

Western Digital (WDC)

\$35.24 (As of 08/27/20)

Price Target (6-12 Months): **\$31.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 08/28/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

5-Strong Sell

Zacks Style Scores:

VGM:A

Value: B

Growth: B

Momentum: C

Summary

Western Digital is bearing the brunt of decline in enterprise IT spending, and soft demand for desktop and smart video hard drives, led by macroeconomic weakness amid the coronavirus pandemic. Declining HDD revenues, shipments and gross margins, owing to ongoing transition to SSDs, is likely to weigh on the top-line performance and limit margin expansion, in the quarters ahead. Moreover, increasing expenses on product enhancements amid intensifying competition from Seagate are likely to dent profitability. However, robust traction for client and enterprise SSDs, and constrained near-term NAND supply, hold promise. Nevertheless, a highly leveraged balance sheet and suspension of dividends remain major concerns and is likely to hurt investor confidence. Notably, shares of Western Digital have underperformed the industry on a year-to-date basis.

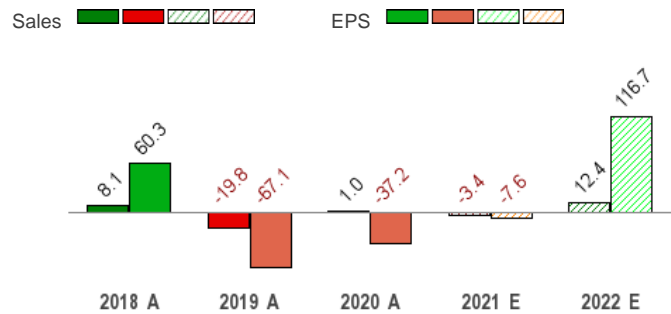
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$72.00 - \$27.40
20 Day Average Volume (sh)	7,101,945
Market Cap	\$10.6 B
YTD Price Change	-44.5%
Beta	1.56
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Computer- Storage Devices
Zacks Industry Rank	Bottom 4% (241 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	2.5%
Last Sales Surprise	-1.4%
EPS F1 Est- 4 week change	-61.3%
Expected Report Date	11/04/2020
Earnings ESP	0.0%

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022	4,223 E	4,502 E	4,290 E	4,335 E	18,160 E
2021	3,833 E	3,990 E	3,913 E	4,075 E	16,162 E
2020	4,040 A	4,234 A	4,175 A	4,287 A	16,736 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022	\$1.20 E	\$1.60 E	\$1.63 E	\$1.74 E	\$6.09 E
2021	\$0.54 E	\$0.57 E	\$0.66 E	\$0.93 E	\$2.81 E
2020	\$0.34 A	\$0.62 A	\$0.85 A	\$1.23 A	\$3.04 A

*Quarterly figures may not add up to annual.

P/E TTM	11.6
P/E F1	12.5
PEG F1	6.3
P/S TTM	0.6

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/27/2020. The reports text is as of 08/28/2020.

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.

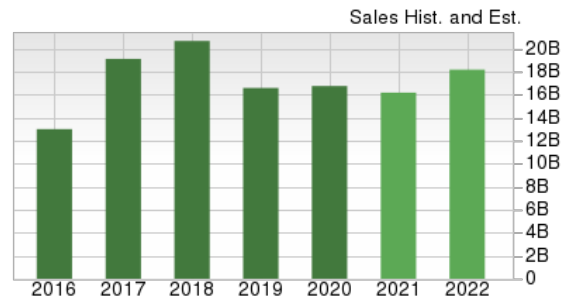
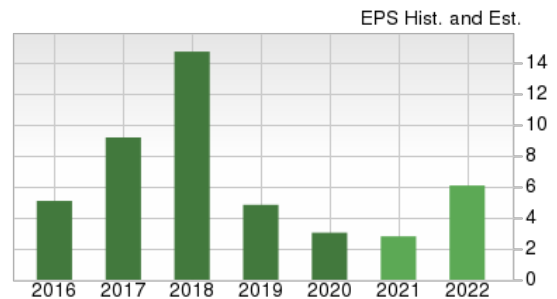
The company markets its products and solutions through original equipment manufacturers (OEMs), distributors and retailers.

