Breaking News

Thursday, November 01, 2007

Hitachi Gains Share in the HE Storage Market in CQ3

Summary and Recommendation

Hitachi (HIT, NR) reported strong results for its storage segment on Wednesday, October 31, 2007. This bodes well for the storage businesses of Sun Microsystems Inc. (JAVA, 2*/Above Average) and Hewlett-Packard (HPQ, 2*/Above Average) for CQ3 (since JAVA and HPQ resell Hitachi storage) as well as for Network Appliance Inc. (NTAP, 2*/Above Average (since Hitachi's and EMC's results show that storage spending is healthy)). Hitachi with its recent USP-V (with thin provisioning) grew 20% Q/Q in the high-end in CQ3, better than the 8% Q/Q growth that we estimate for EMC Corp.'s (EMC, 1*/Buy) Symmetrix and the 5% Q/Q growth we estimate for IBM's (NR) high-end (DS8000). Therefore, Hitachi was the key share gainer in the high-end in CQ3. With strong backlog entering CQ3, we believe that Hitachi's storage segment should be able to grow 10% or greater Q/Q in CQ4.

Key Points

- **Hitachi storage above expectations**. On Wednesday, Hitachi reported storage results for its FQ2 (September) quarter which exceeded its prior expectations. Revenue of 91B Yen was higher than the official 79B guidance and grew 10% Q/Q (5pp greater than EMC's storage systems segment). In addition, Hitachi built strong backlog for CQ4, so we are confident that it should grow 10% Q/Q.
- **HE storage up nearly 20% Q/Q**. Hitachi's high-end storage (USP) revenue grew nearly 20% Q/Q and mid-single-digits Y/Y (better than EMC's -3% Y/Y decline in HE storage), so Hitachi is gaining share in this segment. A key reason for this is the shipment earlier this year of its USP-V which added thin provisioning. Hitachi has now sold a cumulative amount of 7,300 USP controllers since its launch in September 2004. The average amount of controllers/quarter shipped before the most recent quarter was around 650, but Hitachi shipped around 1,300 (2x the average) controllers in the CQ3 07 quarter alone.
- **Derivative – Positive for Sun and HP storage**. Since HDS has an OEM relationship with HP (HPQ) and a reseller relationship with Sun (JAVA) whereby these companies resell HDS' high-end arrays, we view Hitachi's strong storage results as positives for HPQ and JAVA (which reports on Monday, November 5, 2007).
- **Derivative – Positive for Network Appliance**. Hitachi's strong storage results/guidance (due to the strong backlog) and EMC's solid storage results/guidance suggest that storage spending is healthy and will remain so in CQ4. These are more positive data points for Network Appliance.
- **Midrange storage up nearly 20% Q/Q and DD Y/Y**. Hitachi's midrange storage (AMS 1000, WMS 100, Thunder 9500, NSC 55) also grew well – up around 20% Q/Q and a double-digits percentage Y/Y. In September, Hitachi announced its USP-VM midrange array, which adds thin provisioning. This should add to revenue in CQ4 as it began shipping in October.
- **Software/services up DD Q/Q**. Hitachi's software and services segments grew a double-digits percentage Q/Q and mid-single-digits Y/Y.
- **Asia the key driver internationally**. Both APAC (Asia-Pacific) and Japan grew well (around 20% Q/Q) for Hitachi, while EMEA grew double-digits % and the Americas grew a high-single-digits %. We estimate that APAC and Japan combined are around 25% of Hitachi's revenue. These growth rates are much greater than EMC's -3.5% Q/Q revenue growth in Asia; however, EMC's Y/Y growth rate in Asia was 18%, still quite strong.
- **Not much weakness in the financial vertical seen yet**. Hitachi did not see much weakness in the financial vertical in CQ3, but it believes that weakness from this vertical may very well occur in the current quarter.

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Key Points in Detail

Yesterday, Hitachi reported storage results for its FQ2 (September) quarter which exceeded its prior expectations. Revenue of 91B Yen was higher than the official 79B guidance and grew 10% Q/Q (5pp greater than EMC's storage systems segment). In addition, Hitachi built strong backlog for CQ4, so we are confident that it should grow 10% Q/Q.

