
Technology -- Infrastructure -- Data Center

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MARCH QUARTER EARNINGS PREVIEW

Storage takes a breather

Checks across the high-end server and storage food chain detected a more sober tone vs. September and December. Myriad reasons are driving this but chief among our concerns are timing of the server upgrade (x86 and p-Series) cycle, and a disconnect between: a) the trend-line established with H2/09 "relief spend" and channel replenishment and; b) seasonality inherent to a normalizing budgetary cycle. With multiples across the board at the high end of the range and expectations broadly geared to the upside, moving from beat/raise to in-line performance suggests it is a sub-optimal time to be over-exposed to the group. Relative to our coverage, we look to those with carrier exposure – including Juniper, F5, Cisco and Riverbed – as the remaining source of any near-term fundamental upside. We plan to preview this group separately.

Secular trends intact, timing is the question.

While near-term indicators have shifted to "yellow," we want to be clear that our concerns are tactical in nature and that we remain solidly "green" on the mid- to long-term trends. At present, we have no reasonable basis to expect annual IT budgets to be pared, or that key catalysts including the high-end server cycle are impaired. We do, however, recognize that a push-out into the second half will have investor focus shift disproportionately to the traditionally more sober summer demand dynamic. This will, in all probability, weigh on multiples over the next 3-4 months. To the extent we are cautious on the group today, we will more than likely be selectively eyeing weakness into the summer for (re)entry points headed into a brisk H2/2010 outlook.

Downwardly adjusting several ratings, targets and estimates

We are downgrading EMC and QLogic to HOLD from Buy. Emulex is reduced to HOLD and removed as our TOP PICK selection. All are within 5% of our unchanged price targets. Compellent and 3PAR are both reduced from Hold to SELL – given growing valuation sensitivities amid fundamental risk. Double-Take remains HOLD. We will preview NetApp and Brocade in coming weeks (April quarter end), but note downgrades on each in February and November, respectively.

STORAGE PREVIEW SUMMARY

We are taking a broadly more cautious tone across the storage group given classic second derivative signals – in that the materially positive revisions since June 2009 have likely been arrested going into the summer. With most of our stocks trading at the upper end of their multiple range, we view the basket as an under-performer over the coming 3-4 months.

Fundamentally, we currently see no reason to suspect mid- to long-term trends across the sector as having deteriorated; our concern is more tactical in nature. Specifically, we anticipate the March quarter earnings reports and June outlook will carry a much more sober tone than investors and management teams have been more recently accustomed. While at present we believe this is attributable to product transitions and a return to normalizing seasonality, we cannot construct a scenario whereby a more back-end-loaded year warrants unabated multiple expansion. As such, we recommend a step to the sidelines now with an eye toward more attractive entry points headed into the back half.

Over the near term, we anticipate the carrier-exposed companies under coverage to hold the disproportionate likelihood for fundamental out-performance – F5 Networks (FFIV : NASDAQ : \$64.56 | BUY), Juniper Networks (JNPR : NASDAQ : \$31.49 | HOLD), Cisco Systems (CSCO : NASDAQ : \$26.34 | BUY) and Riverbed Technology (RVBD : NASDAQ : \$29.53 | HOLD). Although, similar to our storage names, valuations are by no means on the compelling side, we nonetheless view this basket as the relative safe-haven headed into the summer. We plan to formally preview this group in a separate note in the coming days.

Figure 1: Canaccord Adams preview summary

Company	Rating	Price Target	Report Date	Report Time	Fundamental Expectation vs. Consensus		Expected Reaction	Comments
					March	June		
QLogic (QLGC)	Hold*	\$21.50	~4/30	PM	High end	In-Line	◀ ▶	Solid execution, relative performer
EMC (EMC)	Hold*	\$19.50	4/21	AM	Mixed	Slight downside	◀ ▶ / ▼	v-CX transition, VMW expectations
Double-Take (DBTK)	Hold	\$9.00	~4/28	PM	In-Line	Mixed	◀ ▶	Lowest multiple, reasonable expectations
Compellent (CML)	Sell*	\$12.50	4/28	PM	(-) Pre-announced	downside	▼	Rich multiple, 2nd miss in 2 qtrs. - Red Flag
3PAR (PAR)	Sell*	\$9.50	~5/5	PM	Low end	downside	▼	Highest multiple, >seasonal consensus
Emulex (ELX)	Hold*	\$14.00	~4/27	PM	Low end	downside	▼	Pause ahead of 2H server OEM ramps

VMW (unrated) is majority owned by EMC and reports post-close July 22.