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 reported revenues of \$16.73 billion in the fiscal 2020.

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.



Reasons To Sell:

- ▼ Customer concentration is a major risk for Western Digital. 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.
- ▼ Western Digital has a leveraged balance sheet. As of Jul 3, 2020, net debt amounted to \$6.53 billion. The high debt level jeopardizes its ability to pursue accretive acquisitions and other growth endeavors. Moreover, times interest earned is 0.9X, compared with the industry's figure of 3.4X. Further, the company is required to constantly generate adequate 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.

Risks

- 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.
 - 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.
 - 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 second-quarter 2020 increased 2.8% year over year to 64.8 million units. Going by the IDC report, shipments were up 11.2% on a year-over-year basis and totaled 72.3 million in the period under review. An improving trend in PC shipments is likely to positively impact the business prospects of Western Digital, which continues to depend substantially on PC sales.
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Last Earnings Report

Western Digital Q4 Earnings Beat, Revenues Lag Estimates

Western Digital Corporation reported fourth-quarter fiscal 2020 non-GAAP earnings of \$1.23 per share, which surpassed the Zacks Consensus Estimate by 2.5%. Further, the bottom line improved 624% year over year and 45% sequentially.

Revenues of \$4.287 billion increased 18% year over year. Performance was driven by robust demand from cloud customers during the quarter under review and robust uptake of client Solid State Drive (SSDs) for notebooks. Also, an uptrend in NAND flash pricing contributed to growth.

The top line also improved 2.7% sequentially but lagged the Zacks Consensus Estimate by 1.35%.

Quarter Ending 06/2020

Report Date	Aug 05, 2020
Sales Surprise	-1.35%
EPS Surprise	2.50%
Quarterly EPS	1.23
Annual EPS (TTM)	3.04

Quarter in Detail

Client devices' revenues (45% of total revenues) increased 19% year over year and 5% sequentially to \$1.831 billion, driven by solid revenues from client SSDs.

Moreover, the company witnessed increased demand for notebook solutions due to growing work-from home and web-based learning trends on account of the coronavirus pandemic. However, softened demand for hard drive revenues pertaining to desktop and smart video hard drives limited segment growth.

In Gaming domain, the company commenced shipping of flash solutions for the forthcoming console launches.

Client solutions' revenues (16%) declined 9% year over year to \$687 million. Also, the figure decreased 16% sequentially due to impact of COVID-19's on retail demand.

Notably, lockdowns have forced brick-and-mortar retail stores to temporarily close down. Nevertheless, the company witnessed pickup in June, which continued into July.

Data center devices and solutions' revenues (39%) increased 32% year over year and 11% sequentially to \$1.684 billion, driven by strong traction for Enterprise SSDs.

Additionally, the company is witnessing robust demand for its high capacity drives and ramping production of 16 and 18-terabyte energy assisted drives.

Considering revenues by product group, **HDD** revenues (50.6% of total revenues) declined 3.1% from the year-ago quarter's level and 3.7% on a sequential basis to \$2.049 billion, owing to ongoing transition to SSDs. **Flash** revenues (49.4%) improved 49% from the year-ago quarter's figure and 8.6% sequentially to \$2.238 billion, driven by an uptrend in NAND flash pricing.

Key Metrics

The company shipped 23.1 million HDDs at an average selling price (ASP) of \$87. The reported shipments were lower than the year-ago quarter's figure by 16.6%.

On a quarter-over-quarter basis, HDD Exabytes sales declined 2%. Flash exabytes sales increased 8%. Total exabytes sales (excluding non-memory products) were down 1% sequentially.

ASP/Gigabytes (excluding non-memory products) inched up 1% sequentially.

Margins

Non-GAAP gross margin of 28.9% expanded 470 basis points (bps) on a year-over-year basis.

Notably, non-GAAP Flash gross margin was 30.5%, up from the year-ago quarter figure of 18.7%, driven by pricing uptrends and cost reduction measures. Meanwhile, non-GAAP HDD gross margin contracted 90 bps year over year to 27.2%.

