

Western Digital (WDC)

\$45.07 (As of 05/26/20)

Price Target (6-12 Months): **\$47.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 04/02/20)

Prior Recommendation: Outperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:A

Value: A

Growth: B

Momentum: B

Summary

Western Digital's third-quarter fiscal 2020 results benefited from strong demand for client and enterprise Solid State Drives (SSDs) as well as uptrend in flash pricing. Moreover, solid traction for its 14-terabyte drives and robust traction for 16 and 18-terabyte energy assisted drives is a key catalyst. Further, the coronavirus crisis in China will likely aid the company as it is projected to create a constrained near-term NAND supply and favor its financial performance. However, ballooning debt levels have been troubling Western Digital for quite some time. Also, macroeconomic woes and declining demand for desktop as well as smart video hard drives amid the pandemic are headwinds. Notably, shares have underperformed the industry on a year-to-date basis.

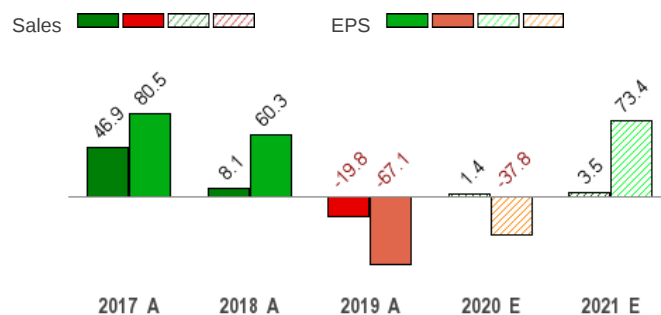
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$72.00 - \$27.40
20 Day Average Volume (sh)	6,440,418
Market Cap	\$13.5 B
YTD Price Change	-29.0%
Beta	1.69
Dividend / Div Yld	\$2.00 / 4.4%
Industry	Computer- Storage Devices
Zacks Industry Rank	Top 34% (86 out of 253)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	-9.6%
Last Sales Surprise	-0.5%
EPS F1 Est- 4 week change	0.1%
Expected Report Date	07/29/2020
Earnings ESP	0.0%
P/E TTM	41.4
P/E F1	20.1
PEG F1	10.1
P/S TTM	0.8

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	4,363 E	4,409 E	4,206 E	4,332 E	17,380 E
2020	4,040 A	4,234 A	4,175 A	4,346 E	16,797 E
2019	5,028 A	4,233 A	3,674 A	3,634 A	16,569 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$1.26 E	\$1.38 E	\$1.26 E	\$1.43 E	\$5.22 E
2020	\$0.34 A	\$0.62 A	\$0.85 A	\$1.20 E	\$3.01 E
2019	\$3.04 A	\$1.45 A	\$0.17 A	\$0.17 A	\$4.84 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 05/26/2020. The reports text is as of 05/27/2020.

Overview

Western Digital Corporation, headquartered in Irvine, CA, is one of the largest hard disk drive (HDD) producers in the U.S. The company designs, develops, manufactures and markets a broad range of HDDs used in desktop PCs, servers, network-attached storage devices, video game consoles, digital video recorders and a host of other consumer electronic devices.

The acquisition of SanDisk enabled the company to venture into the flash drive storage technology space.

Western Digital sells hard drives of 3.5-inch and 2.5-inch form factors with storage capacities ranging from 30 gigabytes (GB) to 6 terabytes (TB).

The company's solid-state drives (SSDs) include 2.5-inch, mSATA, MO-297 and CompactFlash form factors, with storage capacities ranging from 128 megabytes (MB) to 400 GB.

The company also provides WD software applications, such as WD Photos and WD 2GO to the mobile computing market. The company's solutions are compatible with Apple's iOS, Google's Android and Microsoft's Windows Platforms.

The company markets its products and solutions through original equipment manufacturers (OEMs), distributors and retailers.

On Sep 19, 2019, Western Digital inked a deal with DDN, a supplier of big data storage worldwide, to divest its IntelliFlash business in a bid to optimize Data Center Systems portfolio. Per the deal, both the companies have agreed on a multi-year strategic partnership wherein DDN will buy Western Digital's HDD and SSD storage devices.

