tax Benefit (Expense) | (104.3) | (90.0) | (90.0) | (69.9) | (80.5) | (88.4) | (95.5) | (334.3) | (390.3) | (441.9) | (505.1) | (554.2) |
| NOPAT (EBIAT) | $595.4 | $834.7 | $1,437.1 | $348.7 | $402.0 | $441.3 | $476.9 | $1,668.9 | $1,949.8 | $2,208.2 | $2,524.7 | $2,770.2 |
| *% YoY Growth* | | *40.2%* | *72.2%* | | | | | *16.1%* | *16.8%* | *13.3%* | *14.3%* | *9.7%* |
| Depreciation & Amortization | | | | 16.9 | 17.4 | 17.8 | 18.5 | 70.6 | 79.0 | 91.1 | 100.2 | 111.3 |
| Stock-Based Compensation | | | | 61.0 | 67.9 | 73.5 | 79.6 | 281.9 | 315.5 | 350.5 | 390.6 | 428.6 |
| Capital Expenditures | | | | (18.0) | (20.0) | (21.6) | (23.5) | (83.0) | (92.9) | (103.3) | (115.1) | (126.2) |
| Goodwill Impairment | | | | - | - | - | - | - | - | - | - | - |
| (Increase)/Decrease in Working Capital | | | | 238.4 | (67.8) | (35.7) | (155.0) | (20.1) | (132.2) | (56.0) | (102.0) | (222.7) |
| (Increase)/Decrease in LT Items | | | | (3.8) | (14.9) | (3.8) | (3.8) | (3.8) | (3.8) | (15.2) | (3.9) | (3.9) |
| Unlevered Free Cash Flow | | | | $643.3 | $384.5 | $471.4 | $392.8 | $1,914.6 | $2,115.5 | $2,475.4 | $2,794.7 | $2,957.3 |
| *% YoY Growth* | | | | | | | | | *10.5%* | *17.0%* | *12.9%* | *5.8%* |
| Discountable Unlevered Free Cash Flow | | | | $643.3 | $384.5 | $471.4 | $392.8 | $1,892.0 | $2,115.5 | $2,475.4 | $2,794.7 | $2,957.3 |
| *Full-Year Discount* | | | | | | | | *0.86* | *1.86* | *2.86* | *3.86* | *4.86* |
| *Mid-Year Discount* | | | | | | | | *0.43* | *1.36* | *2.36* | *3.36* | *4.36* |
| *Discount Factor* | | | | | | | | *0.96* | *0.88* | *0.80* | *0.72* | *0.66* |
| Present Value of Future Free Cash Flow | | | | | | | | $1,815.2 | $1,855.5 | $1,971.3 | $2,020.7 | $1,941.4 |
| *% Growth* | | | | | | | | | *2.2%* | *6.2%* | *2.5%* | *(3.9%)* |

| Exit Multiple Method: | |
|---|---|
| Terminal Year EBITDA: | $3,435.7 |
| Exit Multiple: | 17.0 x |
| Terminal Value: | 58,407 |
| PV of Terminal Value: | 38,343 |
| PV of Stage 1 Cash Flows: | 9,604 |
| Implied Enterprise Value: | $47,947 |
| (+) Cash & Equivalents: | 4,897 |
| (-) Preferred Stock: | 0 |
| (-) Total Debt: | 0 |
| (-) Pension Obligations: | 0 |
| (-) Non-Controlling Interests: | 0 |
| (-) Capital Leases: | 0 |
| Implied Equity Value: | $52,844 |
| Diluted Shares O/S: | 314.3 |
| Implied Share Price: | $168.15 |
| *% Return:* | *25.0%* |

| Price/Earnings | |
|---|---|
| Current Multiple | 23.2x |
| Historical Average | 29.1x |
| *Premium/(Discount)* | *(20.4%)* |
| *Premium Applied to Historical* | *0.0%* |
| Implied Multiple | 29.1x |
| NTM EPS | $5.54 |
| Implied Price Target | $161 |
| *% Return* | *20.0%* |