Non-GAAP operating expenses declined 1.2% from the year-ago quarter to \$713 million. Management remains focused on undertaking strict spending measures.

Non-GAAP operating income came in at \$527 million, which soared 233.5% year over year. As a percentage of revenues, non-GAAP operating margin of 12.3% expanded 800 bps on a year-over-year basis.

Balance Sheet & Cash Flow

As of Jul 3, 2020, cash and cash equivalents were \$3.048 billion, compared with \$2.943 billion reported as of Apr 3, 2020.

Total debt (including current portion) was \$9.575 billion as of Jul 3, 2020, compared with \$9.629 billion as of Apr 3, 2020, having repaid debt of \$63 million in the fiscal fourth quarter.

Western Digital generated \$172 million in cash from operations compared with \$142 million reported in the previous quarter.

Free cash flow came in at \$261 million compared with \$176 million in the prior quarter.

Guidance

For first-quarter fiscal 2021, revenues are expected in the range of \$3.7-\$3.9 billion. Management projects non-GAAP earnings between 45 cents and 65 cents per share.

Non-GAAP gross margin is anticipated in the range of 25-27%. Non-GAAP operating expenses are expected between \$700 million and \$720 million. Interest and other expenses are estimated between \$70 million and \$80 million.

Recent News

On Aug 20, Western Digital unveiled its next-generation WD brand My Passport, a palm-sized SSD, based on NVMe technology, featuring write speeds of up to 1000MB/s and read speeds of up to 1050MB/s. This storage device will enhance overall drive capacity, dependability and performance.

On Aug 11, Western Digital announced that its OpenFlex open composable platform, based on NVMe over Fabrics (NVMe-oF) architecture, has been selected by ICM Brain and Spine Institute. The offering provides ICM with a faster access to critical data and enables it to resize storage volumes on demand, and address the fight against neurological disorders.

On Jul 8, Western Digital announced the expansion of its HDD technology capabilities into its portfolio of data center solutions. The company's WD Gold offerings now include 16TB and 18TB CMR HDD capacities. Western Digital also introduced new Ultrastar JBOD platforms as well as a new Ultrastar hybrid storage server featuring Ultrastar 16TB and 18TB CMR HDDs.

On Jun 24, Western Digital unveiled the Ultrastar DC SN840 NVMe SSDs and RapidFlex NVMe-oF controllers that combinedly create the new OpenFlex Data24 NVMe-oF Storage Platform, which is designed to support data infrastructures.

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

Valuation

Western Digital's shares have declined 44.5% in the year-to-date period and 34.1% in the trailing 12-month period. While stocks in the Zacks sub-industry are down 30%, same in the Zacks Computer & Technology sector are up 27.6% in the year-to-date period. Over the past year, the Zacks sub-industry is down 16% and the sector is up 43.2%.

The S&P 500 index is up 8.2% in the year-to-date period and 19.5% in the past year.

The stock is currently trading at 10.56X forward 12-month earnings compared with 17.24X for the Zacks sub-industry, 27.62X for the Zacks sector and 23.37X for the S&P 500 index.

In the past five years, the stock has traded as high as 30.07X and as low as 3.89X, with a five-year median of 9.43X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$31 price target reflects 9.29X 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	10.56	17.24	27.62	23.37
	5-Year High	30.07	17.24	27.62	23.37
	5-Year Low	3.89	9.94	16.72	15.25
	5-Year Median	9.43	12.16	19.6	17.58
P/S F12M	Current	0.64	0.94	4.31	3.82
	5-Year High	1.52	1.41	4.31	3.82
	5-Year Low	0.47	0.8	2.32	2.53
	5-Year Median	0.97	1.13	3.14	3.05
EV/EBITDA TTM	Current	6.1	6.84	14.11	13.27
	5-Year High	12.98	13.2	14.21	13.27
	5-Year Low	1.8	2.78	7.59	8.25
	5-Year Median	5.06	5.53	10.94	10.92

