Western Digital to Acquire Hitachi Global Storage Tech for $4.3 Billion

OBJECTIVE ANALYSIS
SEMICONDUCTOR MARKET RESEARCH

Combined Company Revenues to Exceed Seagate's

Summary

On Monday March 7, 2011, Western Digital (WD) announced that the company had reached an agreement to purchase Hitachi Global Storage Technologies (HGST) for $4.3 billion in cash and common stock. The deal has already been approved by both companies' boards and is expected to close in the third quarter assuming regulatory approval. HGST's parent Hitachi will retain a 10% stake in the combined company and HGST's current CEO, Steve Milligan, will be president of the new business reporting to WD president and CEO John Coyne.

Biggest in HDDs

From a unit shipment perspective WD and HGST are the largest and third largest manufacturers of hard disk drives (HDDs). Today Seagate remains the revenue leader, thanks to the company's dominance of the enterprise HDD market. The pending merger will push WD's revenues ahead of Seagate's.

WD is already the unit shipment leader, having surpassed Seagate's unit shipments over a year ago. Combined unit shipments for WD and HGST in 2010 accounted for nearly 48% of the world HDD market.

Hitachi GST was formed by the merger of IBM and Hitachi's HDD units in 2003. After many years of losses HGST turned profitable for most of the last two years. Although the division is profitable, Hitachi was rumored to have been looking to divest itself of its HDD unit for several years. In 2010 and even in 2009 rumors reported that Hitachi was shopping for a buyer for the division with WD mentioned as one of the suitors. WD was also rumored to have been interested in Fujitsu's HDD business before that company was acquired by Toshiba.

A Weaker SSD Presence

This deal has an SSD angle as well. Both WD and HGST participate in the SSD market through different approaches, although neither has a leading market position at this time.

In 2009 WD acquired SSD maker SiliconSystems as a means of entering the SSD market. Although SiliconSystems had its sights set on the enterprise SSD market, WD's current offerings are more strongly oriented towards embedded SSDs for the military and industry, with few offerings of any substance in the enterprise space.

Late in 2008 Hitachi signed a deal with Intel to produce SSDs that would combine the highly-reputed Intel SSD architecture with Hitachi's enterprise HDD interfaces. Hitachi would introduce SAS and Fibre Channel SSDs, with Intel continuing to serve the SATA market. Last November Hitachi introduced the first of these products.

Assuming that the Intel/HGST agreement successfully transfers to WD, WD's enterprise storage group will finally introduce fast SSDs into the enterprise market.

Impact of the New Company

This merger will significantly change the HDD competitive landscape by the end of 2011 when there will remain only four HDD companies with WD commanding close to half of the market. This will put pressure on the other players in the industry to look at their options, possibly driving the formation of additional alliances or mergers over the next year or two.

Of course those who follow the disk drive industry know that merged companies generally don't retain the combined market share of the prior two companies. It remains to be seen if the larger WD will be able to retain a market share close to 50%. There are reasons to believe that the combined company will lose less market share than other merged companies have lost in the past. For one thing HGST brings WD a solid enterprise storage product line, bolstering the fledging enterprise products that WD has introduced over the last few years. Assuming that WD retains HGST's enterprise development and support team it should be possible for the combined company to continue to participate strongly in this market segment and compete against Seagate in that company's most profitable sector.

Not only will WD become an important force in the enterprise HDD market, but the company also looks likely to gain a potentially strong position in SSDs, allowing WD to boast a very broad offering from cost-leading capacity HDDs through high-speed enterprise HDDs and SSDs, addressing all speed levels of the disk drive market. With this strong product portfolio the company will compete very well against Seagate.

There are significant differences that will need to be overcome between HGST and WD. Although WD leads the HDD industry in cost structure by reducing its manufacturing costs and controlling materials costs, HGST suffers from a disjointed international production system which has given the company high costs. This high cost structure has made it difficult for HGST to profit in the competitive HDD business. We would expect WD to move quickly to lower HGST's production costs and further limit the loss of HGST's current customers to lower-priced competitors. However it may take some time to merge the HDD component and HDD production units of the two companies.

Hitachi Data Systems (HDS), another Hitachi division that deals heavily with

HDDs, does not appear to be impacted by this acquisition. HDS manufactures storage arrays based on HDDs from a variety of manufacturers, so the relationship with HGST is loose. HDS has done well for Hitachi and we do not believe that Hitachi is considering selling it.

In summary, this appears to be a very significant deal that should dramatically change the disk drive market while providing WD with a good number of highly complementary products.

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