



## Could Zoom Stock Zoom to \$100?

### Description

*Every day, Wall Street analysts upgrade some stocks, downgrade others, and “initiate coverage” on a few more. But do these analysts even know what they’re talking about? Today, we’re taking one high-profile Wall Street pick and putting it under the microscope....*

True to its name, **Zoom Video Communications** ([NASDAQ: ZM](#)) zoomed [right out of the gate](#), soaring 72% to close at \$62 a share on its [IPO day](#) back in April.

Trading close to \$80 yesterday, Zoom stock has already turned into more than a [two-bagger](#) for early investors — and one analyst believes that it could go even higher within a year. Here’s what you need to know.

### Initiating coverage on Zoom

Early this morning, investment bank R.W. Baird announced it’s initiating coverage of Zoom stock with an overweight rating and a \$100 price target.

Zoom has only been in existence for about eight years now, and only began reporting revenue a couple of years ago (\$60.8 million booked in 2016, according to data from [S&P Global Market Intelligence](#)). But already, the videoconferencing-as-a-service business has taken off like a rocket. Sales more than doubled between 2016 and 2017, then did that again in 2018. Things have slowed down a *bit* since — but even so, Baird points out, Zoom’s 95.7% year-over-year revenue growth in fiscal Q2 2020 was pretty impressive.

Profits are growing impressively, too. The company delivered full-year [GAAP](#) profits for the first time in 2018 — about \$7.6 million — and is up to \$12.9 million in GAAP profit on a trailing-12-month basis.

In adjusted terms, that works out to about [\\$0.08 per share](#) — four times the pro forma profit earned in fiscal Q2 2019. And Zoom has even bigger plans for the future.

## Zooming out to guidance

Q2 earnings released earlier this month revealed Zoom management giving new guidance for this year: Sales rising as much as 78% to \$590 million, and adjusted profits more than quadrupling to \$0.18-\$0.19 per share.

Reviewing the results, Baird believes that Zoom Video has a “large” total addressable market of folks who could potentially benefit from better videoconferencing, and is impressed at how quickly the company has moved to capture this market “in just a few short years.”

Aside from video, the analyst argues that Zoom’s “Zoom Phone” service, which [launched in January 2019](#), could be another key to growth, opening “another large frontier in replacing legacy phone systems” among its customers. In the post-earnings Q2 conference call, CFO Kelly Steckelberg confirmed that the cloud-based phone service’s rollout is “doing well, we’ve seen traction in Zoom Phone across all segments of the business ... [and] approximately 50% of Zoom Phone is coming from customers with [annual revenue] greater than 100K or more.”

## Valuing Zoom

With sales growth rates at or near 100%, and profits growing even faster, you’d probably expect Zoom stock to cost a lot — and you’d be right!

In contrast to “most other high-growth SaaS names,” notes Baird, Zoom already boasts “strong profitability,” with GAAP profits of \$0.03 per share over the past year, and adjusted profits expected to be six times as strong by the end of fiscal 2020. But to own a piece of that growth, you’re going to be expected to pay through the nose: 2,742 times trailing GAAP earnings (according to Yahoo! Finance’s latest tally) and 442 times forward earnings. (Valuation based on trailing free cash flow is very close to that based on forward earnings — about 451 times.)

Baird acknowledges that this is kind of a “premium valuation” for the stock, yet nonetheless argues it is “justified by the industry-leading growth, estimate upside potential, strong profitability and significant Zoom Phone potential.”

But is the analyst right about that?

Honestly, I’m not so sure Baird is. Consider that although profitable today, analysts who cover Zoom — on average — predict that it will dip back into GAAP unprofitability as early as next year as the company continues to invest in growth. Moreover, most analysts see GAAP losses *growing*, not shrinking, as time goes by — \$0.03 per share in losses next year becoming \$0.21 in 2021, and \$0.36 in 2022.

Granted, if you look far enough down the road, these same analysts see adjusted profits and free cash flow exploding in outlying years, with Zoom potentially earning more than \$1 a share (pro forma) in 2023, and generating more than \$400 million in free cash flow that year, according to S&P Global. Still, that’s a long time to ask an investor to wait to learn if Zoom will really turn out to be a profitable company, and it gives competitors a lot of time to disrupt Zoom’s business before it ever becomes

consistently profitable.

Personally, despite Baird's recommendation today, I think I'll pass on Zoom.

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