* Downgraded today.

Source: Company reports and Canaccord Adams estimates

EMC CORP. (EMC : NYSE : \$18.53 | HOLD, \$19.50 PT)**Maintain price target, downgrade to HOLD**

Although normally we might view EMC as a potential safe haven candidate, the shares are presently within <5% of our \$19.50 price target (16x our \$1.26 C2011E EPS). At the same time, we are concerned that VMware sentiment may be peaking, and could suffer damage if the high-end server market fails to deliver on schedule. This carries valuation implications for EMC. Coupled with our broader concerns across the sector, we cannot reasonably expect EMC to provide positive returns over the near term. Upon either a) share retrenchment or b) improving sector-level demand indications, we would view EMC as among the top priorities to revisit. On a 2011E basis, the shares are currently trading at a two-year median of 16x our \$1.26 non-GAAP EPS forecast.

- EMC is scheduled to report June results on April 21 before the market opens. For FQ1/10 (March), we estimate a roughly in-line quarter vs. consensus at \$3.7B and non-GAAP EPS of \$0.24.
- Management provides annual but not quarterly guidance. We do, however, see some risk to the June quarter consensus revenue and our estimate of \$3.8B (+3% Q/Q). While modeled at average seasonality, the company is expected to refresh its mid-range CLARiiON (v-CX) between April and May. As a contributor, CLARiiON has in recent years been more material during the first half given more high-end (Symmetrix) seasonality.
- For the 2010 year, our estimates are only nominally changed at the revenue line (slight back-end skew), while our EPS estimate remains \$1.13 vs. consensus \$1.14. We do not expect management to frame the macro in a more positive light relative to the 3%-5% IT spend projections provided during the last earnings call. At the same time, we see no near-term catalyst to provide upside for the previously provided 20% operating margin target for the year.

Figure 5: EMC Corporation estimates vs. consensus

FY End: Dec	Q110E	Q210E	FY2010E	FY2011E
Revenue	\$ 3,707	\$ 3,837	\$ 15,990	\$ 17,546
Q/Q	(9.6%)	3.5%		
Y/Y	17.7%	17.8%	14.0%	9.7%
Change	\$ (31)	\$ (36)	\$ (53)	NA
Consensus	\$3,686	\$3,940	\$16,011	\$17,509
EPS	\$0.24	\$0.25	\$1.13	\$1.26
Q/Q	(28.8%)	6.1%		
Y/Y	46.9%	41.2%	24.4%	12.2%
Change	\$0.00	\$0.00	\$0.00	NA
Consensus	\$0.24	\$0.26	\$1.14	\$1.30

Source: Thomson One estimates, and Canaccord Adams estimates

EMULEX CORP. (ELX : NYSE : \$13.57 | HOLD, \$14.00 PT)**Downgrade to HOLD; reducing near-term estimates and removing TOP PICK designation**

- We are removing Emulex as our TOP PICK selection while reducing our rating to HOLD. The stock is less than 5% from our price target, having delivered a 31% return since mid-December 2009. Although we continue to view the stock as holding the potential for the \$15-16 level over the coming 12-18 months, we anticipate the next three to four months will present investors with more attractive entry levels.
- Chief among our concerns is what appears to be normalizing seasonality on exceptionally difficult Q/Q compares for the company – given the +27% Q/Q revenue performance of December. Coupled with exacerbations attributable to server refresh timing, and broadly held investor perception that guidance was conservative, we see March and June expectation at risk.
- While complicating the near term, we view this as entirely a matter of timing, with no implication for our mid- to long-term thesis. We continue to view the server upgrade cycle as a clear catalyst for Emulex – albeit now shifted incrementally toward H2/C2010 and C2011.
- For March, we now model revenue at the low end of the guidance range. At \$101M we are ~\$2M below consensus. We expect that embedded likely out-performed, while adapters showed above previously expected seasonality. Note that checks suggest IBM's p-Series was partly to blame given a choppy start for the refreshed platform.
- For June, we expect management will likely strike a more cautious tone – given it is increasingly apparent that material offsets from CNAs cannot be reasonably expected until the September and December quarters. As such, we view June consensus as being at risk to the tune of \$4-5M.
- Our price target for Emulex remains unchanged at \$14, or 19x our C2010 EPS estimate of \$0.74 and 16x our C2011 EPS estimate of \$0.90.