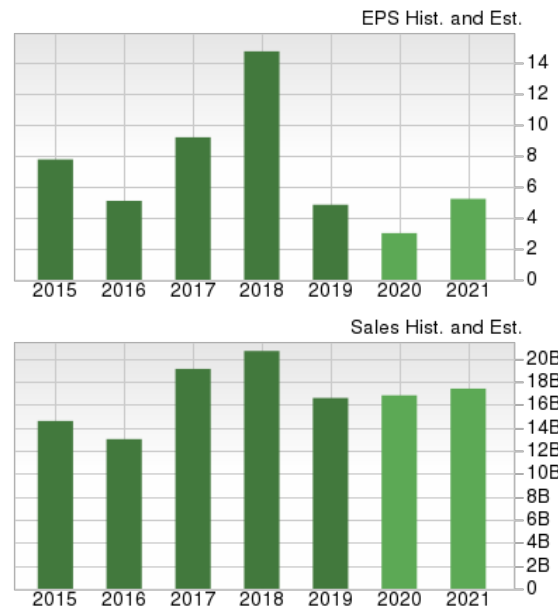
Western Digital mainly competes with companies like Intel, Micron, Samsung Electronics Co. Ltd., Seagate Technology and Toshiba Corporation.

The company competes with other hard drive manufacturers with offerings in the desktop, notebook, enterprise computer, consumer electronic devices and external storage markets.

Western Digital reported revenues of \$16.57 billion in the fiscal 2019.

Geographically, Americas, Asia, and Europe and Middle East and Africa (EMEA), contributed 26%, 19% and 55%, respectively to fiscal 2019 revenues.

During fiscal 2019, about 45% of total revenue came from its top 10 customers.



Reasons To Buy:

▲ Western Digital has been active on the acquisition front. The Amplidata, sTec, Velobit, Arkeia Software Solutions and Virident Systems acquisitions have not only strengthened its small-to-medium sized business solutions but also expanded its SSD product portfolio. These strategic takeovers are expected to provide the company with a competitive edge. The acquisition of SanDisk has opened new avenues of growth for Western Digital and will help it boost market traction in the newer storage technology – SSD. The merger will lead to economies of scale, lower costs, greater market reach and acquisitions of new technologies, among other synergies. The company will also be able to offer competitive solutions in cloud-based computing, which has taken over digital storage solution space over the past couple of years. Notably, after completing the SanDisk acquisition, Western Digital posted year-over-year revenue growth for the first time in the past seven quarters.

The shift toward non-PC applications, secular growth of digital data and growing exposure to the SMBs space are expected to aid Western Digital in improving financial performance.

▲ With the acquisition of SanDisk, Western Digital has forayed into NAND products. NAND flash chips are critical for portable electronic devices. The improving prices for NAND chips make us optimistic about the company's near-term performance. As per various sources, NAND prices have improved primarily due to a better product mix optimization and stronger-than-expected demand for PCs, servers and mobiles. This can be further substantiated by the fact that HP, during its latest earnings conference, has hinted that there may be a shortage of DRAM and Flash memory chips. Any shortage in supply will push prices up, thereby boosting Western Digital's near-term results. Furthermore, the company is expected to benefit from strong demand for NAND flash memory chips, which is used in smartphones and tablets. Driven by new tablet products and greater adoption of solid state drive (SSD), total demand in the NAND flash memory industry could surpass manufacturing capacity, leading to a periodic shortage and higher pricing in the near term.

▲ Prominent storage players, like Western Digital have been expanding into the SSD storage market due to the decline in the PC market. SSDs are faster and more energy efficient than traditional hard drives. They also occupy less space making them more suitable for mobile computing devices. The emergence of thinner laptops and tablets over the past few years has created an ideal market for SSDs, which are therefore entering the higher end of the market. SSDs are also being used in servers due to the reduction in latency, which in turn facilitates faster response to real-time applications. E-Commerce and financial enterprises need quicker response time and thus data centers serving these clients are opting for SSDs. The secular growth of digital data, modest growth in the TAM and higher demand for storage will remain the growth catalysts for storage in general and especially for SSDs. This is what led Mordor Intelligence to project SSD market witnessing a CAGR of 14.9% during 2019-2025. The SSD segment's growth potential is a major positive for Western Digital because this could offset the losses stemming from the secular decline in the PC market, which does not necessarily use SSDs.