## Multiples Valuation

### Implied Share Price

| WACC | | Exit Multiple 15.0x | 16.0x | 17.0x | 18.0x | 19.0x |
|---|---|---|---|---|---|---|
| | 9.1% | $158.84 | $166.31 | $173.78 | $181.25 | $188.71 |
| | 9.6% | $156.29 | $163.61 | $170.93 | $178.25 | $185.57 |
| | 10.1% | $153.79 | $160.97 | $168.15 | $175.32 | $182.50 |
| | 10.6% | $151.36 | $158.39 | $165.43 | $172.47 | $179.50 |
| | 11.1% | $148.98 | $155.88 | $162.78 | $169.68 | $176.58 |

| EPS | | NTM P/E 27.1x | 28.1x | 29.1x | 30.1x | 31.1x |
|---|---|---|---|---|---|---|
| | $4.43 | $120.32 | $124.76 | $129.19 | $133.62 | $138.06 |
| | $4.99 | $135.36 | $140.35 | $145.34 | $150.33 | $155.32 |
| | $5.54 | $150.40 | $155.95 | $161.49 | $167.03 | $172.57 |
| | $6.10 | $165.44 | $171.54 | $177.64 | $183.73 | $189.83 |
| | $6.65 | $180.48 | $187.13 | $193.79 | $200.44 | $207.09 |

### Implied % Return

| WACC | | Exit Multiple 15.0x | 16.0x | 17.0x | 18.0x | 19.0x |
|---|---|---|---|---|---|---|
| | 9.1% | 18.1% | 23.6% | 29.2% | 34.7% | 40.3% |
| | 9.6% | 16.2% | 21.6% | 27.1% | 32.5% | 37.9% |
| | 10.1% | 14.3% | 19.7% | 25.0% | 30.3% | 35.7% |
| | 10.6% | 12.5% | 17.7% | 23.0% | 28.2% | 33.4% |
| | 11.1% | 10.7% | 15.9% | 21.0% | 26.1% | 31.3% |

| EPS | | NTM P/E 27.1x | 28.1x | 29.1x | 30.1x | 31.1x |
|---|---|---|---|---|---|---|
| | $4.43 | (10.6%) | (7.3%) | (4.0%) | (0.7%) | 2.6% |
| | $4.99 | 0.6% | 4.3% | 8.0% | 11.7% | 15.5% |
| | $5.54 | 11.8% | 15.9% | 20.0% | 24.2% | 28.3% |
| | $6.10 | 23.0% | 27.5% | 32.0% | 36.6% | 41.1% |
| | $6.65 | 34.2% | 39.1% | 44.0% | 49.0% | 53.9% |

### Returns Profile

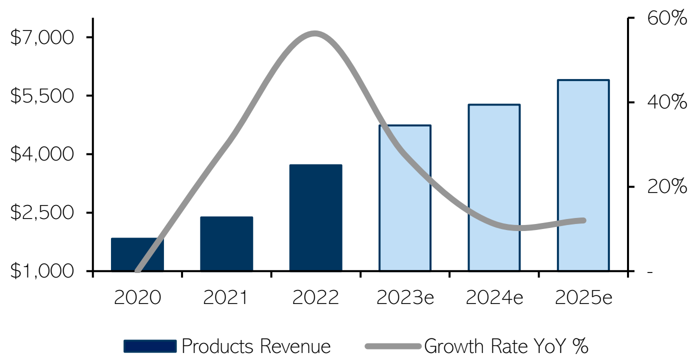
| | Methodology | Implied PT | Implied Return |
|---|---|---|---|
| | DCF | | |
| *50.0%* | *Exit Multiple* | *$168* | *25.0%* |
| *0.0%* | *Perpetual Growth Rate* | *$151* | *12.1%* |
| | Historical Multiples | | |
| *50.0%* | *NTM P/E* | *$161* | *20.0%* |
| *0.0%* | *NTM P/E Spread to Comps* | *$144* | *7.1%* |
| *0.0%* | *NTM EV/EBITDA* | *$162* | *20.3%* |
| *0.0%* | *NTM EV/EBITDA Spread to Comps* | *$158* | *17.7%* |
| | Blended Average | *$157* | *17.0%* |
| | Weighted Average | *$165* | *22.5%* |

