

Pure Storage Inc.(PSTG)

\$17.20 (As of 12/27/19)

Price Target (6-12 Months): **\$19.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/28/19)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

2-Buy

Zacks Style Scores:

VGM:C

Value: F

Growth: A

Momentum: F

Summary

Pure Storage is benefiting from robust adoption of cloud storage solutions, including Cloud Block Store, ObjectEngine Cloud and CloudSnap. Further, Pure Storage continues to enhance its all-flash portfolio — including AIRI, FlashArray, FlashBlade and FlashStack offerings — with new low-latency and high-bandwidth support capabilities, which holds promise. Particularly, strong FlashBlade implementation and deal wins from the Government segment, is a positive. Additionally, strong go-to-market strategies bode well. However, pricing declines and tough business environment remain deterrents. Further, increasing competition from established storage players like HPE and NetApp is a major concern. Lack of big international customers is also a headwind.

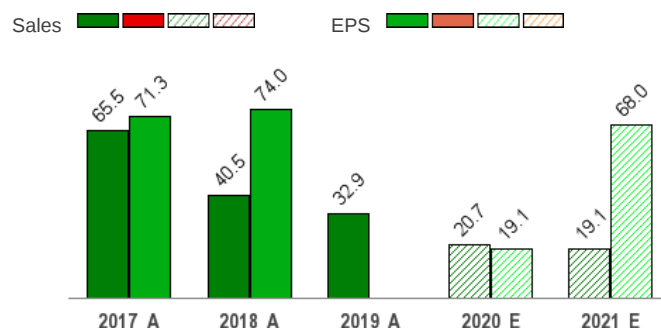
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$23.53 - \$12.68
20 Day Average Volume (sh)	2,654,873
Market Cap	\$4.5 B
YTD Price Change	7.0%
Beta	1.66
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computer- Storage Devices
Zacks Industry Rank	Bottom 31% (174 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	44.4%
Last Sales Surprise	-2.8%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	NA
Earnings ESP	0.0%
P/E TTM	101.2
P/E F1	68.8
PEG F1	3.5
P/S TTM	2.9

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	380 E	457 E	516 E	592 E	1,955 E
2020	327 A	396 A	428 A	489 E	1,641 E
2019	256 A	309 A	373 A	422 A	1,360 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	-\$0.08 E	\$0.04 E	\$0.18 E	\$0.30 E	\$0.42 E
2020	-\$0.11 A	\$0.01 A	\$0.13 A	\$0.21 E	\$0.25 E
2019	-\$0.07 A	\$0.01 A	\$0.13 A	\$0.14 A	\$0.21 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 12/27/2019. The reports text is as of 12/30/2019.

Overview

Founded in 2009 and headquartered in Mountain View, CA, Pure Storage Inc. (PSTG) provides software-defined all-flash solutions that are uniquely fast and cloud-capable for customers. The company is the pioneer of Evergreen Storage business model of hardware and software innovation, support and maintenance, which eliminate the 3–5 year forklift refresh cycle of legacy storage systems.

Pure Storage's primary offerings are FlashArray and FlashBlade products, which include Purity Operating Environment (Purity OE) software, Pure1 cloud-based software, and FlashStack, the company's joint converged infrastructure solution with Cisco.

Notably, in 2018, the company had launched Cloud Data Services, a suite of new cloud offerings that aids customers to invest in single storage architecture. This data platform helps customers scale their businesses through real-time and accurate analytics, hereby increasing operational efficiency and enhancing user experience.

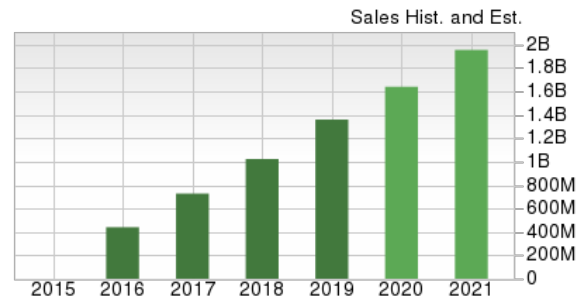
The company's platforms are designed to maximize the performance of flash, by taking advantage of native high bandwidth and low latency PCIe/NVMe networking.

Pure Storage became a public company in Oct 2015. As of Oct 31, 2019, the company's customer base comprised around 7,000 organizations, including more than 40% of the Fortune 500. The company's customers includes enterprise and commercial organizations, cloud, Global Systems Integrators, consumer web, education, energy, financial services, governments, healthcare, manufacturing, media, retail and telecommunications.

The company reported revenues of almost \$1.36 billion in fiscal 2019. Product revenues amounted to 79% of the total revenues, while Support contributed the rest of 21%.

Geographically, the U.S. contributed 70% of the total revenues, while the Rest of the World amounted to 30%.