▲ The company is expected to get good mileage from its cloud-based business. Cloud-based storage has become the order of the day. Consumers are increasingly using software like Google Drive, Microsoft Skydrive, Dropbox and iCloud, which provide the convenience of accessing content through different gadgets such as smartphones, tablets and personal computers. The access to content on multiple devices is possible because the data is stored in the cloud. This in turn is pressuring the cloud servers, resulting in a growing need to make them more efficient. For this purpose, Western Digital is developing drives filled with helium that consume 23% less power while increasing the storage capacity by 40%. The company has expanded its My Cloud solutions with My Cloud EX4, a broader portfolio of network attached storage (NAS) hard drives. My Cloud EX4 enables users to manage huge volumes of digital data, which in turn helps them to store, organize and secure photos, videos, music and important documents from computers and mobile devices. My Cloud EX4 will help the company meet growing business needs with improved flexibility and security, and can be accessed through iOS and Android operating systems allowing users to access their files via smartphones or tablets. Given the massive increase in cloud activity, the company is expected to find a number of takers for these products.

Reasons To Sell:

- ▼ Customer concentration is a major risk for Western Digital. During fiscal 2019, about 45% of total revenue came from its top 10 customers compared with 42% in fiscal 2018. The high level of customer concentration in a market with a few buyers and very low switching costs means that it is relatively easy to lose a customer. Moreover, the loss of a single order or customer affects the operating performance significantly. Therefore, the company is always under pressure to improve and maintain customer relations.
- ▼ Western Digital faces stiff competition from Seagate, Hitachi, Samsung and Intel in the storage market and from SSD pureplays such as SanDisk and Micron. The competition has resulted in a decline in the average selling price (ASP). Any decline in ASP will impact the results if shipments do not improve considerably. The disk drive market is highly competitive and has experienced drastic pricing pressure due to supply/demand volatility. In the near future, hard disk companies might be exposed to pressures as customers such as tablet PC makers choose flash cards for storage purposes instead of the customary hard disks. The situation may compel companies to cut hard disk prices, which may in turn hurt margins.
- ▼ PCs continue to be the biggest users of HDDs, and Western Digital still derives the bulk of its revenues from these devices. Per Gartner's preliminary data, PC shipments in first-quarter 2020 declined 12.3% year over year to 51.6 million units. Going by the IDC report, shipments were down 9.8% on a year-over-year basis and totaled 53.2 million in the period under review. A declining trend in PC shipments negatively impacted business prospects of Western Digital, which continues to depend substantially on PC sales.
- ▼ Western Digital has a leveraged balance sheet. As of Apr 3, 2020, net debt amounted to \$6.686 billion. Moreover, total debt to total equity of 104.8% is much higher than the industry's figure of 55.1%. High debt level jeopardizes its ability to pursue accretive acquisitions and other growth endeavors. Moreover, the company is required to constantly generate adequate amount of cash flows to meet debt requirements. On Apr 30, Western Digital suspended its dividend policy to strengthen reinvestment in innovation and growth as well as to facilitate ongoing deleveraging efforts.

Customer concentration, leveraged balance sheet and stiff competition from other major storage players remain major concerns limiting the growth prospects of Western Digital.

Last Earnings Report

Western Digital Q3 Earnings and Revenues Lag Estimates

Western Digital Corporation reported third-quarter fiscal 2020 non-GAAP earnings of 85 cents per share, which surged 400% year over year and 37.1% sequentially.

Revenues of \$4.175 billion increased 14% year over year. Performance was driven by robust demand from cloud customers during the fiscal third quarter and an uptrend in flash pricing.

However, the figure declined 1.4% sequentially.

Quarter Ending 03/2020

Report Date	Apr 30, 2020
Sales Surprise	-0.48%
EPS Surprise	-9.57%
Quarterly EPS	0.85
Annual EPS (TTM)	1.09

Quarter in Detail

Client devices (43.9% of total revenues) increased 13% year over year and 2% sequentially to \$1.831 billion, driven by solid revenues from client Solid State Drive (SSDs) and recovery in flash pricing.

Moreover, the company witnessed increased demand for notebook solutions due to growing work-from home and e-learning trends stemming from the coronavirus pandemic. However, softened demand for desktop and smart video hard drives hurt segment growth.

Client solutions (19.7%) increased 2% year over year to \$821 million. However, the figure declined 13% sequentially due to COVID-19's impact on retail demand.

Notably, lockdowns have forced brick and mortar retail stores to temporarily close down. The company expects the closure of physical stores to be a headwind in the near term.

Data center devices and solutions (36.4%) increased 22% year over year and 2% sequentially to \$1.523 billion, driven by strong traction for Enterprise SSDs. Notably, the company's latest 96-layer NVMe-based SSDs have completed more than 20 qualifications, with more than 100 qualifications in progress at multiple Cloud and OEM customers.

