

ARLO Q2 2019

Summary

Yesterday, Arlo reported Q2 2019 results. Revenue for the second quarter beat consensus expectations by 8%. This was positive. The negative came when management issued third quarter revenue guidance for \$100MM (at the midpoint), 28% below consensus expectations of \$128MM. Most importantly, management maintained annual revenue guidance of \$400MM (at the midpoint). While third quarter revenue is going to be lower than the Street expected, management is confident that 4th quarter revenue, on the backs of two new product launches, will accelerate meaningfully, allowing the company to hit its annual guidance.

Shares traded down 25% this morning but have come back and are down ~15% at the time of this report. I think the stock has been oversold and represents a buying opportunity.

Additional Details

Below, I've shown Arlo's quarterly revenue progression.

Arlo Quarterly Revenue

Year	Quarter	Revenue (MM)	Y/Y Growth	Q/Q Growth
2016	Q1	\$24		
2016	Q2	\$40		66.7%
2016	Q3	\$47		17.5%
2016	Q4	\$74	57.4%	57.4%
2017	Q1	\$62	158.3%	-16.2%
2017	Q2	\$79	97.5%	27.4%
2017	Q3	\$105	123.4%	32.9%
2017	Q4	\$125	68.9%	19.0%
2018	Q1	\$101	62.9%	-19.2%
2018	Q2	\$111	40.5%	9.9%
2018	Q3	\$131	24.8%	18.0%
2018	Q4	\$128	2.0%	-2.7%
2019	Q1	\$58	-42.7%	-54.6%
2019	Q2	\$84	-24.7%	44.4%
2019	Q3 Estimate	\$108	-17.6%	29.2%
2019	Q4 Estimate	\$150	17.6%	38.9%
2019	Full Year	\$400		

While management has guided to \$100MM of Q3 revenue, I'm assuming revenue beats guidance and comes in at \$108MM (consistent with prior quarter beats).

If that is the case, Arlo will need to generate \$150MM of revenue in Q4 to meet annual guidance (18% annual growth and 39% sequential growth).

While this may seem like a big jump, management is confident it will get there due to:

- 1) Inventories have returned to normal levels.
- 2) Arlo is launching two new products (a more affordable camera and a video doorbell) in the second half of the year. These products will be available for the holiday season and will drive revenue growth in the 4th quarter.

New Product Launch

In the third quarter, Arlo will be launching a new 2K resolution camera. This product will leverage many of the Ultra's capabilities, but will only have 2K (versus 4K for the Ultra) resolution. It will also be launched at a more affordable price point.

Arlo will also launch a video doorbell that integrates with the Arlo system.

Both new products will come with a three month Arlo Smart subscription (\$2.99 per camera per month) and management is confident this will drive accelerate in paid subscribers and service revenue.

Service Revenue

Service revenue continues to grow (+23% y/y in the quarter) and is on track to total \$47MM by year end (12% of total). As service revenue continues to improve, Arlo's gross margin will rise.

Importantly, no service revenue is being derived by Arlo Ultra purchasers as a one year subscription to Arlo Smart was included in the original purchase. As such, Arlo should see significant growth (>25%) in service revenue in 2020.

Valuation

With the sell off, Arlo has a market cap of \$234MM. Meanwhile, it has net cash on its balance sheet of \$140MM. Therefore, Arlo is trading at an enterprise value of \$94MM, and an enterprise value to 2019 revenue multiple of 0.23x. Other public consumer hardware peers include FitBit, Sonos, GoPro, and Roku. As shown in the chart below, other consumer hardware companies trade at a median EV / 2019 revenue multiple of 0.54x.

Company Name	Ticker	Price	Market Cap (MM)	Enterprise Value	Revenue Growth '20/'19	EV / EBITDA			EV / Revenue			2019 EBITDA Margin	Cash Available
Sonos Inc	SONO	\$10.06	\$1,056	\$774	10%	25.4x	8.6x	6.5x	0.68x	0.61x	0.56x	8.5%	\$283
Fitbit Inc	FIT	\$3.22	\$832	\$264	2%	-2.1x	-3.8x	-5.9x	0.17x	0.18x	0.18x	-3.0%	\$568
GoPro Inc	GPRO	\$4.53	\$698	\$676	2%	-12.5x	6.9x	6.0x	0.59x	0.54x	0.53x	8.8%	\$22
Roku Inc	ROKU	\$99.94	\$11,322	\$10,893	34%	-18215.8x	653.1x	201.9x	14.67x	10.38x	7.74x	3.8%	\$429
Median						-2.1x	6.9x	6.0x	0.59x	0.58x	0.54x		
Arlo Technologies Inc	ARLO	\$3.13	\$234	\$94	19%	-2.2x	-1.0x	-1.7x	0.20x	0.23x	0.20x	-22.9%	\$140

Further, Arlo looks attractive on a precedent transaction basis. Arlo's two main competitors are Nest and Ring. Google acquired Nest for \$3.2BN (6.9x forward revenue). Ring started out as a smart doorbell company, but has added outdoor cameras. Amazon acquired the company in 2018 for \$1.6BN (3.3x forward revenue).

Another helpful data point is that Belkin, a consumer electronics manufacturer, that was growing at 4% was acquired in 2018 by Foxconn for \$866MM. [Per this filing](#), we can see that Belkin most recently had sales of \$789MM. This purchase price implies a 1.1x revenue multiple. Belkin is a private company, and thus, I'm not able to determine if Belkin has any cash/debt on its balance sheet (this would change the revenue multiple). Nonetheless, the transaction suggests ARLO is attractively valued at 0.23x 2019 revenue.

I believe ARLO deserves to trade inline with peers at an EV/ 2020 revenue multiple of 0.58x, implying fair value of \$5.00. There could be significantly more upside if Arlo were to be acquired.