Figure 6: Emulex estimates vs. consensus

FY End: Jun	Q3 10E	Q4 10E	FY2010E	FY2011E
Revenue	\$ 101	\$ 103	\$ 398	\$ 446
Q/Q	(6.5%)	1.7%		
Y/Y	28.8%	29.8%	5.2%	12.0%
Change	\$ (1.4)	\$ (1.8)	\$ (3.2)	\$ 14
Consensus	\$103	\$107	\$403	\$459
EPS	\$ 0.15	\$ 0.18	\$ 0.59	\$ 0.81
Q/Q	(13.7%)	15.1%		
Y/Y	183.8%	90.5%	(0.5%)	37.3%
Change	\$ (0.02)	\$ (0.00)	\$ (0.02)	\$ 0.02
Consensus	\$ 0.16	\$ 0.18	\$ 0.58	\$ 0.82

Source: Thomson One estimates, and Canaccord Adams estimates

QLOGIC (QLGC : NASDAQ : \$20.81 | HOLD, \$21.50 PT)**Downgrade to HOLD, maintain estimates and \$21.50 target**

- QLogic is expected to be among the stronger fundamental performers relative to guidance for the March quarter, and should guide in-line for June. This alone has us more favorably disposed to the name on a relative basis. However, as the shares are also within striking distance (<5%) of our price target, and given our sector-level concerns, we do not foresee the stock pushing through this key resistance level prior to a return to positive estimate revisions – which we view as a back-half event.
- Given it is the company's fiscal year end, QLogic won't report until late April – subjecting the company to what we expect to be more cautious news flow from others reporting earlier in the cycle. However, in contrast, we view QLogic as likely to report at the upper end of guidance – aided by some early momentum in switching and ramping CNA.
- For June, we expect guidance to indicate some level of caution relative to the timing associated with incremental contribution from the server upgrade cycle – which may incrementally push estimates into the back half of the calendar year.
- We would view with an opportunistic eye any material weakness in QLogic into the summer months – given the company's tight opex discipline (leverage), ramping switch business, and pending server cycle contribution.
- Our price target remains \$21.50, or 18x our \$1.18 C2010 EPS estimate and 16x our \$1.34 C2011E EPS.

Figure 9: QLGC estimates vs. consensus

FY End: March	Q4 10E	Q1 11E	FY 2011E	FY 2012E
Revenue	\$ 143	\$ 147	\$ 618	\$ 672
Q/Q	(4.0%)	2.4%		
Y/Y	9.6%	19.4%	13.2%	8.6%
Change	\$ 0	\$ 0	\$ 6	N/A
Consensus	\$143	\$146	\$613	N/A
EPS	\$ 0.26	\$ 0.28	\$ 1.22	\$ 1.37
Q/Q	(4.0%)	2.4%		
Y/Y	29.5%	39.1%	24.1%	12.3%
Change	\$ 0.00	\$ (0.00)	\$ (0.00)	N/A
Consensus	\$ 0.26	\$ 0.27	\$ 1.19	N/A

Source: Thomson One estimates, and Canaccord Adams estimates

3PAR (PAR : NYSE : \$10.50 | SELL, \$9.50 PT)**Valuation comes into focus; downgrade from Hold to SELL**