Additionally, the company is witnessing robust demand for its 14-terabyte drives and robust traction for 16 and 18-terabyte energy assisted drives.

Considering revenues by product group, **HDD** revenues (50.6% of total revenues) increased 2% from the year-ago quarter's level to \$2.114 billion. However, the figure dropped 11.8% on a sequential basis. **Flash** revenues (49.4%) improved 28% from the year-ago quarter's figure and 12.1% sequentially to \$2.061 billion.

Key Metrics

The company shipped 24.4 million HDDs at an average selling price (ASP) of \$85. The reported shipments were lower than the year-ago quarter's figure by 12.2%.

On a quarter-over-quarter basis, HDD Exabytes sales declined 6%. Flash exabytes sales increased 7%. Total exabytes sales (excluding non-memory products) were down 5% sequentially.

ASP/Gigabytes (excluding non-memory products) moved up 5% sequentially.

Margins

Non-GAAP gross margin of 27.9% expanded 260 basis points (bps) on a year-over-year basis.

Notably, non-GAAP Flash gross margin expanded 560 bps from the year-ago quarter's figure, driven stronger pricing trends and cost reduction measures. Meanwhile, non-GAAP HDD gross margin expanded 70 bps year over year to 29.3%.

Non-GAAP operating expenses declined 0.5% from the year-ago quarter's level to \$738 million. Management remains focused on undertaking strict spending measures.

Non-GAAP operating income came in at \$427 million, which increased 129.6% year over year. As a percentage of revenues, non-GAAP operating margin of 10.22% expanded 516 bps on a year-over-year basis.

Balance Sheet & Cash Flow

As of Apr 3, 2020, cash and cash equivalents were \$2.943 billion, down from \$3.137 billion reported as of Dec 31, 2019.

Total debt (including current portion) was \$9.629 billion as of Apr 3, down from \$9.986 billion as of Dec 31, 2019, having repaid debt of \$212 million in the third quarter.

Western Digital generated \$204 million in cash from operations compared with \$257 million reported in the previous quarter.

Free cash outflow came in at \$110 million compared with free cash flow of \$377 million in the prior quarter.

During the quarter, the company paid out dividends worth \$149 million.

On Apr 30, Western Digital suspended its dividend policy to strengthen reinvestment in innovation and growth as well as to facilitate ongoing deleveraging efforts.

Guidance

For fourth-quarter fiscal 2020, revenues are expected in the range of \$4.25-\$4.45 billion.

Non-GAAP gross margin is anticipated in the range of 29-31%.

Non-GAAP operating expenses are expected between \$740 million and \$760 million. Interest and other expenses are estimated between \$75 million and \$80 million.

Management projects non-GAAP earnings between \$1.00 cents and \$1.05 per share.

Recent News

On Apr 30, Western Digital suspended its dividend policy to strengthen reinvestment in innovation and growth as well as to facilitate ongoing deleveraging efforts.

On Mar 18, Western Digital announced that its Ultrastar Data60 and Ultrastar Data102 hybrid storage platforms have been adopted by Acronis to meet its storage capacity needs.

On Mar 17, it was announced that Quantum Corp. concluded the acquisition of Western Digital's ActiveScale business.

Valuation

Western Digital shares are down 29% in the year-to-date period and up 13.8% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 24% while the Zacks Computer & Technology sector is up 2.7% in the year-to-date period. Over the past year, the Zacks sub-industry is down 6.7% while the sector is up 19.7%.

The S&P 500 index is down 8.1% in the year-to-date period but up 5.3% in the past year.

The stock is currently trading at 9.96X forward 12-month earnings, which compares to 12.26X for the Zacks sub-industry, 24.05X for the Zacks sector and 21.5X for the S&P 500 index.

Over the past five years, the stock has traded as high as 30.07X and as low as 3.89X, with a 5-year median of 9.59X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our \$47 price target reflects 10.39X forward 12-month earnings.

