Zoom Video Communications — Overweight

Strong EPS and Customer Growth to Unlock Profit Potential Under Pandemic; Initiate Buy & $165 PT

Thesis

In lieu of the current macroeconomic slowdown, Zoom Video Communications provides investors with a strong long play when considering, primarily, the three major factors that have impacted all economic life in the recent fiscal quarter - i.e, COVID-19, corporate shifts to 'Work from home' policy, and dramatic changes to the global macroeconomic health. Therefore, we are initiating an overweight rating on the firm that finds considerable opportunity in these factors by setting a price target of $165 by Q1 2021.

- **The Coronavirus pandemic** has brought massive shifts to the way that we live our lives across the world. As the virus spread from China to the rest of the world, it revealed just how unprepared our globalized society is to the threat of a highly infectious virus. Universities, schools, and offices began to close down out of interest in protecting their students and staff from this potentially deadly infection. As a result, Zoom quickly emerged as the frontrunner in the virtual classroom and meeting software space. Its ease of use and affordability gave it a clear advantage over rival software such as Microsoft Teams and Google Hangouts and has resulted in significant revenue-generating user base growth (see figure 1.0). Furthermore, due to its exponential improvement in LTV/CAC (as a result of inward customer draw vs. outward draw), the firm has seen a significant improvement in its unrealized earnings potential.

- **The popularity of online classes and work from home jobs** has steadily increased over the past few years. It is estimated that as many as 25% of all college students - over 5.4 million - have taken an online class, with almost half of those students taking online classes exclusively. In the United States, past data suggests that almost 3% of the workforce - 3.7 million employees - worked from home at least half of the time. As this pandemic only further proves the feasibility of working from home, more and more jobs will move out of the office and into the homes of the employees. This has already been exemplified in Zoom's financials for Q4 2020, which detailed the acquisition of quarterly user base growth that equaled the entirety of customer base expansion seen in the previous 3 quarters.

- **Zoom's applications go beyond the classroom and business meetings,** such as its remote IT services and even personal communication. Zoom is in pole position to become the preferred platform for professional telecommunication, even long after the threat of the Coronavirus is eliminated. The current global macroeconomic condition also presents perfect economic support for an expansion in Zoom's operations exiting this pandemic - as firms look to cut costs holistically, the use of virtual platforms dramatically helps a variety of large firms reduce overhead and help reduce bottom line damage.

Description

Zoom Video Communications is a communications platform that aims to connect people through the means of video, voice, and content sharing in order to mimic the benefits of in-person meetings.

PRICE: $135.92
As of 4/13/2020
TARGET: $165.00
As of 3/30/2020

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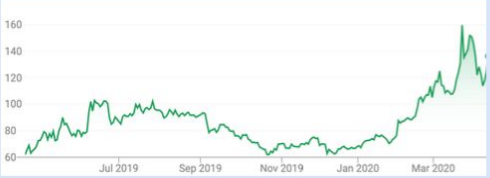
Summary	Current
FYE21 Rev (Bn)	$932.42
FY21E EPS	0.43
52-Week High/Low	$164.94/$59.94
Shares Out (mil)	111.8
Market Cap. (Bn)	$39.91
3M Avg Vol (mil)	10.62
Book Value/Share	$2.99
Dividend Yield	--

1-Year Chart:



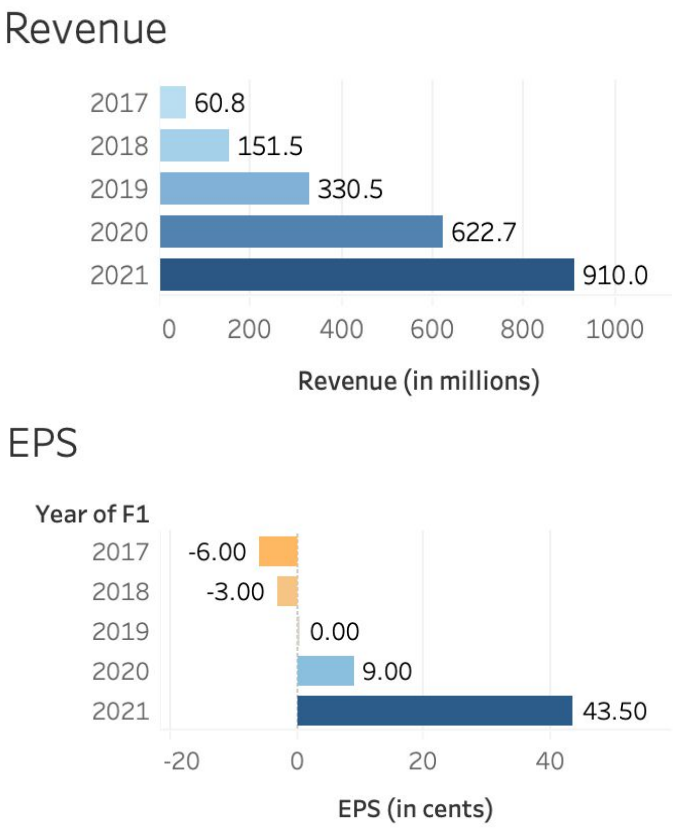
Risks of PT & Recommendation

1. Economic Slowdown
2. Liquidity for Investors
3. Privacy Breach

Financial Strength and Unrealized Growth Potential

On a fundamentally financial level, Zoom has, through its corporate history, presented strong growth across key metrics concerning its fiscal health. Between 2016 and 2019, Zoom's revenue has, on average, more than doubled YoY (see figure 1.2) - this has allowed Zoom to offset any infrastructure costs incurred by the SaaS firm's rapid growth, allowing it to realize positive earnings moving into FY21.

Figure 1.0 - Annual Revenue and EPS



This rapid growth, seen as Zoom has become the primary video conferencing companies and universities across the nation, only further aids strong company financials. Before the COVID-19 outbreak, Zoom posted a 388% increase in EBITDA between January 2018 and January 2019 - further demonstrating Zoom's rapid growth is the fact that their EBIT more than doubled in 2019, showcasing the company's strong operating profitability. This profitability can also be seen in the company's strong margins as it has a Gross Profit Margin of ~81%. This highlights the efficiency of the company and points to Zoom being able to use its massive amount of free cash flow, which grew 397% in 2019, to further improve the company through capital expenditure or acquisitions - exhibited further in the firm's operating margin improving 900 basis points YoY to 14.2% for the year. This only additionally highlights the firm's path to profitability, but indicates top-line growth will only further lead to bottom line growth during this pandemic.

Looking forward, FY21 figures, discussed in Zoom's Q4 FY20, also project 2021 revenue growth to $910 million and EPS growth to $0.45, which further supports the firm's financial strength and growth opportunity moving into the next year. Although Zoom is currently trading at an extremely expensive P/E ratio of over 1800, this is more so indicative of how much Zoom's stock has grown in the first quarter of 2020 (entering the realm of profitability). Even still, Zoom is still a strong momentum buy as numerous signs point to Zoom being able to continue growing. As for its technicals, Zoom had a "golden cross" in early March as the 50-day moving average surpassed the 200-day moving average. Although Zoom's revenue has already been growing at an accelerated rate for years, it has the potential to grow even more in 2020 — and bring Zoom's stock price with it as well.

In considering a more in-depth X-Ray of Zoom's financials, we also find further support for the company's financial strength and health which make it a strong candidate for long term growth. Primarily, it currently holds an extremely low Debt/Equity ratio of 0.8, due to the firm only holding $70 million in long term debt. With a Current Ratio of 3.3, the company also presents substantial liquidity strength allowing it to weather any unprecedented concerns that may arise in lieu of the current pandemic. In accordance with earnings potential, this leads to further sustenance for any realization of growth.

User Growth and Privacy Concerns

This increase in revenue has come with an increase in profit-generating users utilizing Zoom's platform. With schools and companies transitioning to online instruction without periods of free trial, the opportunity for future revenue growth only improves for Zoom as more users utilize their platform. In fact, while Zoom acquired 13 million users through 2019, the company reported that it had already gained more users in the first three months of 2020 alone. As seen in both the EMEA and the Americas (figure 1.3), Zoom has seen global expansion that hasn't been frontloaded in any one region (85% Rev. Growth - Americas, 117% Rev. Growth - EMEA). This provides supplementary support for a post-pandemic expansion in the global user base that will lead to an accelerated realization of earnings in FY21. This extensive expansion in its revenue generating user base, alas, also presents a cost. Particularly, with this beneficial expansion comes an increase in expected annual infrastructure costs and privacy concerns.

Specifically, due to its expansion in scale, Zoom must incur expanding costs to maintain its quickly growing user base. Considering that this pandemic may have pushed infrastructure costs beyond projections, added inefficiencies may lead to heightening operational costs.