As of 08/27/2020

Industry Analysis Zacks Industry Rank: Bottom 4% (241 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Intel Corporation (INTC)	Neutral	3
Micron Technology, Inc. (MU)	Neutral	3
Netlist, Inc. (NLST)	Neutral	2
NetApp, Inc. (NTAP)	Neutral	4
Pure Storage, Inc. (PSTG)	Neutral	4
Seagate Technology PLC (STX)	Neutral	3
Teradata Corporation (TDC)	Neutral	2
Quantum Corporation (QMCO)	Underperform	5

Industry Comparison Industry: Computer- Storage Devices				Industry Peers		
	WDC	X Industry	S&P 500	MU	NTAP	STX
Zacks Recommendation (Long Term)	Underperform	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	5	-	-	3	4	3
VGM Score	A	-	-	C	A	C
Market Cap	10.56 B	793.84 M	23.67 B	49.57 B	9.75 B	11.73 B
# of Analysts	7	4	14	8	10	7
Dividend Yield	0.00%	0.00%	1.64%	0.00%	4.37%	5.71%
Value Score	B	-	-	A	B	B
Cash/Price	0.30	0.19	0.07	0.18	0.31	0.15
EV/EBITDA	8.66	8.35	13.33	3.74	8.35	8.78
PEG Ratio	6.27	2.26	3.05	1.59	1.13	7.95
Price/Book (P/B)	1.11	5.14	3.18	1.31	34.31	6.54
Price/Cash Flow (P/CF)	4.64	9.56	12.81	3.93	9.56	7.36
P/E (F1)	12.54	13.20	21.68	16.35	13.44	9.62
Price/Sales (P/S)	0.63	1.44	2.50	2.45	1.78	1.12
Earnings Yield	7.97%	4.89%	4.43%	6.12%	7.45%	10.41%
Debt/Equity	0.97	0.19	0.74	0.17	9.26	2.33
Cash Flow (\$/share)	7.60	-0.07	6.94	11.36	4.59	6.19
Growth Score	B	-	-	C	B	B
Hist. EPS Growth (3-5 yrs)	-27.79%	-7.13%	10.41%	69.37%	27.41%	13.53%
Proj. EPS Growth (F1/F0)	-7.71%	-7.51%	-4.94%	-57.03%	-19.31%	-4.33%
Curr. Cash Flow Growth	-23.42%	-37.62%	5.22%	-35.35%	-17.99%	-17.09%
Hist. Cash Flow Growth (3-5 yrs)	-5.08%	1.04%	8.50%	15.84%	1.04%	-7.56%
Current Ratio	2.05	1.62	1.35	2.89	1.62	1.51
Debt/Capital	49.31%	43.38%	43.86%	14.58%	90.25%	69.93%
Net Margin	-1.49%	-1.49%	10.25%	11.16%	14.47%	9.55%
Return on Equity	6.72%	3.31%	14.66%	6.31%	240.01%	68.62%
Sales/Assets	0.65	0.93	0.50	0.40	0.71	1.19
Proj. Sales Growth (F1/F0)	-3.43%	0.00%	-1.43%	-9.27%	-6.09%	-2.91%
Momentum Score	C	-	-	F	A	F
Daily Price Chg	2.76%	-0.02%	0.43%	-0.76%	4.03%	-0.39%
1 Week Price Chg	-5.68%	0.00%	-1.45%	-6.45%	-0.75%	-0.51%
4 Week Price Chg	-17.59%	1.24%	3.75%	-12.06%	2.47%	2.59%
12 Week Price Chg	-23.36%	-1.49%	3.95%	-12.89%	-2.98%	-15.73%
52 Week Price Chg	-36.02%	-5.12%	2.75%	-0.11%	-8.33%	-6.89%
20 Day Average Volume	7,101,945	407,186	1,887,168	19,079,504	4,005,681	2,908,863
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	-61.30%	-16.00%	0.79%	-0.94%	-0.88%	-19.07%
(F1) EPS Est 12 week change	-61.30%	-5.55%	3.43%	12.30%	-2.21%	-15.91%
(Q1) EPS Est Mthly Chg	-66.34%	-1.30%	0.00%	-2.40%	1.03%	-2.60%

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	B
Growth Score	B
Momentum Score	C
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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