

Western Digital Corp.

Recommendation	Price	Price Target	Margin of Safety
Buy	\$63.58	\$87.57	37.73%

Sector: Technology

Sub-Industry: Computer Data Storage

Summary: Western Digital Corporation is an American computer data storage company and one of the largest computer hard disk drive manufacturers in the world.

Key Stock Statistics

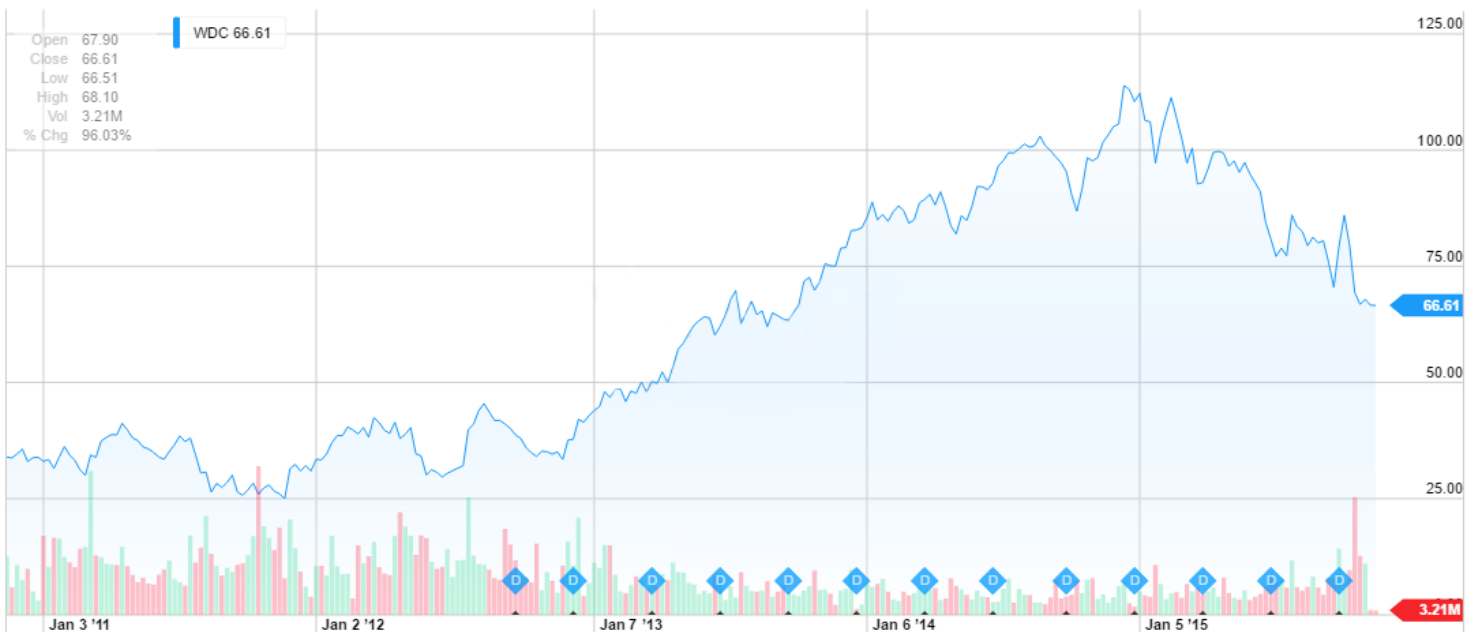
52-Wk Range	\$66.08 - 112.16	Most Recent Dividend	\$0.50	P/B	1.68
Beta	1.54	Dividend Yield	3.00%	ROE	14.40%
Shares Outstanding (M)	231.24	Trailing 12-Month EPS	\$1.12	S&P Credit Rating	- - -
Market Capitalization (B)	\$15.40B	Trailing 12-Month P/E	12.50	Institutional Ownership	90.40

Investment Highlights

- ✓ Largest computer hard disk drive manufacturers in the world along with Seagate Technology
- ✓ Responsible for a number of industry innovations.
- ✓ Western Digital Hard drives and SSD memory are largely sought after by the PC community for its reliability and quality.
- ✓ Announces their acquisition of SanDisk as of 10/21/2015
- ✓ Prior HGST acquisitions. Was very successful.