## FINANCIAL ANALYSIS

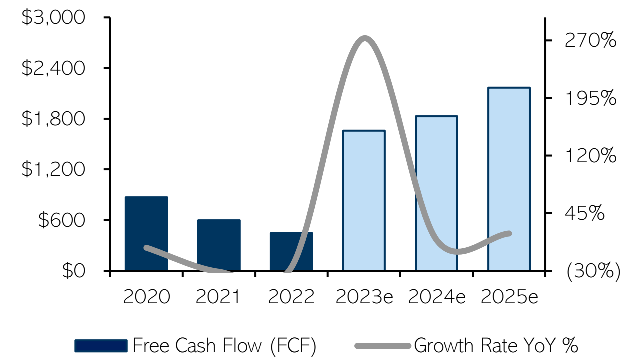
### Revenue Build

| Summary | 2020 | 2021 | 2022 | 2023e | 2024e | 2025e | 2026e | 2027e | Historical | Projected |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Company Revenue | $2,317.5 | $2,948.0 | $4,381.3 | $5,536.5 | $6,195.6 | $6,883.5 | $7,670.3 | $8,416.1 | *23.6%* | *13.9%* |
| *% Growth YoY* | | *27.2%* | *48.6%* | *26.4%* | *11.9%* | *11.1%* | *11.4%* | *9.7%* | | |
| Products Revenue | $1,830.8 | $2,377.7 | $3,716.1 | $4,738.3 | $5,269.6 | $5,902.0 | $6,610.2 | $7,271.2 | *26.6%* | *14.4%* |
| *% Growth YoY* | | *29.9%* | *56.3%* | *27.5%* | *11.2%* | *12.0%* | *12.0%* | *10.0%* | | |
| *% of Total Revenue* | *79.0%* | *80.7%* | *84.8%* | *85.6%* | *85.1%* | *85.7%* | *86.2%* | *86.4%* | | |
| Services Revenue | $486.7 | $570.3 | $665.2 | $798.3 | $926.0 | $981.6 | $1,060.1 | $1,144.9 | *11.0%* | *11.5%* |
| *% Growth* | | *17.2%* | *16.6%* | *20.0%* | *16.0%* | *6.0%* | *8.0%* | *8.0%* | | |
| *% of Total Revenue* | *21.0%* | *19.3%* | *15.2%* | *14.4%* | *14.9%* | *14.3%* | *13.8%* | *13.6%* | | |

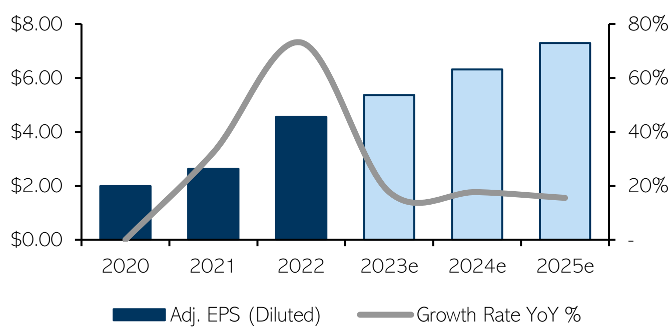
### Product Revenue



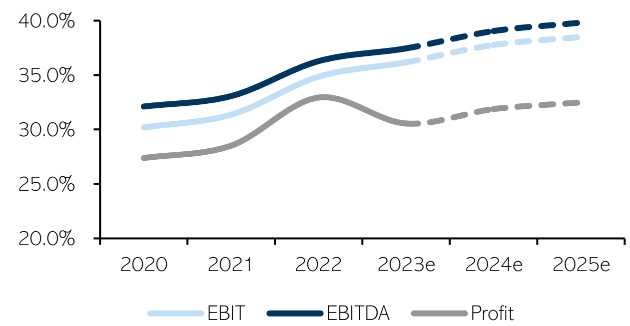

### Free Cash Flow




### Earnings Per Share




### Margins



## APPENDIX

**Exhibit I: Street Discussion Summary – "The Apple of Data Switches"**

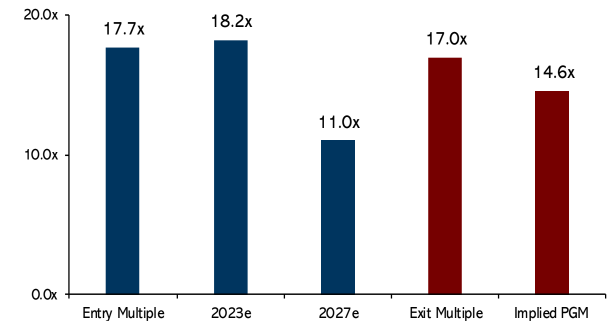
**Analyst: Woo Jin Ho | Positive Outlook**

Due to ANET earnings coming out between our pre-pitch memo and the ICR deadline, we did not connect with a sell-side analyst, but we had the privilege to discuss our thesis with Senior Analyst Woo Jin from Bloomberg Intelligence. Previously, he was an equity research analyst at Bank of America, Nomura Securities, and Oppenheimer.

