National Instruments Corporation (NATI)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

<table>
<thead>
<tr>
<th>Price ($) (5/21/20):</th>
<th>37.49</th>
</tr>
</thead>
<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>48 - 20</td>
</tr>
<tr>
<td>Market Cap (mil):</td>
<td>4,926</td>
</tr>
<tr>
<td>Shares Out (mil):</td>
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</tr>
<tr>
<td>Float (mil):</td>
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<tr>
<td>Avg. Daily Vol (mil):</td>
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<tr>
<td>Dividend ($) :</td>
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<td>Yield (%):</td>
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<tr>
<td>Rating:</td>
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<tr>
<td>Suitability:</td>
<td>FY Dec</td>
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<tr>
<td>Price Target ($)</td>
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<tr>
<td>L-Term Rev. Gr Rate Est:</td>
<td>Q1</td>
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<tr>
<td></td>
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<tr>
<td>L-Term EPS Gr Rate Est:</td>
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<tr>
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<tr>
<td>Debt/Cap:</td>
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<tr>
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<tr>
<td>% Growth</td>
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<td>% Operating Margin</td>
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<tr>
<td>% EBITDA Margin</td>
<td>FY P/E</td>
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<tr>
<td>% EBITDA Margin</td>
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Headquartered: Austin, TX

IPO/Founded: 1995/1976

Management:
- President & CEO: Eric Starkloff
- CFO, Treasurer & EVP: Karen Rapp
- Head of IR: Marissa Vidaurri

Company Description

NATI aims to be "the leader in software-defined automated test and automated measurement systems." A core strategic element is enabling engineers to leverage its graphical programming software to develop their test IP, which in turn drives demand for its hardware instruments (for measuring electrical signals or physical phenomena, e.g., temperature, pressure, speed, volume, flow or vibration). NATI leverages commercial computing platforms (processors, A-D converters, FPGAs) to create sophisticated, re-purposable T&M platforms/systems, often cheaper and more flexible than similar vendor-defined box instruments. A focus on providing "systems" has steadily increased NATI's average order size (~$6,350 in 2018, +6% 10-year CAGR) and TAM expansion and increased customer wallet share.

Revenue Profile

Sales by Product
- Software 20%
- DAQ/Control 20%
- Mezzanine 42%
- Other 18%

Sales by Geography CY19
- APAC 55%
- EMEA 35%
- Americas 10%

Target Markets
- Semiconductor ~15-20%: $7.6 +10-15% 18%
- Transportation ~15%: $1.7 +10-12% 9%
- A&D & Govt. ~15-20%: $1.7 +6-9% 3%
- Portfolio ~50%: $5.0 +5-6% 2%

Total: 100% $10.0 +6-10% 4%

Company Description

- Products: Software (~20% of sales*) platform revolves around core LabVIEW franchise (graphical programming platform, est. >300K+ installed base) that is the main control platform, enables repurposing of hardware (flexibility). Hardware platforms capture, analyze and display wireless/RF/electronic signals and other physical phenomena (vibration, motion, temperature, etc.); include PXI, CompactRIO and CompactDAQ (data acquisition).

Quick Summary

Richard C. Eastman, CFA
Sr. Research Analyst
reastman@rwbaird.com
414.765.3647

Robert W. Mason, CFA
Sr. Research Associate
rmason@rwbaird.com
615.341.7111

Revenue Profile

- Sales by Product
- Sales by Geography CY19

Source: Company reports, Baird estimates

Products: Software (~20% of sales*) platform revolves around core LabVIEW franchise (graphical programming platform, est. >300K+ installed base) that is the main control platform, enables repurposing of hardware (flexibility). Hardware platforms capture, analyze and display wireless/RF/electronic signals and other physical phenomena (vibration, motion, temperature, etc.); include PXI, CompactRIO and CompactDAQ (data acquisition).

Source: Company Reports, *Baird estimates

Competition

Software competitors: KEYS, Mathworks (private), object-oriented programming languages (e.g., C++, Python). Hardware competitors: traditional instrument companies- KEYS, Anritsu (6754-JP), TER, Advantest (6857-JP), COHU, Tektronix (FTV).

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Sr. Research Analyst
reastman@rwbaird.com
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Robert W. Mason, CFA
Sr. Research Associate
rmason@rwbaird.com
615.341.7111
Outperform-rated. We continue to believe NATI is positioned well to benefit from recovery in spend post the COVID demand disruption. We expect the business to recover Q/Q from an uncertain low level (we are modeling -15% Y/Y) in Q2. Encouragingly, large (>20K) order growth remained +HSD% in Q1, with order strength in the three targeted verticals, particularly Semiconductor, +DD%. Caveat, orders -5% Y/Y through Apr-20 and we expect to trail off further. We believe NATI has an early-mid stage opportunity to benefit from the test demand opportunity as 5G communications spend continues. NATI’s model has shifted toward “system level” sales, as customer preferences/demands require test solutions versus single point test modules, which is driving orders sizes higher (orders >20K are 59% of sales).