- We are downgrading 3PAR to SELL from Hold on valuation concerns. The stock closed Wednesday at \$10.50, our former price target. At issue are three sources of risk: A) EMC's CLARiiON refresh will present incremental competitive risk in an already challenging environment; B) federal budgets continue to show signs of delayed funding – shifting demand to the right and; C) PAR is now the high-multiple stock in a sector we believe will be coming under pressure in coming weeks/months. The greatest risk to our near-term thesis is one of acquisition which, although plausible, we have no reason to suspect is imminent.
- For March, we are modeled at \$51.0M, the low end of guidance versus consensus of \$52.7M (mid-point). However, we see at least moderate risk to this estimate given it implies 2% growth in what industry checks suggest is a seasonal or sub-seasonal quarter for the sector. At the same time, 3PAR is facing some comparison challenges given the stronger-than-expected December quarter. Note that MySpace was a 12% customer in December, and is not expected to return in March.
- 3PAR will be impacted by the Compellent sympathy trade. Following the second miss in as many quarters, Compellent is down 17% after hours. Although concentrated among different customer bases and facing unique competitive dynamics, 3PAR is now the high-multiple stock in our coverage group – at 94x C2010E EPS and 3.1x sales. Given both company-specific fundamental risk and sector-specific valuation risk, we view 3PAR's multiple as unsustainable over the near- to mid-term.
- Price target reduced from \$10.50 to \$9.50. Our revised price target is driven primarily by multiple, given our estimate revisions are relatively modest. However, absent positive revisions, we are strained to find precedent to support current valuation levels. Our \$9.50 target employs a 2.5x revenue multiple on C2011E (2.8x C2010E), or 43x C2011E EPS (85x C2010E). Note that our 2.8x C2010E multiple is equal to the median multiple 3PAR has received over the last two years. This compares to Compellent (after-market) at 2.9x C2010E sales and 60x C2010E EPS.

Figure 2: 3PAR estimates vs. consensus

FY End: March	Q4 10E	Q1 11E	FY 2011E	FY 2012E
Revenue	\$ 51	\$ 53	\$ 226	\$ 268
Q/Q	1.7%	3.3%		
Y/Y	5.1%	18.4%	17.8%	19.0%
Change	\$ (2)	\$ (1)	\$ (4)	\$ (6)
Consensus	\$53	\$53	\$230	N/A
EPS	\$ 0.01	\$ 0.02	\$ 0.15	\$ 0.24
Q/Q	(54.2%)	62.6%		
Y/Y	(3.6%)	nmf	112.2%	59.4%
Change	\$ 0.00	\$ 0.00	\$ 0.02	\$ (0.01)
Consensus	\$ 0.02	\$ 0.02	\$ 0.15	N/A

Source: Thomson One estimates, and Canaccord Adams estimates

COMPELLENT (CML : NYSE : \$17.56 | SELL, \$12.50 PT)**Preannounces again. Downgrade from Hold to SELL**

- After yesterday's close, Compellent negatively preannounced its FQ1/10 (March) revenues, with full results expected on April 28. MarchQ is now expected at \$31-\$32M (vs. prior \$35-\$37M) representing a -12 to -13% Q/Q decline. To date, the company has grown seasonally in Q1 versus a storage industry typically down 8-10% Q/Q. Importantly, this marks the second consecutive quarter of disappointment, coming on the heels of a mid-November secondary. This, in and of itself, likely carries a punitive element.
- More troubling is the dramatic reversal of fortunes for the company amid muscle-flexing from larger competitors NetApp and EMC. We believe this is now showing signs of structural challenge and casts further doubt on the sustainability of the company's technical advantages. Something typically not quickly fixed.
- Downgrading to SELL. We view the company as very likely to undergo material revaluation – beyond the 17% suggested in after-hours trading – as credibility and technological differentiation fall under heavy scrutiny. Moreover, we note that consensus continues to embed a sub-statutory tax rate, which we view as being at high risk of proving too low over during the H2/C2010 and 2011 timeframe.
- Our price target is reduced from \$18.00 to \$12.50, or 30x our C2011E EPS (fully taxed) of \$0.41. On a C2010E basis, this assumes a 54x earnings multiple and a 2.8x revenue multiple.