Pure Storage faces significant competition from the likes of Hitachi, NetApp, Dell EMC, HP Enterprise, Lenovo and IBM.



Reasons To Buy:

- ▲ Adoption of flash storage is increasing rapidly, particularly at enterprises, due to inherent advantages of speed (i.e. responsiveness), portability, efficiency and reliability over legacy storage systems. Moreover, ongoing data explosion has become a major driver for flash storage systems. Market research firm IDC forecasts that by 2025, the global datasphere will grow to 175 zettabytes (that is a trillion gigabytes) compared with 33 zettabytes (ZB) generated in 2018. More importantly, almost 49% of this will be stored in the public cloud infrastructure. Due to the high performance and low latency features of flash-storage, it is the ideal storage technology to harness this data explosion. We believe that being a pure-play flash storage provider Pure Storage is well-positioned to benefit from this trend. Shared storage (including NAS/SAN/Object/ Backup appliance) has a total addressable market (TAM) of almost \$26 billion, which presents growth opportunities. The company's expanding product portfolio that includes platforms like NVMe, Purity FlashBlade, 75 blades up to 8 PB of storage, Object Storage, and Active Cluster, Cloud solutions that run on AWS holds promise.
- ▲ All-Flash Arrays (AFA) is gradually becoming the preferred storage choice of data-center operators as they have become more cost-effective as compared with traditional data storage systems. Moreover, usage of flash arrays lowers power consumption that reduces data center operating expenses (low electricity bill) over the long term. AFAs also require less space and they usually have a simpler user interface which makes management of the systems easy. These features are driving top-line growth. Gartner placed the company in the leader's quadrant in its latest Magic Quadrant for Primary Storage. We note that Pure Storage is regarded as a pioneer of the all-flash array category and the solid growth projections bodes well for long-term growth.
- ▲ The company is fast gaining traction in the flash storage market, which is evident from its accelerating customer base. Customer growth have been exemplary – count surging from 300 in first-quarter fiscal 2015 to 4,800 in first-quarter fiscal 2019 – a CAGR of 100%. Increasing spending from top 25 customers is a major growth driver. Improving penetration into Global 2000 and Fortune 500 is also worth watching. We believe that customer base will continue to expand driven by the impressive product portfolio, innovative pipeline, strong partner base and growth potential from an almost untapped sales force (almost 60% has < 15 months tenure). Moreover, robust demand for FlashArray and FlashBlade products is projected to boost the top line.
- ▲ Pure Storage is targeting the 500 leading cloud providers to boost top-line growth. Moreover, increasing demand for flash storage (due to improving affordability) in the small and medium business (SMB) segment presents significant growth opportunity. The company also sees strong growth prospects in the data-driven markets of artificial intelligence (AI), machine learning, Internet of Things (IoT), Real-time Analytics, Log Analytics and Simulation. The company cited IDC data, which predicts that the cloud storage market will hit \$6 billion in fiscal 2020, witnessing a CAGR of 32%. The company's FlashBlade product has been gaining traction in the AI market. Additionally, the Pure1 META platform – which enables customers to forecast performance requirements to more accurately and timely provision of resources – has significant growth prospect over the long term.
- ▲ The company has a rich partner ecosystem, which is a growth driver. Its partnership with Cisco for FlashStack is worth mentioning. We believe that the hyper-converged solution will continue to gain traction among enterprises going forward. We believe that the expanding partner base, including NVIDIA will further drive customer base (which registered 29% year-over-year growth in third-quarter fiscal 2020).

Growing adoption of flash storage, advantages of AFA in data centers, impressive product portfolio, strong partner base and growth prospect in emerging data-driven markets are key positives.

Reasons To Sell:

- ▼ Pure Storage faces intensifying competition in the flash-based storage market. The competition has resulted in a decline in the average selling price (ASP). Any decline in ASP is likely to impact the results if shipments do not improve considerably.
- ▼ Moreover, lack of big-shot international customers is a headwind for the company. We note that revenues from customers outside the U.S. were 28% in fiscal 2019. The company doesn't have significant presence in the Asia-Pacific market, which has strong demand for flash-based storage systems. This is a headwind in our view.
- ▼ Further, Pure Storage has been incurring operating losses since inception and has an accumulated deficit of \$1.28 billion as of Oct 31, 2019. The company does not expect to generate profit sooner amid continuing investments on research & development and sales & marketing. Despite the increasing top line, mounting losses doesn't augur well for investor confidence in our view.
- ▼ The company is trading at premium in terms of Price/Book (P/B). Pure Storage currently has a trailing 12-month P/B ratio of 5.75, which compares unfavorably with some extent with what the industry witnessed over the last year. Hence, valuation looks slightly stretched from P/B perspective.

Intensifying competition, lack of international customers and mounting losses are major concerns.