- **1Q results consistent with Apr. 3 pre-release.** 1Q adjusted EPS $0.26 and sales $309M (-1% Y/Y), +2% organic, were consistent with NATI’s early-April preview (LINK). Organic orders >20K increased +7% Y/Y, while orders <$20K declined -8%. The AWR software business divested in early-Jan will be a -2pp sales headwind through CY20.
- **Not providing 2Q guidance.** NATI cited a “highly uncertain” impact from COVID-19 on overall macro in deciding not to provide specific 2Q sales/EPS guidance. We’re not surprised since the bulk of NATI’s revenues are short turn in nature; backlog and visibility is very limited. Still, NATI did indicate QTD orders (Apr.) were -5% Y/Y, fading from 1Q (+1%) but more favorable than we suspected. NATI will provide a 2Q business update on June 9.
- **Focused on profitability, keeping growth engine intact.** NATI indicated 2Q non-GAAP opex is targeted down -1.2% (or -2% Y/Y). While NATI executed planned strategic realignment during 1Q (mostly non-COVID-related, headcount -300 Q/Q), ongoing expense controls to deal with macro headwinds biased toward temporary/discretionary measures (curtailed hiring, delayed merit increases, travel, etc.) to remain positioned for a recovery. Our CY20E assumes adjusted opex holds flat Y/Y (2H20E +3% Y/Y).
- **Fine-tuned/raised our CY20E/21E adjusted EPS; we assume 2Q/3Q20 sales decline less severe.** Our updated published estimates also now reflect “adjusted EPS” (prior published EPS reflected GAAP). Our CY20E / 21E adjusted EPS increase to $1.05 / $1.68 compared to our prior $0.78 / $1.14. We expect 2Q20E sales/orders -15% Y/Y, more than the -5% QTD (Apr.) performance reflective of the steep PMI drops globally. However, we no longer model 2009 levels of sales declines (20%+) in 2Q/3Q. China/APAC already showing sequential order improvement (March +3% vs. 1Q -12%) and we anticipate re-openings in Americas/EMEA in the next 1-2 months. We also model 3Q/4Q sales improving Q/Q from 2Q levels.
- **1Q details:** Semi business unit orders +DD% (same as 4Q19) continuing to benefit from sub-6Ghz 5G spend. NATI did suggest ramping of larger opportunities for 5G mmWave automated production test now favor early-’21 vs. management’s prior 2H20 expectation, although overall mmWave timing visibility not great. A/D/G orders also remained solid, +MSD%. Transportation also +MSD% owing to electrification/ADAS, and proved stronger than we expected. Portfolio (~55% of NATI) business unit orders +HSD%. Overall software sales grew +MSD%.

Investment Thesis

- **NATI is the leading virtual instruments provider.** NATI targets growth +4-7pp above the T&M industry/peers, consistent with 2012-2017 performance averaging +6pp above peers. Outperformance expected through share gains and SAM growth by: 1) displacing dedicated instruments with virtual instruments in many functional areas by capitalizing on the flexibility, connectivity and cost-effectiveness of virtual instruments; 2) raising systems level content/value within customers’ processes (e.g., avg. order size grown from $2,500 to $6,300 over the last 13 years by selling more sophisticated/higher ASP solutions); 3) leveraging LabVIEW installed base to introduce new hardware instruments and applications, and 4) NATI looking to semi, transportation/automotive and A/D and govt. (~50% of NATI) to lead growth with +LDD% performance.
- **RF Test acceleration prospects increasingly favorable.** Expanding presence in semiconductor and wireless pervasiveness provides greater opportunity for NATI to leverage an increased RF presence, with 5G development/rollout and IoT/asset monitoring areas where we view NATI’s flexible platforms as increasingly relevant, well positioned.
- **Operating leverage opportunity.** NATI has committed to a model (through 2020) that translates to low-50s% profit conversion, assuming sales growth. Investments have depressed EBIT leverage the past 3-4 years but we expect this headwind will moderate (but onus on management to deliver). Leverage will become more visible with sales growth.
- **Intensified focus on financial model.** Since the end of CY16 NATI has had an intensified focus to around expense discipline, opportunity management/narrowed strategic market focus, sales force and marketing re-organization by market groups (previously product centric). Progress has been visible in expenses/margins, while we believe the latter also have opportunity to be leveraged in improved demand conditions via sales growth.
- **Valuation.** $46 price target assumes shares trade at 25X our CY21E adjusted EPS, plus cash/share of $4.00, or 17.5X our CY21E EBITDA. Both ranges within NATI’s six-year average EV/EBITDA and adjusted P/E ranges of 13X-19X and 20X-30X, respectively.

Risks & Caveats

- **Economic sensitivity.** NATI’s sales growth historically has been strongly correlated to industrial production/ISM/PMI.
- **Currency fluctuations.** NATI derives ~60% of sales/pre-tax income outside the U.S. Stronger/weaker USD can have both translational/transactional impacts on NATI results.
- **Market acceptance and limitations.** Virtual instruments have not been fully embraced by the marketplace. Dedicated instruments can be perceived as more reliable in certain cases.
- **Increasing contribution of larger order sizes.** Orders >20K vital to NATI’s long-term growth strategy but potentially introduce greater cyclical sales volatility.
Appendix - Important Disclosures and Analyst Certification

Approved on 22 May 2020 12:48EDT/ Published on 22 May 2020 12:53EDT.

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