- **How's our thesis?** He started off by saying he was very impressed with our writing and questioned if we utilized ChatGPT. Woo Jin agrees with our thesis and suggested a slight adjustment to our model to reflect that the Services segment revenue lags behind the growth of the Products segment. Additionally, he was more optimistic than management's sales guidance and thought the Streets estimates were on the low end.
- **What do you think about ANET's high concentration in META & MSFT?** This dependence is a concern for some investors because of simply having so much exposure to two companies. However, ANET's longstanding relationship, which has grown over the years, makes Woo Jin worry little. While high concentration is always a worry, there are arguably no two better customers to have in the space. Also, now is the opportunity for ANET to build similar relationships with the other Cloud Titans. GOOG and AMZN do a lot of the networking equipment themselves. While META and MSFT have been partners for a long time and work together with ANET to develop and address their needs, GOOG has only minimally utilized ANET's products and services. Right now, could be an inflection point for ANET, with GOOG laying off many of its engineers. It may be the time that GOOG will outsource its IT and networking needs more to ANET, a potential for a strong revenue boost at a time when its Cloud Titan revenues normalize.
- **How big of an impact will AI play?** Obviously right now AI is the main thing on investors' minds and is the hot topic everyone is talking about. Realistically the expanded use-cases and new applications will not be a big driver in our investment horizon and not likely for the next five or so years, at least. However, this will definitely keep the multiple up higher as investors will anticipate progress and growth from the names that are in front of the curve and eventually reap the full benefits of AI technology and capabilities.
- **Is no debt bad?** In the high interest rate environment having zero debt should be seen as an asset. While this may not be the most optimal capital structure in the long run, it provides the management team to have the dry powder it needs to be flexible when its competitors are more limited especially when the cost of debt is so high. Most impressive is how well ANET is able to generate cash. Its competitors cannot compare to its 61.0% gross margin and 40.0% operating margin.
- **How does Arista compare to its competitors?** A benefit for CSCO is that so many people know the operating system, while ANET's EOS is still relatively new. Yet, he called ANET the Apple of the Networking Equipment Industry. Relating Arista to a Lamborghini, it is ready to go for everything customers want: SPEED. It is specifically designed to be as fast as possible. All it needs is a bit of fine-tuning to the client, and it's perfect. Cisco is like a Honda. It has the stuff to make everyone comfortable, but it requires a lot of excess effort of added installations and modifications to make it fast. At the end of the day, even after all the work, it still won't give them the same speed that ANET will. Speed is the most important for the Cloud Titans.
- **What are some things that most investors are overlooking?** Many don't realize that ANET uses Broadcom's chips, which is its engine. ANET can make the chips run well, add components, and customize the product for its client while maintaining high speed. Additionally, its relationships with Meta and Microsoft are a huge moat: ANET can work with them, constantly talk to them, and ask them what they need, what they are looking for, and what they can improve. The Company can then deliver new and updated products with minimal delay. This is a huge asset for ANET.

## Exhibit II: Model Output

Multiples Analysis (EV/EBITDA)




| Return Summary | |
|---|---|
| **Exit Multiple Method** | |
| Implied Enterprise Value: | $47,947 |
| Implied Equity Value: | 52,844 |
| Implied Share Price: | $168 |
| % Return: | 25.0% |
| **Perpetuity Growth Method** | |
| Implied Enterprise Value: | $42,499 |
| Implied Equity Value: | 47,396 |
| Implied Share Price: | $151 |
| % Return: | 12.1% |

