**The Motley Fool**
Near an All-Time High, Is Arris Group Still a Buy?
By Adam Levy
May 14, 2014
http://www.fool.com/investing/general/2014/05/14/near-an-all-time-high-is-arris-group-inc-still-a-b.aspx

Since Arris Group provided guidance for its second quarter well above analysts' expectations, shares are trading closer to their all-time high price. At around $29, the company trades at a trailing P/E over 600 on a GAAP basis. Shares are up about 76% over the last year since the acquisition of Motorola Home closed.

Looking at the company's cash flow, however, you can see why shares have rocketed skyward. In the four quarters since closing the acquisition of Motorola Home, Arris' free cash flow has climbed 535% compared to the previous four quarters. At this rate, the acquisition will pay for itself in just a few years.

Compared to more stable cash cows that Arris competes with, like Cisco Systems, Arris is priced more inexpensively compared to its cash flow.

Let's take a look at what's going on with Arris' cash flow, and see if it makes a good buy for investors.

**Cash flow**
As mentioned, the acquisition of Motorola Home added a huge boost to the top line and cash flow. Now more than a full year since the acquisition closed, we have a better picture of how Motorola Home impacts the company's operations.

Over the last 12 months, Arris generated $4.49 billion in revenue, resulting in $4.1 million in net income. Looking at free cash flow, however, the company does much better, with $477 million in cash generated. That means it turned 10.6% of its revenue into free cash flow.

Comparatively, Cisco Systems is much more efficient at turning its revenue into cash flow. The company generated $11.42 billion in FCF in the 12 months ending Jan. 25 on revenue of $47.87 billion. That's 23.9% of revenue turned into free cash flow.

**How Arris increased cash flow**
In an effort to understand the quality of Arris Group's ballooning cash flow, we'll have to take a deeper dive into the cash flow statement.

Arris naturally saw an increase in depreciation and inventories as a result of the Motorola Home acquisition. The company also saw an increase in accounts payable that doesn't seem out of the ordinary, considering a similar increase in accounts receivable.

| Line Item | Contribution to Free Cash Flow (TTM) |
|---|---|
| Net income | $6.690 million |
| Depreciation | $75.001 million |

| | |
|---|---|
| Change in inventories | $110.864 million |
| Change in accounts payable | $177.416 million |
| Change in accounts receivable | $177.585 million |

Source: ARRIS Group's 10-Q and 10-K

Overall, the percentage of cash flow coming from more questionable sources -- like last year's $32.5 million related to Comcast's investment in the company -- has decreased significantly. Additionally, the company has once again turned profitable, with net income of $40.8 million in the first quarter and $6.7 million over the trailing 12 months.

**Valuation**

On a price-to-FCF basis, Arris is priced relatively inexpensively. With a market cap around $4.15 billion, Arris is trading at just 8.7 times free cash flow. Comparatively, Cisco is trading at 10.5 times its free cash flow from 2013.

With much stronger growth expected from the smaller Arris Group, the set-top box maker appears to be undervalued compared to its biggest competitor. Arris is trading at a 20% discount on a price-to-FCF basis, which is nearly consistent with the consensus target price from analysts of $33.78 -- 16.5% upside -- compared to Cisco's price target of just $23.84 -- 2.7% upside.

**Still time to buy**

Although Arris is trading within 10% of its all-time high, it still looks appealing from a cash-flow basis. With management's strong outlook for the second quarter and encouraging comments for the third quarter, cash flow should remain strong through 2014. Not to mention, the shift toward IP-delivered television strongly favors the company's future.

###

**The Motley Fool**
Is Arris Group, Inc. Just a Flash in the Pan?
By Adam Levy
May 13, 2014
http://www.fool.com/investing/general/2014/05/13/is-arris-group-just-a-flash-in-the-pan.aspx

Arris Group announced its first quarter earnings on Tuesday, beating estimates on both the top and bottom lines. The big news from the AT&T and Comcast set-top box maker, however, came in the form of the monster guidance management provided. This quarter is the first comparable quarter since the acquisition of Motorola Home from Google last year.