Figure 3: Compellent estimates vs. prior consensus

FY End: Dec	Q110E	Q210E	FY2010E	FY2011E
Revenue	\$ 32	\$ 34	\$ 146	\$ 186
Q/Q	(12.5%)	8.4%		
Y/Y	13.1%	19.9%	16.7%	27.3%
Change	\$ (21)	\$ (19)	\$ (83)	\$ (88)
Consensus	\$ (4)	\$ (4)	\$ (13)	\$ (20)
EPS	\$ 0.01	\$ 0.06	\$ 0.23	\$ 0.41
Q/Q	(80.3%)	316.5%		
Y/Y	(74.1%)	27.2%	(15.2%)	77.1%
Change	\$ (0.02)	\$ (0.00)	\$ (0.02)	\$ 0.05
Consensus	\$0.05	\$0.08	\$0.35	\$0.48

Source: Thomson One estimates, and Canaccord Adams estimates

DOUBLE-TAKE SOFTWARE (DBTK : NASDAQ : \$8.81 | HOLD, \$9 PT)**Maintain HOLD rating and \$9 price target**

- While certainly not expected to benefit from the first-half demand dynamic we fear is taking shape, Double-Take has a handful of unique dynamics that likely prevent the shares from being negatively impacted. First and foremost, the company had previously reined in revenue expectations to a very seasonally reasonable level. Second, management has guided to an aggressive first-half opex ramp. Together, these leave below-average fundamental risk, in our view. Finally, ignoring the fact it is our only software pure-play, Double-Take has the absolute lowest multiple in our group – at roughly 16x our C2011E EPS of \$0.57. Our \$9 target represents P/S of 2.4x and P/E of 25x C2010E.

Figure 4: Double-Take estimates vs. consensus

FY End: Dec	Q110E	Q210E	FY2010E	FY2011E
Revenue	\$ 21	\$ 22	\$ 91	\$ 104
Q/Q	(8.5%)	6.5%		
Y/Y	14.7%	5.6%	9.8%	13.9%
Change	\$ (0)	\$ 0	\$ 1	\$ 2
Consensus	\$ 21	\$ 22	\$ 92	\$ 103
EPS	\$ 0.04	\$ 0.08	\$ 0.34	\$ 0.57
Q/Q	(70.7%)	111.3%		
Y/Y	na	(27.1%)	(15.8%)	67.2%
Change	\$ (0.00)	\$ (0.00)	\$ (0.02)	\$ (0.05)
Consensus	\$0.04	\$0.08	\$0.34	\$0.51

Source: Thomson One estimates, and Canaccord Adams estimates

INVESTMENT RISKS

EMC Corporation

Specific risks that could negatively influence EMC shares and/or our fundamental outlook include:

- Volatility in VMware's fundamentals and/or share price. As an 84% owner of VMware, EMC reports results on a consolidated basis. As such, fundamental pressure due to competition, ELA pricing, secular trends or otherwise would negatively impact our outlook for EMC. Moreover, representing approximately 33% of EMC's market capitalization, share volatility at VMware would have a negatively correlated impact on core EMC's valuation multiple.
- Dell as an OEM partner. EMC counts Dell as its only major customer, at approximately 12% of sales in 2008. Recently, Dell has made public statements pertaining to its desire to make "transformative acquisitions." Should said activity include the purchase of a storage systems supplier, our fundamental outlook could be negatively impacted.
- Concentration within financial services. We estimate that in a typical year financial services contributes 20% or more of EMC revenues. Moreover, Citigroup has historically been among the top three customers. Given the ongoing secular pressures within that industry and the potential for further deterioration, EMC's growth forecast could be jeopardized.
- Competition. There has, in recent years, been an increase in newer entrants in the storage market, many of which offer products that could be deemed disruptive to the storage market. Although still small relative to the total addressable market, one or more of these vendors could emerge as a material source of competition in the future.

Emulex

Specific risks inherent to an investment in Emulex shares include:

- The company's ability to retain market share in Fibre Channel host bus adapters in the face of increased competition from QLogic and Brocade.
- Compared to the duopolistic nature of the company's markets over the last several years, next generation opportunities will likely become more competitive. Although several key OEM wins have been secured, it is yet unclear as to the degree Emulex can / will retain first movers advantage in these next generation design slots.
- The company's embedded group (ESP) has faced material secular headwinds in the recent past. Should the company fail to adapt to new market requirements, or fail to adequately align resources, our forecasts could be negatively impacted.
- The degree to which the server industry undergoes a high end refresh in CY 2010, driven by the introduction of 8-core x86 processors. Moreover, should key server platforms be delayed, Emulex revenues may be pushed into subsequent period(s) resulting in diminished investor confidence (multiple).