| | Annuals | | | | | | | CAGR | CAGR |
|---|---|---|---|---|---|---|---|---|---|
| Consolidated Financials | 2021 | 2022 | 2023e | 2024e | 2025e | 2026e | 2027e | Historical | Projected |
| Revenue | $2,948 | $4,381 | $5,537 | $6,196 | $6,884 | $7,670 | $8,416 | *37.5%* | *13.9%* |
| *YoY % Growth* | *27.2%* | *48.6%* | *26.4%* | *11.9%* | *11.1%* | *11.4%* | *9.7%* | | |
| Gross Profit | $1,881 | $2,676 | $3,420 | $3,889 | $4,337 | $4,909 | $5,386 | *34.4%* | *15.0%* |
| *% Margin* | *63.8%* | *61.1%* | *61.8%* | *62.8%* | *63.0%* | *64.0%* | *64.0%* | | |
| *YoY % Growth* | *26.9%* | *42.3%* | *27.8%* | *13.7%* | *11.5%* | *13.2%* | *9.7%* | | |
| EBITDA | $975 | $1,590 | $2,074 | $2,419 | $2,741 | $3,130 | $3,436 | *47.7%* | *16.8%* |
| *Margin* | *33.1%* | *36.3%* | *37.5%* | *39.0%* | *39.8%* | *40.8%* | *40.8%* | | |
| *YoY % Growth* | *32.2%* | *65.1%* | *31.2%* | *16.8%* | *13.2%* | *14.3%* | *9.7%* | | |
| Net Income (Loss) | $841 | $1,443 | $1,692 | $1,975 | $2,236 | $2,556 | $2,805 | *50.8%* | *14.2%* |
| *Margin* | *28.5%* | *32.9%* | *30.6%* | *31.9%* | *32.5%* | *33.3%* | *33.3%* | | |
| *YoY % Growth* | *32.5%* | *71.6%* | *17.2%* | *16.8%* | *13.2%* | *14.3%* | *9.7%* | | |
| Adj. EPS (Diluted) | $3 | $5 | $5 | $6 | $7 | $9 | $10 | *(24.4%)* | *16.5%* |
| *YoY % Growth* | *(67.0%)* | *73.1%* | *17.7%* | *17.7%* | *15.5%* | *18.2%* | *13.6%* | | |
| Free Cash Flow | $597 | $445 | $1,659 | $1,829 | $2,168 | $2,439 | $2,567 | *(28.5%)* | *11.5%* |
| *YoY % Growth* | *(31.3%)* | *(25.5%)* | *272.8%* | *10.2%* | *18.5%* | *12.5%* | *5.2%* | | |

| | Annuals | | | | | | | Average | Average |
|---|---|---|---|---|---|---|---|---|---|
| Capitalization and Key Ratios | 2021 | 2022 | 2023e | 2024e | 2025e | 2026e | 2027e | Historical | Projected |
| Leverage | | | | | | | | | |
| Total Debt / EBITDA | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | *0.0x* | *0.0x* |
| Total Debt / Equity | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | *0.0x* | *0.0x* |
| Total Debt / Total Assets | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | 0.0x | *0.0x* | *0.0x* |
| Liquidity | | | | | | | | | |
| Current Ratio | 4.3x | 4.3x | 4.7x | 5.4x | 6.3x | 6.7x | 7.1x | *4.5x* | *6.0x* |
| Quick Ratio | 3.5x | 3.1x | 3.6x | 4.4x | 5.3x | 5.7x | 6.1x | *3.6x* | *5.0x* |
| Cash Ratio | 3.1x | 2.3x | 3.1x | 3.8x | 4.7x | 5.1x | 5.6x | *3.0x* | *4.5x* |
| Profitability | | | | | | | | | |
| Return on Assets (ROA) | 14.7% | 21.3% | 19.2% | 17.8% | 17.7% | 17.2% | 16.2% | *16.5%* | *17.6%* |
| Return on Equity (ROE) | 21.1% | 29.5% | 25.6% | 22.8% | 21.8% | 20.9% | 19.4% | *23.3%* | *22.1%* |
| Return on Inv. Capital (ROIC) | 21.1% | 29.5% | 25.6% | 22.8% | 21.8% | 20.9% | 19.4% | *23.3%* | *22.1%* |
| Efficiency | | | | | | | | | |
| Asset Turnover | 0.5x | 0.6x | 0.6x | 0.6x | 0.5x | 0.5x | 0.5x | *0.5x* | *0.5x* |
| Days Sales Outstanding | 56.1 | 60.0 | 61.4 | 58.4 | 55.0 | 55.0 | 55.0 | *57.4* | *57.0* |
| Days Inventory Outstanding | 193.2 | 207.6 | 228.8 | 219.0 | 195.0 | 195.0 | 195.0 | *188.6* | *206.6* |
| Days Payables Outstanding | 57.6 | 46.6 | 45.2 | 48.1 | 30.0 | 45.0 | 45.0 | *53.2* | *42.7* |
| Cash Conversion Cycle | 191.7 | 221.0 | 244.9 | 229.4 | 220.0 | 205.0 | 205.0 | *192.9* | *220.9* |