For the second quarter, management expects earnings per share of $0.64 to $0.70 on revenue of $1.41 billion to $1.45 billion. Analysts had been modelling EPS of $0.50 on revenue of $1.22 billion.

The news sent shares higher after hours, opening for trading Wednesday nearly 16% above Tuesday's closing price. While a lot of big money is moving into the stock based on its short-term strength, Foolish investors want to see long-term strength in its business model.

Based on the latest numbers from Arris, the company looks to possess enough strength to maintain elevated revenue for the long-haul.

**Short-term numbers**

- **Book-to-bill ratio of 1.37.** A book-to-bill ratio above one is a strong short-term indicator of demand. All said, the company booked about $450 million more in sales than it could ship last quarter, resulting in a boost to its backlog. How quickly the company is able to get through those extra orders will be key to its long-term growth trajectory. In the short-term, it's easy money.
- **Order backlog of $996.1 million.** Arris' backlog increased 85% from the end of last quarter, when it stood at $538.6 million. A small portion of the backlog was likely due to supply constraints on the E6000, but the vast majority is due to strong demand for its products across the board. Unit shipments for its broadband high-speed data devices grew 20% sequentially.
- **Inventory declined $44 million.** Usually seeing an inventory decline is a sign that a company expects weaker sales going forward. In the case of Arris, however, it may just be a sign that it's having trouble keeping up with demand -- a much better problem to have. Nonetheless, investors should watch to see this number build back up to previous levels if not higher in the coming quarters.

**Long-term story**

Arris operates in a market that's currently in flux: cable operators are looking to differentiate their products, Internet speeds are getting faster, and video delivery is being rethought.

Arris is positioned to take advantage of all of these changes within the industry.

- **Differentiated products.** A lot has been made of Comcast's XG1 set-top box. Although Comcast did a lot of work and spent a lot of money developing the box, Arris technology is behind it all. Arris saw a strong lift in sales due to the XG1 in the fourth quarter, and sales leveled off (as expected) in the first quarter.

  Comcast, likewise, is seeing improvements in video subscribers, adding 43,000 and 24,000 net

new

  video subscribers in the fourth quarter and first quarter, respectively.

  AT&T, another large customer of Arris, advertises its WiFi-enabled, put-the-TV-anywhere set-top boxes, in an attempt to differentiate its product. The telco added 194,000 and 201,000 net new subscribers to its television service in the fourth quarter and first quarter, respectively.

- **Faster Internet speeds.** AT&T also recently announced that it would begin a roll-out of gigabit Internet service. This is just one response, among many, to Google's expansion of Fiber. As Google becomes more serious with the project, with plans of rolling it out to nine new cities, it appears to have achieved its initial goal -- getting Internet providers to boost speeds.

  There's already strong demand for Arris' high-speed data products as exemplified by its 20% unit growth, but further speed improvements by telcos and cable operators will lead to long-term success at Arris.

- **New forms of video delivery.** The future of video delivery is through Internet protocol. While most cable and telcos have begun the transition to IPTV, it's a long and ongoing process. Arris is positioned well with its video gateway products, as well as its multiscreen delivery software, which is bolstered by its recent acquisition of SeaWell, which specializes in video encoding. IPTV also allows for dynamic ad insertion, for which Arris has a solution as well. The transition may lead to an accelerated upgrade cycle for Arris, in addition to further revenue opportunities in the long-run.

**Good numbers, good story**

ARRIS positive momentum is not just about short-term improvements in demand. This is a long-term trend, and Arris appears to be gaining market share against its competitors. As a result, I believe Arris will continue to see strength in its revenue growth, and despite margin pressure due to increased mix of its CPE division, it should see excellent earnings growth as well. Trading at a non-GAAP earnings multiple in the low-teens, I think it still represents a great stock to buy.