QLogic

- The company's ability to gain share in its primary markets, including Fibre Channel adapters and network switching, which to date have frequently allowed the company to grow at above-market rates of growth.
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- The potential for acquisition, either of the company itself or a close competitor, which could drive valuation-led share appreciation beyond that supported by nearer-term fundamentals.
- The degree to which the company maintains its duopolistic market share and associated margin profile in next-generation products, many of which are based on newly developed protocols that could provide a window for market entry from new competitors.
- The rate of contribution from the company's two "non-core" businesses including Royalty/Service (Other) and Silicon products, both of which contribute above average margins but carry above average volatility.

3PAR

Consistent with most recently issued shares, 3PAR shareholders face incremental risks associated with limited operational history and relatively thin trading volumes (681K ADV).

Risks specific to 3PAR share ownership include:

- A 30% concentration of ownership within two of the company's venture backers. Should one or both opt to liquidate, the shares would likely come under pressure.
- Competition in the high end of the market is intense. Specifically, EMC has proven to be much more price aggressive when pitching to "strategic" accounts. Moreover, EMC's recently unveiled V-Max architecture moves the company incrementally closer to 3PAR's core value proposition. Although not likely to ever be as elegant a solution as 3PAR's purpose-built platform, customers could view it as sufficient enough to meet their evolving needs.
- Although customer concentration for 3PAR is not consistently a risk (AT&T was the only 10% customer in FQ4), vertical concentration could be considered such. Specifically, the company's top verticals (B2B service providers and Web 2.0 (e.g. MySpace) companies) both have accounts that are known to order in particularly non-linear fashion.
- Revenue from existing customers is consistently greater than 75% of total for 3PAR. Although an attractive figure from the perspective of customer satisfaction/loyalty, over time it could raise concerns relative to account saturation.

Compellent

Consistent with most newly issued shares, Compellent shareholder face incremental risks associated with limited operational history and relatively thin trading volumes (220K ADV).

Risks specific to our Compellent thesis include:

- The company's venture backers own approximately 25% of the shares outstanding, representing a potential for future selling pressure.
 - Compellent leverages open source technology (Linux) in its core Storage Center offering. Although we understand that the company is in compliance with respect to the terms of the GNU General Purpose License agreement, there can be no assurance that in future claims of infringement will not arise.
 - The company's indirect channel approach, while effective in serving the mid-market, may not be suitable for larger enterprises. As such, addressing future growth
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opportunities may require the company spend in advance of revenue. Moreover, although employing a "direct-assist" model, the company does not maintain comparable levels of account control versus its direct sales competitors, which can reduce visibility and/or complicate the company's ability to defend market share over time.

- Compellent competes against much larger companies with substantially greater distribution channels, R&D budgets and installed base. Although we believe the potential for disruption prevents many of these competitors from aggressively following Compellent's approach today, there can be no assurance that competitive products are not offered in the future.

Double-Take Software

Specific risks inherent to Double-Take shareholders include:

- The company's relatively light trading volumes (148,000 ADV) can contribute to greater than average share price volatility. Related, two of the company's venture backers hold approximately 16% of the shares outstanding. Should one or either opt to diversify their holdings, the shares could come under considerable pressure.
- Expansion into tangential markets, particularly when occupied with established vendors, can require aggressive pricing, incremental investment and lead to diversion of company resources from core efforts.
- The data center is expected to undergo a dramatic transformation in the coming years, as traditional IT layers are converged. Although our initial opinion is that this would place more versus less emphasis on the company's products, to the extent that this transformation witnesses a de-featurization of servers, the company's revenues could be materially impacted.

Companies also mentioned in this report:

- Brocade Communications (BRCD : NASDAQ : \$6.12 | HOLD)
 - NetApp (NTAP : NASDAQ : \$35.12 | HOLD)
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Global Stock Ratings
(as of 1 April 2010)

Rating	Coverage Universe		IB Clients
	#	%	%
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Speculative Buy	83	12.4%	59.0%
Hold	159	23.8%	16.4%
Sell	20	3.0%	0.0%
	668	100.0%	

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