See Table 1 below.

Table 1: Hitachi Storage Revenue

	H1 06		H2 06			H1 07		H2 07	
	Jun-06	Sep-06	Dec-06	Mar-07		Jun-07	Sep-07	Dec-07	Mar-08	
	FQ1 06	**FQ2 06**	**FQ3 06**	**FQ4 06**	**F2006**	**FQ1 07**	**FQ2 07**	**FQ3 07**	**FQ4 07**	**F2007**
Hitachi Storage (Yen-M) - Disclosed Publicly	**77,000**	**85,000**	**93,000**	**93,000**	**348,000**	**83,000**	**91,000**	**100,100**	**98,098**	**360,000**
Y/Y % Change	22.2%	7.6%	4.5%	6.9%	**9.4%**	7.8%	7.1%	7.6%	5.5%	**3.4%**
Q/Q % Change	-11.5%	10.4%	9.4%	0.0%		-10.8%	9.6%	10.0%	-2.0%	
H1/H2 Revenue		162,000		186,000			174,000		198,198	360,000
Y/Y % Change for H		14.1%		5.7%			7.4%		6.6%	
							162,000		186,000	
							5/07 guided		10/07 guided	
Hitachi Storage ($US) - Converted	**664**	**733**	**802**	**802**	**3,000**	**716**	**784**	**863**	**846**	**3,209**
Y/Y % Change	22.2%	7.6%	4.5%	6.9%	9.4%	7.8%	7.1%	7.6%	5.5%	3.4%
Q/Q % Change	-11.5%	10.4%	9.4%	0.0%		-10.8%	9.6%	10.0%	-2.0%	
Yen/$ used	116	116	116	116	116	116	116	116	116	112
Note: Hitachi Storage includes HDS plus sales of storage in Japan										
Compare: EMC Storage System Revenue	**1,148**	**1,296**	**1,459**	**1,303**	**5,205**	**1,347**	**1,405**			
Y/Y % Change						17.4%	8.5%			
Q/Q % Change		12.9%	12.6%	-10.7%		3.4%	4.3%			
Hitachi Storage Growth Q/Q - EMC Growth Q/Q:		-2%	-3%	11%	0%	-14%	5%			
Hitachi Operating Margin					8.0%					8.0%
										5/07 guided

Source: Company reports, Caris & Co. Estimates

We had an opportunity to interview management about the results. We spoke with Laurie Spindler (Director of Investor Relations, HDS), Claus Mikkelsen (Chief Scientist, HDS), and Brenda Peffer (VP, Global Marketing, HDS) on Wednesday. (Remember that HDS includes all of Hitachi's storage except Japan.).

Key highlights are as follows:

- **HE storage up nearly 20% Q/Q**. Hitachi's high-end storage (USP) revenue grew nearly 20% Q/Q and mid-single-digits Y/Y (better than EMC's -3% Y/Y decline in HE storage), so Hitachi is gaining share here. A key reason for this is the shipment earlier this year of its USP-V which added thin provisioning. Hitachi has now sold a cumulative amount of 7,300 USP controllers since its launch in September 2004. The average amount of controllers/quarter shipped before the most recent quarter was around 650, but Hitachi shipped around 1,300 (2x the average) controllers in the CQ3 07 quarter alone.
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Companies mentioned in this report:

Ticker	Rating	Price	Cap ($Bil)	Date	Analyst
JAVA	2/Above Avg	$5.71	$19.5	10/31/2007	Shebly Seyrafi, CFA
HPQ	2/Above Avg	$52.12	$134.4	10/31/2007	Shebly Seyrafi, CFA
NTAP	2/Above Avg	$31.00	$11.0	10/31/2007	Shebly Seyrafi, CFA
EMC	1/Buy	$25.39	$53.3	10/31/2007	Shebly Seyrafi, CFA

Ratings Distribution Chart:

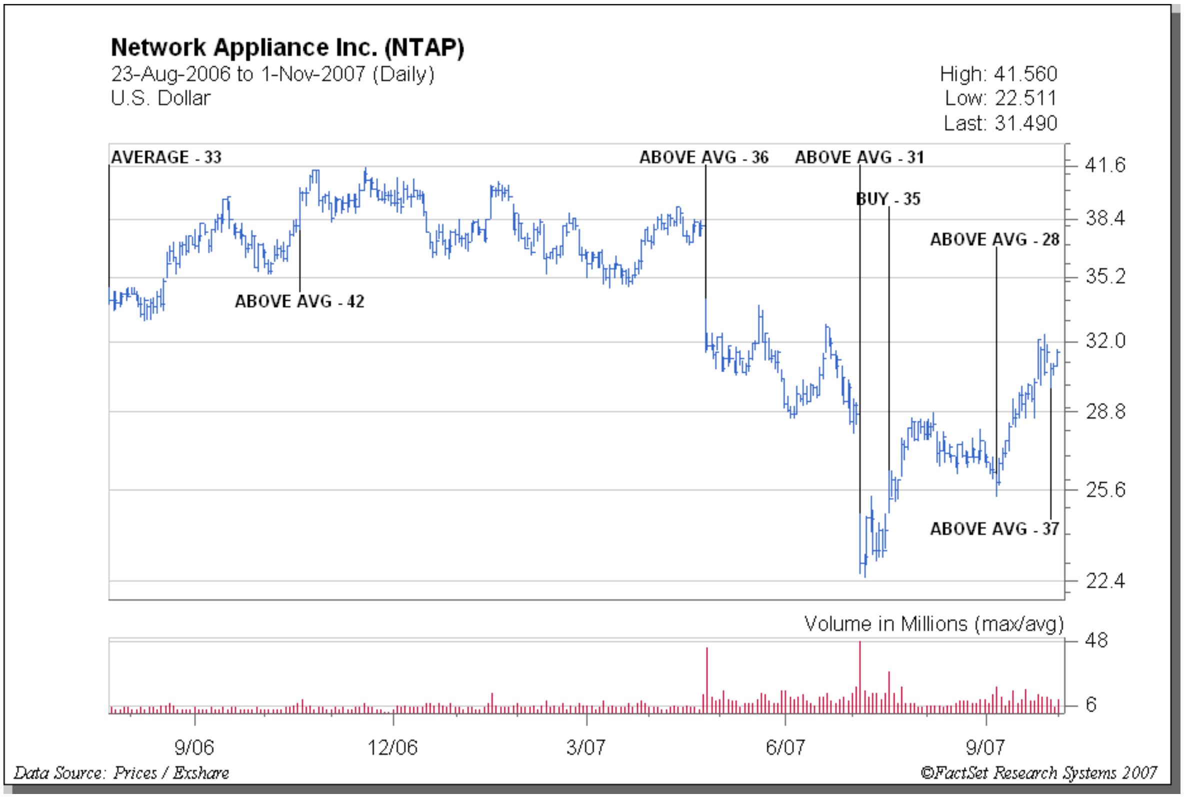
Total Securities Rated 122			
Buy			
Number of Ratings	% of Ratings	No. Provided IB Services	% Provided IB Services
77	63.11%	1	1.30%
Hold/Neutral			
Number of Ratings	% of Ratings	No. Provided IB Services	% Provided IB Services
38	31.15%	1	2.63%
Sell			
Number of Ratings	% of Ratings	No. Provided IB Services	% Provided IB Services
7	5.74%	1	14.29%

First Call ratings are adapted to the above chart as follows: 1 & 2 = Buy, 3 = Hold/Neutral, 4 & 5 = Sell

*Note: Caris & Company utilizes the First Call rating system when assigning ratings in equity research reports. The following is a list of each numerical rating and its respective definition.

1 Buy
2 Above Average
3 Average
4 Below Average
5 Sell

Unless otherwise noted, stock prices reflected herein are the closing price through the business day immediately preceding the date of this report.