More importantly, however, Zoom has now faced - due to its expanding user base - a subsequent increase in concerns regarding privacy; concerns that admittedly exhibit a clear risk to the stock's path to $165 and beyond. Nevertheless, similarly, we believe the company will be able to eliminate similar problems by attempting to address and resolve such issues (as was discussed by its CEO, Eric Yuan, during a recent announcement). This will put to rest any slowdown that may act to prevent Zoom's rapid financial growth.

A Value-Driven Approach

During the novel coronavirus outbreak, various social video apps have seen substantial growth in its user base. These social video apps include Zoom, Houseparty, and Discord. According to app intelligence provider Apptopia, Zoom currently has seen the fastest growth in active daily user count. Since January 2020, Zoom has increased its global daily active user base (DAU) by 67%, growing from 90,000 worldwide users in January 2020 to 323,000 users in March 2020. Daily downloads of the app have risen from 171,574 in January 2020 to 2,410,171 in March 2020. Given the growth rate in revenue due to new user growth in the last few months, we estimate that a 15-20% increase in Zoom's stock price is justified.

Figure 1.2 - User Growth

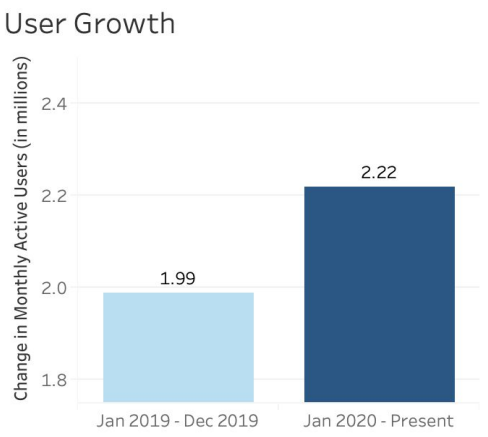


Figure 1.3 - Americas and EMEA Revenue

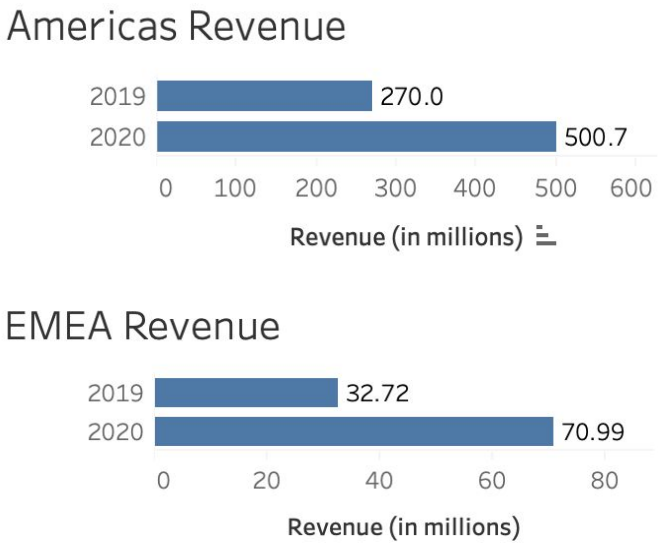
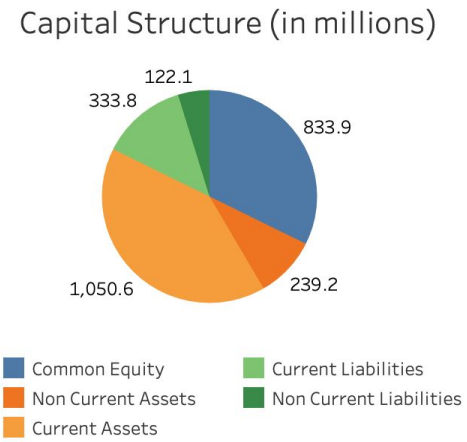


Figure 1.4 - Capital Structure



Key Stakeholders and Capital Structure

Zoom founder and CEO, Eric Yuan is currently the highest stakeholder, owning 22% of the company. Principally, he presents the company with strong stewardship. This, coupled with strong institutional presence provides further support services that ensure the firm is able to capitalize upon this opportunity to its fullest (with Emergence Capital and Sequoia Capital being Zoom's largest outside stakeholders, owning 12.5% and 11.4% respectively).

Zoom also ended Q4 with approximately $855 million in cash, cash equivalents and marketable securities, excluding restricted cash. In Q4, operating cash flow was $37 million, up from $16 million or 129% year-over-year. Free cash flow was $27 million, up from $6 million or 368% year-over-year. This further presents Zoom with the capability to stave off any external financial concerns discussed earlier and incur additional expenses tied to the exponential increase in operating infrastructure costs.