Last Earnings Report

Pure Storage Q3 Earnings Beat, Revenues Miss Estimates

Pure Storage reported non-GAAP earnings of 13 cents per share in the third quarter of fiscal 2020, beating the Zacks Consensus Estimate by 44.4%. However, earnings were flat on a year-over-year basis.

Total revenues rose 15% from the year-ago quarter's level to \$428.4 million. However, the reported figure lagged the Zacks Consensus Estimate by 2.8%. Further, the top line missed management's guidance of \$434-\$446 million due to higher-than-expected pricing declines and weakness in U.S.-based large enterprise business.

Nonetheless, year-over-year increase in revenues can be attributed to strong FlashBlade implementation and new deal wins from Government segment on improving go-to-market strategies.

Quarter Ending **10/2019**

Report Date	Nov 21, 2019
Sales Surprise	-2.77%
EPS Surprise	44.44%
Quarterly EPS	0.13
Annual EPS (TTM)	0.17

Segmental Details

In the fiscal third quarter, Product revenues (contributed 75.5% to total revenues) of \$323.3 million increased 8.2% on a year-over-year basis, primarily on the back of existing customers and continued expansion of the customer base.

During the reported quarter, Pure Storage added more than 400 customers, bringing the total count to more than 7,000 organizations.

Robust adoption of strong product portfolio, including the likes of FlashArray, FlashStack and FlashBlade business segments, is a key catalyst.

Support subscription revenues (24.5%) of \$105.1 million surged 42.5% on a year-over-year basis, driven by the company's ongoing support contracts.

Operating Details

Non-GAAP gross margin expanded 360 basis points (bps) from the year-ago quarter's level to 71.7%. Management had anticipated non-GAAP gross margin in the range of 66-69%. Better-than-expected gross margin was primarily driven by lower costs.

Non-GAAP Product gross margin expanded 490 bps from the year-ago quarter's level to 73% on benefits from component costs.

Non-GAAP Support subscription gross margin was 67.5%, which contracted 60 bps on a year-over-year basis.

Total operating expenses surged 19% year over year to \$328.9 million. As a percentage of total revenues, the figure came in at 76.8%, which expanded 270 bps on a year-over-year basis.

Pure Storage reported a non-GAAP operating margin of 6.8%, which contracted 230 bps on a year-over-year basis.

Balance Sheet & Cash Flow

Pure Storage exited the quarter ended Oct 31, 2019 with cash, cash equivalents and marketable securities of \$1.24 billion, up from \$1.18 billion in the prior quarter.

Cash flow from operations during the reported quarter was \$64.3 million compared with \$48.8 million in the fiscal second quarter.

Free cash flow, excluding the impact of employee stock purchase plan (ESPP), was \$45.6 million compared with \$14.2 million in the prior quarter.

Guidance

Pure Storage expects revenues in the range of \$484-\$496 million (mid-point \$490 million) in fourth-quarter fiscal 2020.

For fourth-quarter fiscal 2020, Pure Storage anticipates non-GAAP gross margin in the range of 67.5-70.5%. Non-GAAP operating margin is expected in the band of 10-14%.

Moreover, management updated its fiscal 2020 outlook. The company now expects revenues in the band of \$1.635-\$1.647 billion (previous guidance \$1.645-\$1.715 billion).

For fiscal 2020, the company now expects non-GAAP gross margin in the band of 69.2-70.1% (previous guidance 67-69%). Non-GAAP operating margin is now anticipated in the range of 2.6-3.9% (previous guidance 2.25-4.75%).

Recent News

On **Dec 3, 2019**, Pure Storage announced that Nu Skin, provider of beauty and wellness products, will utilize Pure's Cloud Block Store for AWS.

On **Sep 20, 2019**, Pure Storage announced that Gartner placed it in the leader's quadrant in the latter's latest Magic Quadrant for Primary Storage.

On **Sep 16, 2019**, Pure Storage unveiled its Technology Alliance Partner Program (TAP), a program for participating technology and solutions partners.

On **Aug 12, 2019**, Pure Storage was declared a winner in the Enterprise Network Storage category of the CRN 2019 Annual Report Card (ARC) awards program.

Valuation

Pure Storage shares are up 10.1% in the past six-month period, and 7% over the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Computer & Technology sector are up 11.6% and 13.4%, respectively in the past six-month period. Over the past year, the Zacks sub-industry and sector are up 26.5% and 35.6%, respectively.

The S&P 500 index is up 10.8% in the past six-month period and 30.7% in the past year.

The stock is currently trading at 2.32X forward 12-month sales, which compares to 1.15X for the Zacks sub-industry, 3.44X for the Zacks sector and 3.41X for the S&P 500 index.

Over the past three years, the stock has traded as high as 4.41X and as low as 1.72X, with a 3-year median of 2.64X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$19 price target reflects 2.56X forward 12-month sales.