The table below shows summary valuation data for WDC

Valuation Multiples - WDC					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.96	12.26	24.05	21.5
	5-Year High	30.07	16.98	24.05	21.5
	5-Year Low	3.89	9.94	16.72	15.23
	5-Year Median	9.59	12.14	19.24	17.49
P/S F12M	Current	0.78	0.95	3.66	3.33
	5-Year High	1.54	1.41	3.66	3.44
	5-Year Low	0.47	0.8	2.32	2.53
	5-Year Median	1.04	1.16	3.1	3.01
EV/EBITDA TTM	Current	8.92	9.74	11.77	10.93
	5-Year High	12.98	13.2	12.72	12.86
	5-Year Low	1.8	2.78	7.57	8.26
	5-Year Median	5	5.49	10.72	10.79

As of 05/26/2020

Industry Analysis Zacks Industry Rank: Top 34% (86 out of 253)



Top Peers

Company (Ticker)	Rec	Rank
Intel Corporation (INTC)	Neutral	3
Micron Technology, Inc. (MU)	Neutral	4
Netlist, Inc. (NLST)	Neutral	3
NetApp, Inc. (NTAP)	Neutral	4
Pure Storage, Inc. (PSTG)	Neutral	3
Qumu Corporation (QUMU)	Neutral	3
Seagate Technology PLC (STX)	Neutral	2
Teradata Corporation (TDC)	Neutral	3

Industry Comparison Industry: Computer- Storage Devices				Industry Peers		
	WDC	X Industry	S&P 500	MU	NTAP	STX
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	3	-	-	4	4	2
VGM Score	A	-	-	B	A	A
Market Cap	13.51 B	1.31 B	21.18 B	50.94 B	9.98 B	13.14 B
# of Analysts	7	7	14	9	8	7
Dividend Yield	4.44%	0.00%	2.03%	0.00%	4.25%	5.08%
Value Score	A	-	-	A	A	A
Cash/Price	0.23	0.24	0.06	0.15	0.30	0.12
EV/EBITDA	9.80	5.54	12.37	3.89	5.54	7.31
PEG Ratio	9.76	5.78	2.88	2.40	1.20	8.49
Price/Book (P/B)	1.46	4.49	2.90	1.38	35.40	7.33
Price/Cash Flow (P/CF)	4.44	9.92	11.55	4.03	9.00	7.19
P/E (F1)	19.51	20.16	21.24	24.66	14.30	10.27
Price/Sales (P/S)	0.84	1.22	2.24	2.60	1.78	1.27
Earnings Yield	4.97%	1.42%	4.57%	4.06%	7.00%	9.75%
Debt/Equity	1.01	0.20	0.76	0.15	4.06	2.28
Cash Flow (\$/share)	10.15	0.07	6.96	11.36	5.02	7.12
Growth Score	B	-	-	D	B	C
Hist. EPS Growth (3-5 yrs)	-25.55%	-6.87%	10.87%	69.73%	26.08%	11.81%
Proj. EPS Growth (F1/F0)	-53.80%	-0.83%	-10.31%	-70.75%	-6.04%	3.44%
Curr. Cash Flow Growth	-53.72%	-28.62%	5.46%	-35.35%	21.12%	-13.19%
Hist. Cash Flow Growth (3-5 yrs)	-1.49%	6.16%	8.55%	15.84%	2.57%	-6.14%
Current Ratio	1.91	1.49	1.29	2.74	1.20	1.49
Debt/Capital	50.27%	40.71%	44.54%	13.61%	80.25%	69.54%
Net Margin	-3.70%	-2.58%	10.59%	11.72%	18.19%	17.57%
Return on Equity	3.42%	1.66%	16.29%	7.16%	123.49%	62.81%
Sales/Assets	0.62	0.90	0.55	0.40	0.71	1.17
Proj. Sales Growth (F1/F0)	1.37%	0.00%	-2.34%	-14.79%	-4.04%	2.00%
Momentum Score	B	-	-	A	A	D
Daily Price Chg	6.25%	0.88%	2.82%	1.91%	1.03%	0.47%
1 Week Price Chg	8.19%	6.67%	4.99%	1.19%	5.43%	6.68%
4 Week Price Chg	0.83%	2.67%	3.55%	1.08%	6.79%	4.51%
12 Week Price Chg	-20.83%	1.97%	-4.95%	-11.58%	-1.68%	1.97%
52 Week Price Chg	13.87%	-5.78%	-3.04%	39.04%	-25.63%	20.10%
20 Day Average Volume	6,440,418	267,017	2,429,758	21,850,978	1,808,006	2,057,635
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.12%	0.00%	-2.27%	-0.86%	0.00%	0.00%
(F1) EPS Est 12 week change	-4.72%	-22.62%	-16.39%	-13.54%	-20.24%	-1.55%
(Q1) EPS Est Mthly Chg	7.76%	0.00%	-4.03%	0.00%	0.00%	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	A
Growth Score	B
Momentum Score	B
VGM Score	A

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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