

Hard-drive makers see big run-ups on PC recovery hopes

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Investors willing to make early bets on the recovery of the PC sector have scored big with Seagate Technology and Western Digital Corp. -- two makers of hard-disk drives that have seen their market values more than triple so far this year.

When the year started, there were few reasons to believe that Seagate and Western Digital would be any better than they were during 2008.

Many tech companies saw their businesses and stock prices take a beating last year, and the two hard-drive makers were among the most-bruised of the sector. Declines in corporate spending on high-end tech gear, including storage products, was largely to blame for the downfall that dragged down Western Digital's stock by more than 61 percent, while Seagate shares plummeted by 83 percent.

Things became so bad for Seagate that in early January, the company went to the extreme of shaking up its executive ranks by replacing CEO Bill Watkins with Chairman Stephen Luczo.

But since then, both [hard-disk drive](#) makers have seen their fortunes turn. When Western Digital reported its fiscal fourth-quarter results in July, [net income](#) came in at \$173 million, or 76 cents a share -- blowing away Wall Street's estimates for earnings of 28 cents a share for the period. The company's \$1.9 billion in revenue also easily exceeded the \$1.6 billion expected by analysts.

And while still in the red, Seagate managed to cut its fourth-quarter loss to \$81 million, or 16 cents a share, on sales of \$2.35 billion -- also exceeding Wall Street's estimates for the period.

Also, Seagate announced on Tuesday that, because of stronger-than-expected demand, hard-drive shipments and revenue will be above previous forecasts for the current quarter.

The results -- along with forecasts for a recovery in the PC sector later this year -- have boosted sentiment around the companies' shares. Since the first of the year, Seagate shares have soared by 241 percent, while Western Digital has gained a comparable 206 percent. The [Nasdaq](#), by contrast, is up about 36 percent for the year.

Analysts who follow the hard-disk drive market say there have been several factors that have contributed to the turnaround for Seagate and Western Digital, and should continue to bolster both companies through the rest of the year and into 2010.

According to Mark Moskowitz, of JPMorgan, the reasons for the upbeat feeling about the industry include expected improvements in seasonal demand and anticipation over the planned October release of Microsoft Corp.'s Windows 7 operating system.

Additionally, Moskowitz said hard-disk drive price and inventory levels are becoming more favorable due to increases in drive demand and reductions in industry production capacity.

"Better than expected demand for both desktop and notebook drives is a key driver," Moskowitz wrote in a report last week, adding that upgrades involving servers running on Intel Corp.'s Nehalem chips "are leading to some stabilization within enterprise [hard-disk drives]."

Moskowitz recently raised his hard-disk drive shipment forecast to 146.1 million units for the September business quarter and 154.5 million for the three months ending in December. He also estimates there will sales of 607.4 million hard-disk drives in 2010, up from his earlier forecast of shipments of 525.7 million units.

At UBS, analyst Arun Sharma recently began coverage of both Seagate and Western Digital with buy ratings. Sharma called Western Digital the "best in class in a volatile landscape," and said Seagate was "a turnaround play" with a new management team focusing on expanding the company's margins.

Sharma cited Western Digital's "history of execution" as being a positive factor for the company's current position.

"The company was not immune from the sudden drop-off in demand for hard-disk drives in late 2008 and early 2009," Sharma said. [But] we believe Western Digital was the most efficient vendor in the industry at adjusting its cost structure and restructuring its business to reflect the current demand environment."

Sharma also was upbeat about what he called Western Digital's leadership in the markets for notebook PC and external hard-disk drive storage.

With regards to Seagate, Sharma said the company presents greater risk and reward possibilities than Western Digital. Sharma said Seagate's lead in the desktop PC and enterprise hard-disk drive markets give it some momentum to build upon its recent gains, and that company's long-term gross margin targets of between 18 percent and 24 percent could end up being conservative.

However, Sharma said Seagate's turnaround plans remain predicated on

the company's ability to execute. He said the recent changes in management, and more focus on the notebook PC market suggest Seagate is taking some of the right steps to build upon the confidence that has helped improve its stock growth this year.

Keith Bachman of BMO Capital Markets favors Seagate over Western Digital, based on the former's exposure to the enterprise market, which is seeing gains from demand for servers and storage.

"Consistent with our [previous] note, we believe drive industry fundamentals remain healthy, with strong demand levels and lean inventory," Bachman wrote in a Sept. 18 report, in which he raised Seagate's price target to \$18 from \$13 and Western Digital to \$40 from \$36.

Both stocks are currently trading near their median price targets. Seagate closed Tuesday at \$15.68. Price targets on the stock range from \$10 to \$20, with the median at \$17.25, according to data from Thomson Reuters.

Western Digital last closed at \$36.25, near its median target of \$38. Current price targets range from \$21 to \$44.

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