

Super Micro May Top HP Enterprise

Data points suggest Super Micro is better positioned as an enterprise-hardware vendor.

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Data points suggest <u>Super Micro Computer</u> is much better positioned as an enterprisehardware vendor than transforming <u>Hewlett Packard Enterprise</u>.

Super Micro (ticker: SMCI) data point #1: Checks indicate Super Micro is doing very well within the service-provider vertical. We recently spoke with one of the big three server original equipment manufacturer (OEM) representatives (Dell Technologies (DVMT), HPE (HPE), and Lenovo [of China]) focused on the service-provider market (i.e. <u>AT&T</u> (T), <u>Verizon Communications</u> (VZ), etc.) and learned they were finding Super Micro increasingly showing up in the service-provider accounts with compelling SKUs that the server OEM did not have a competitive answer for.

This data point adds to our confidence from our March 23 note where we cited Super Micro as our new top pick for 2017 (replacing <u>Nimble Storage</u> (NMBL) to be acquired by HPE) given: 1) evidence of continued strength in large enterprise (which service provider may be considered part of); 2) <u>Intel</u>'s (INTC) Purley server cycle should be a driver of growth for Super Micro in the second half of calendar 2017; and 3) a compelling valuation, trading at only 11 times our above-consensus fiscal 2018 earnings-per-share estimate, while poised to continue to post 20% year-over-year revenue and EPS growth for multiple years to come.

Super Micro data point #2: x86 Server industry is likely seeing strength per Dell analyst day commentary, a positive for all server vendors. Dell held an analyst day on April 5 to discuss the company's strategy, integration of the EMC business and strategy to quickly de-lever. Chief Financial Officer Tom Sweet indicated the integration plans are largely on track, though yellow flagged that the \$2 billion in cost synergies has been taking longer to realize, consistent with our checks that suggest dysfunction between EMC and Dell storage sales teams. On an overall basis, Mr. Sweet also noted that server trends looked good, despite growing concerns of a slowdown in hyperscale capitalexpenditure spend rate, which we believe is partially the reason for the 500 basis points of Super Micro underperformance since we cited Super Micro as our top pick for 2017 on March 23. The other reason is that Super Micro has yet to announce an earnings release date, which typically comes on Thursday after market close in the second week after the quarter closes, and sometimes with a negative or positive pre-announce. Thus, we believe there is some fear of another negative preannouncement, especially given noise about a digesting hyperscale information-technology (IT) capital-equipment spending environment (Super Micro has an latest-12-months exposure of about 15%). Given our near-term data points that are server and Super Micro specific, we are biased to believing Super Micro will be posting at least in-line results and guidance. As a reminder, Super Micro provided midpoint March quarter revenue guidance of \$600 million (up 13% year-over-year, versus typically growing 20% year-over-year) and consensus June quarter estimate is \$639 million (up 22% year-over-year).

Super Micro data point #3: HPE takes formal step one of two to become a more-focused enterprise-hardware player, which weakens HPE's hand versus Super Micro, in our view. On April 1, HPE officially spun off and merged its Enterprise Services business (the fiscal 2016 revenue of \$18.9 billion and operating profit of \$1.46 billion, versus total revenue of \$50.1 billion and operating profit of \$5.65 billion before corporate overhead allocations) with CSC into a new entity called DXC Technology (DXC). HPE will be spinning off its Software business (fiscal 2016 revenue of \$3.2 billion and operating profit of \$750 million before corporate overhead expense allocations), leaving HPE largely as a server, storage, and networking hardware company. Agreements are in place with DXC to support current joint customers and grow the business as well as HPE Chief Executive Meg Whitman has a seat on the board of DXC, which should keep those customers as HPE customers, at least through

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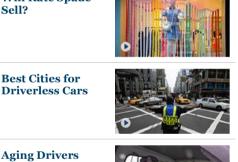
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the term of the agreement with DXC. However, we expect DXC to seek best-in-class hardware partners for new customer engagements. We do view Nimble and 3PAR as strong storage products that we expect will do well, but we do not view HPE's server lineup as highly differentiated or best-in-class, which we note will represent about 70% of HPE revenue (including associated technology services) and likely operating profits too. Relative to Super Micro, we believe spinning off the services and software divisions weakens the company's hand, especially on a longer-term basis.

Adjusting HPE estimates for Services spin and removing price target until Software spin is completed. Consistent with midpoint fiscal 2017 EPS guidance associated with the Enterprise Services spinoff and merge with CSC, we are reducing our fiscal 2017 EPS estimate from \$1.93 to \$1.51, which is in line with management's prior communications. Also consistent with management's prior guidance, we expect that once the HP Software spinoff and merge with <u>Micro Focus International</u> (MCFUF) is complete, fiscal 2017 midpoint EPS guidance will be reduced another 12 cents to \$1.39. We expect the go forward annualized earnings power to be about \$1.20 a share and the company to have around \$6.5 billion of gross cash and \$14 billion of debt, of which \$10 billion will be related to HP Financial Services. For the time being, we are removing our 12-month price target of \$23 and expect to reinstate a price target once the HPE Software spin is complete.

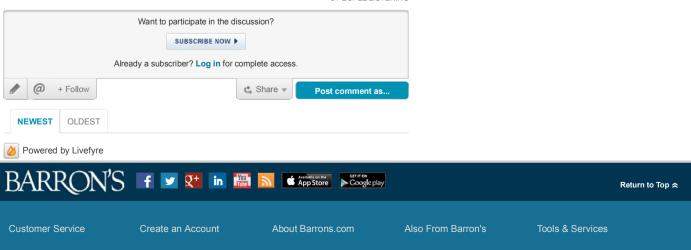
-- Nehal Chokshi

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