###

**The Motley Fool**
5 Quotes Arris Group, Inc. Investors Must Hear
By Adam Levy
May 12, 2014
http://www.fool.com/investing/general/2014/05/12/5-quotes-arris-group-investors-must-hear.aspx

ARRIS Group reported its first quarter earnings on Tuesday, and it guided for earnings well above expectations for its second quarter. When the company reports again in three months or so, management expects a number between $1.41 billion and $1.45 billion for its revenue resulting in between $0.64 to $0.70 in earnings per share. Analysts had forecast earnings of $0.50 on $1.22 billion in sales.

Management, speaking on the company's earnings call, gave indications that it's business is in a good position for long term growth. The acquisition of Motorola Home has allowed it to grow its video and broadband solutions for customers like AT&T, which is rapidly growing its U-Verse service.

Here are five quotes every ARRIS investor should hear.

**Sustainability**
At first glance, the higher-than-expected guidance for the second quarter may look like ARRIS is simply accounting for the increased backlog it generated in the first quarter. While the backlog increased 85%, all indications are that the strength is continuing into the second quarter. CEO Bob Stanzione had the following to say:

> *Although we are not giving guidance for the third quarter at this time, we are far enough into the second quarter that we have fairly decent visibility into the third, and it looks like the third quarter is shaping up very nicely.*

**Gaining share in a growing market**
One reason for Stanzione's positive outlook on the company's future of its market. With customers like AT&T attempting to differentiate its service through the set-top box (AT&T's box receives the video signal over WiFi), there's high demand for new video solutions in order to stand out.

Stanzione also commented that the company is gaining market share:

> *Right now, with the share that we are gaining -- we are gaining share, I believe, in both CPE as well as in network and cloud -- as well as the fairly vibrant market that we are selling into ... we see this business doing very well right into the future.*

**Accelerating upgrade cycle**
One way to sell more is for customers to upgrade more frequently. Larry Robinson, President of ARRIS' CPE division, believes that cable operators and telcos will refresh set-top boxes more often:

> *I think, longer-term, we are anticipating that there will be ... an acceleration of that refresh cycle. So typically boxes will remain in the field for quite sometime historically. We think with the*

*application and service innovation that's taking place, it's setting the stage nicely for boxes to be refreshed on a much bigger rate than historically has been done.*

Whether that's from improved technology or churn within the industry is unclear. AT&T was the beneficiary of significant churn last year, as the traditional cable operators lost subscribers to telco operators. AT&T added 194,000 and 201,000 net new subscribers to its television service in the fourth quarter and first quarter, respectively. It accounted for 11% of ARRIS' revenue last quarter.

**Gross margin expansion**
Since acquiring Motorola Home, ARRIS' gross margin contracted noticeably as it sells more CPE products. Last quarter, the product mix within CPE carried an even lower margin, leading to a gross margin of 28.3%. Looking forward, Stanzione believes its margins will be fine in the long run, as revenue growth more than makes up the difference:

*I think we're probably at a good place in gross margins, but maybe some upside from what we had in the first quarter. ... It could [rise]. But it's not -- we are not talking material amounts here.*

**Growing software business**
One product that could help improve gross margin, is ARRIS ability to install software mechanisms to unlock capacity in its products. This option can be particularly attractive to operators that don't want to spend money on a team of workers to upgrade hardware. Although this would result in a lower revenue per megabit at ARRIS, its gross margin on software license sales would be relatively high.

Stanzione sees this becoming a larger part of the business:

*Most of the equipment we are selling today is new hardware and software, and what we expect to see over the coming quarters is a growing mix of software license sales into the installed base that we're seeing now.*

**Putting it all together**
ARRIS is positioned well in the market, attracting sales and gaining share since its purchase of Motorola Home. Management's confidence on the conference call ought to inspire confidence in investors.

###