The table below shows summary valuation data for PSTG

Valuation Multiples - PSTG					
		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	2.32	1.15	3.44	3.41
	3-Year High	4.41	1.51	3.45	3.41
	3-Year Low	1.72	1	2.61	2.76
	3-Year Median	2.64	1.25	3.14	3.12
P/B TTM	Current	5.75	3.58	5.32	4.42
	3-Year High	10.27	4.09	5.33	4.42
	3-Year Low	4.02	2.29	3.54	3.36
	3-Year Median	6.59	3.07	4.5	3.88
EV/Sales TTM	Current	2.41	1.65	4.18	3.24
	3-Year High	5.03	1.79	4.19	3.3
	3-Year Low	1.78	1.04	3.04	2.46
	3-Year Median	2.95	1.48	3.72	2.95

As of 12/27/2019

Industry Analysis Zacks Industry Rank: Bottom 31% (174 out of 252)



Top Peers

Hewlett Packard Enterprise Company (HPE)	Neutral
International Business Machines Corporation (IBM)	Neutral
Micron Technology, Inc. (MU)	Neutral
NetApp, Inc. (NTAP)	Neutral
Nutanix Inc. (NTNX)	Neutral
Seagate Technology PLC (STX)	Neutral
Teradata Corporation (TDC)	Neutral
Western Digital Corporation (WDC)	Neutral

Industry Comparison Industry: Computer- Storage Devices				Industry Peers		
	PSTG Neutral	X Industry	S&P 500	HPE Neutral	IBM Neutral	NTAP Neutral
VGM Score	C	-	-	A	B	B
Market Cap	4.48 B	763.15 M	23.80 B	20.56 B	119.80 B	14.02 B
# of Analysts	9	7.5	13	7	8	9
Dividend Yield	0.00%	0.00%	1.78%	3.02%	4.79%	3.13%
Value Score	F	-	-	A	A	A
Cash/Price	0.28	0.19	0.04	0.19	0.09	0.21
EV/EBITDA	-44.17	8.02	13.88	6.16	10.28	8.48
PEG Ratio	3.50	3.18	2.13	1.28	2.11	1.20
Price/Book (P/B)	5.76	7.30	3.33	1.20	6.62	26.16
Price/Cash Flow (P/CF)	NA	12.26	13.55	4.21	7.15	12.46
P/E (F1)	68.80	19.53	19.62	8.52	10.57	14.28
Price/Sales (P/S)	2.85	1.50	2.66	0.71	1.55	2.43
Earnings Yield	1.45%	3.90%	5.09%	11.76%	9.46%	7.00%
Debt/Equity	0.73	0.37	0.71	0.55	3.40	2.14
Cash Flow (\$/share)	-0.29	0.42	6.94	3.79	18.86	5.02
Growth Score	A	-	-	A	D	C
Hist. EPS Growth (3-5 yrs)	NA%	1.83%	10.48%	-4.78%	-3.75%	23.42%
Proj. EPS Growth (F1/F0)	18.52%	-5.81%	6.14%	5.49%	-7.32%	-4.82%
Curr. Cash Flow Growth	-39.40%	-3.92%	14.75%	-2.58%	-1.93%	21.12%
Hist. Cash Flow Growth (3-5 yrs)	1.04%	-0.23%	8.93%	-3.09%	-5.41%	2.57%
Current Ratio	3.31	1.45	1.24	0.79	1.09	1.31
Debt/Capital	42.29%	41.09%	42.92%	35.39%	77.29%	68.11%
Net Margin	-14.11%	0.51%	11.06%	3.60%	10.00%	17.20%
Return on Equity	-24.66%	5.61%	17.10%	13.55%	67.12%	95.04%
Sales/Assets	0.75	0.91	0.54	0.57	0.55	0.71
Proj. Sales Growth (F1/F0)	20.65%	0.00%	2.49%	0.32%	-3.22%	-8.09%
Momentum Score	F	-	-	F	B	B
Daily Price Chg	-1.27%	-0.27%	0.21%	0.25%	-0.05%	-0.54%
1 Week Price Chg	2.67%	1.20%	1.46%	-2.81%	1.03%	-1.85%
4 Week Price Chg	4.92%	0.15%	1.98%	0.13%	0.85%	3.25%
12 Week Price Chg	4.79%	2.84%	9.78%	10.07%	-5.01%	21.59%
52 Week Price Chg	8.04%	31.82%	28.47%	21.83%	18.57%	5.25%
20 Day Average Volume	2,654,873	152,554	1,778,443	7,439,987	3,155,845	1,761,210
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.11%	0.03%	0.00%
(F1) EPS Est 12 week change	12.32%	4.83%	0.12%	6.39%	-0.01%	6.91%
(Q1) EPS Est Mthly Chg	-100.00%	0.00%	0.00%	0.69%	0.13%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	A
Momentum Score	F
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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