Network Appliance Inc. (NTAP)
23-Aug-2006 to 1-Nov-2007 (Daily)
U.S. Dollar
High: 41.560
Low: 22.511
Last: 31.490
AVERAGE - 33
ABOVE AVG - 42
ABOVE AVG - 36
ABOVE AVG - 31
BUY - 35
ABOVE AVG - 28
ABOVE AVG - 37
41.6
38.4
35.2
32.0
28.8
25.6
22.4
Volume in Millions (max/avg)
48
6
9/06
12/06
3/07
6/07
9/07
Data Source: Prices / Exshare
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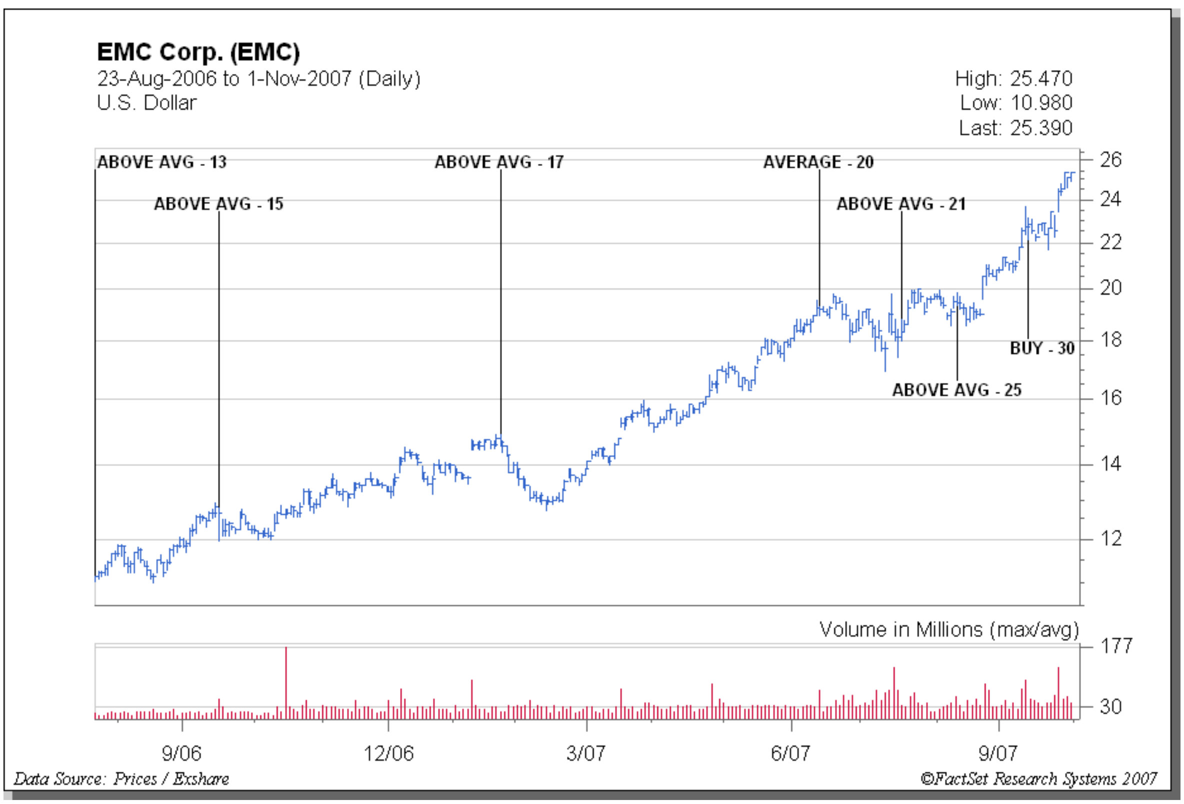
EMC Corp. (EMC)
23-Aug-2006 to 1-Nov-2007 (Daily)
U.S. Dollar
High: 25.470
Low: 10.980
Last: 25.390
ABOVE AVG - 13
ABOVE AVG - 15
ABOVE AVG - 17
AVERAGE - 20
ABOVE AVG - 21
BUY - 30
ABOVE AVG - 25
26
24
22
20
18
16
14
12
Volume in Millions (max/avg)
177
30
9/06
12/06
3/07
6/07
9/07
Data Source: Prices / Exshare
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