## Exhibit III: Supplemental Valuation Graphs

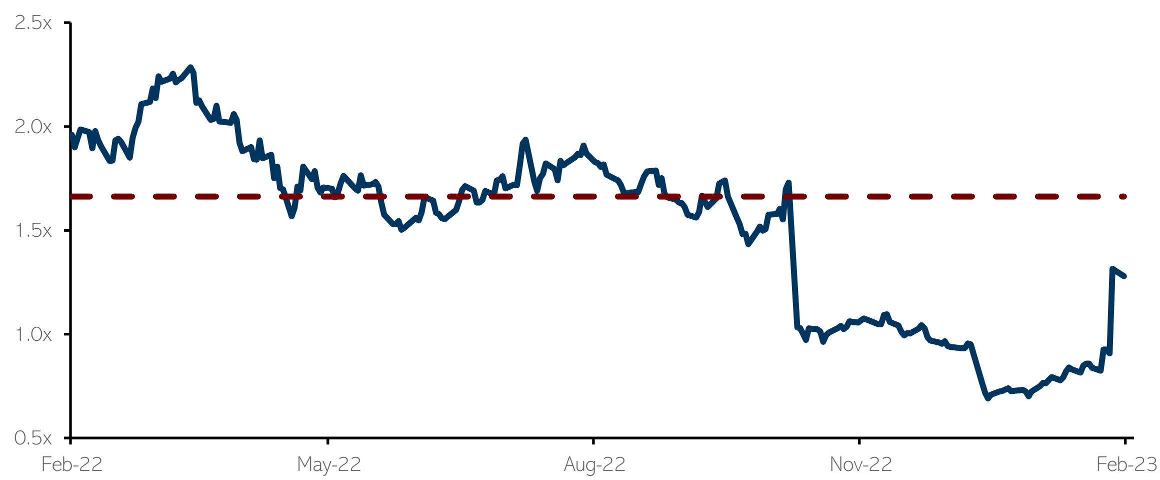
Three-Year NTM EV/EBITDA


*Source: Bloomberg*

Three-Year NTM P/E

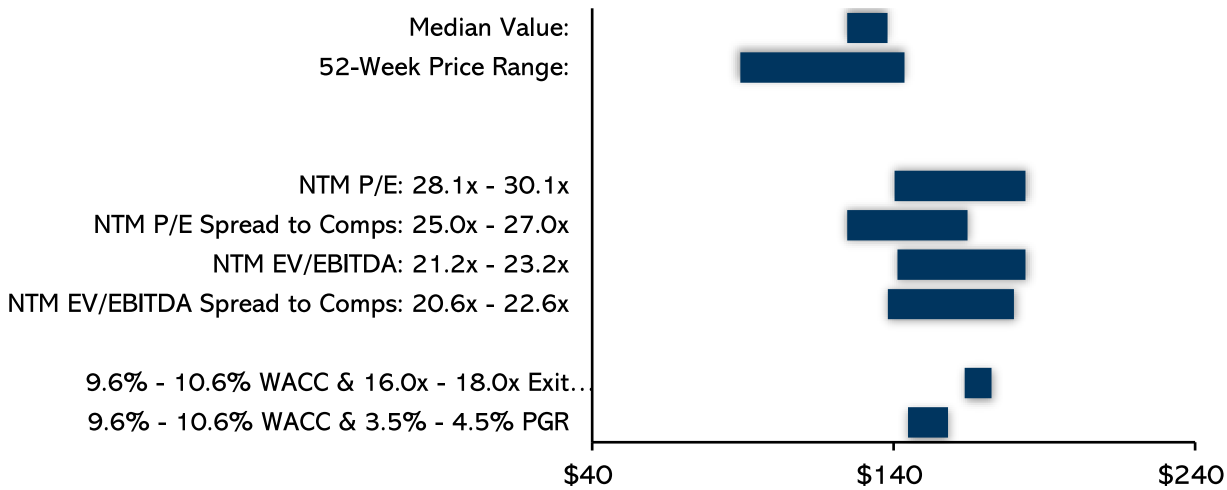

*Source: Bloomberg*

One-Year NTM PEG




*Source: Bloomberg*

Exhibit IV: DCF Implied Valuation



## TFA STATEMENT

Established in honor of Professor William C. Dunkelberg, former Dean of the Fox School of Business, for his tireless dedication to educating students in "real-world" principles of economics and business, the William C. Dunkelberg (WCD) Owl Fund will ensure that future generations of students have exposure to a challenging, practical learning experience. Managed by Fox School of Business graduate and undergraduate students with oversight from its Board of Directors, the WCD Owl Fund's goals are threefold:

- Provide students with hands-on investment management experience
- Enable students to work in a team-based setting in consultation with investment professionals.
- Connect student participants with nationally recognized money managers and financial institutions

Earnings from the fund will be reinvested net of fund expenses, which are primarily trading and auditing costs and partial scholarships for student participants.

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