Large			
Mid			
Small			
	Value	Core	Growth

Style Box



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Company Overview

Western Digital Corporation designs, manufactures, and markets many different lines of storage products that are used in a wide variety of electronic systems. Created in 1970 Western Digital has focused their products towards American use for computer data storage. They are widely recognized online and with their customers to have the most quality and reliable storage products on the market. With an emphasis on their energy efficient drives that use a number of ways to save energy while having reliable data storage by primarily cycling through different disk writing speeds when seen to be appropriate.

Western Digital has also been busy making acquisitions the most recent and successful one being HGST formerly known as Hitachi Global Storage Technologies who sell hard drives, Solid-State drives, and also work in subsidiary with VMware a very powerful emulating software program.

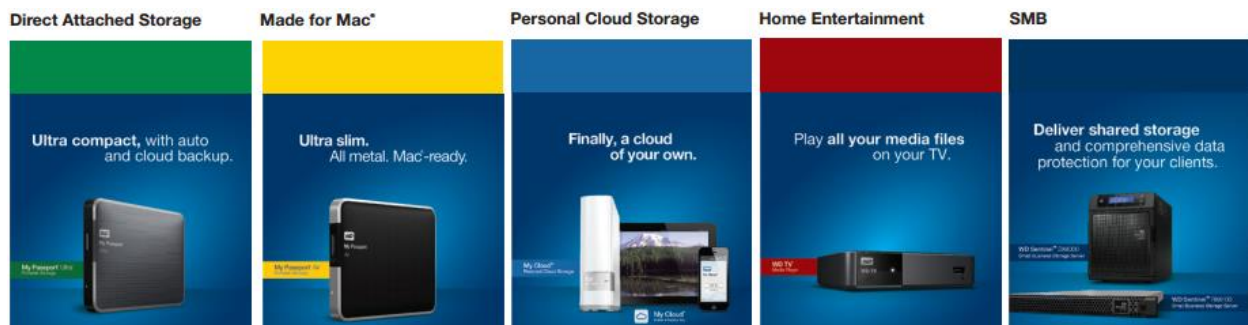
Western Digital have clear visions and goals for their technology and it is made clear on their website what they are striving to do with their products. Any of their products that are made are made with a purpose to fall in one of the five categories of their technology divisions, Everyday, Capacity, Performance, NAS, and Surveillance.



With the above being the product focus Western Digital then has created five different product lines where these product focus can reside in. The five product lines being the following:

- **Direct Attached Storage:** This includes hard disk drives or Solid State Drives. Products are set up to connect to any device with a USB drive plugin. And can instantly boost the storage on any device, and have a wide variety of uses.
- **Made for Mac:** Made for Mac hard drives and Solid State drives are Western Digital's quality products just specifically built to fit Mac book mobile and non-mobile Macs. With the acquisition of SanDisk and their already ongoing deal with Apple we may see more opportunities opened through this door.

- **Personal Cloud Storage:** Personal Cloud Storage products offered by Western Digital are simple. Cloud storage in your house hold, allowing you to add files to a universal drive over wifi accessible to all users that can connect to it. These products can be used use for backups, or just extra storage. Connecting your personal cloud storage drive with Dropbox means that you can access these files anywhere.
- **Home Entertainment:** Home entertainment products consist of products such as media players, DVR expanders, and storage products meant to hold 4K UHD Movies, TV storage, and Gaming storage. Most of these products already being portable each have different features such as recording.
- **SMB:** Server Message Block storage provides a method for client applications in a computer to read and write files on and to server programs on a computer network. Server Message Block storage units are mainly used for companies recording surveillance footage.



All of these products are sold not only in the US but also internationally. With all other primary product examples it allows us to see how it might play into their business strategy. Western Digital again focuses on creating quality and reliable technology through product development.

Business Strategy

Growth

As a well-known and respected company in a rapidly changing and competitive technology hardware market Western Digital is expected to preform consistently and to keep improving on their developments they've made so far in the industry. They also need to keep the scaling growth of their company match the demand and the growth of the technology sector. Western Digital also believes in three main strategies to allow them to grow and increase their market share, which are:

Expansion in Emerging Markets:

Western Digital management expects large growth in emerging markets, as can be observed from some Middle East, and Eastern markets today. They believe growth in Asia could be as high as 10% a year as more and more people have access to personal computers and the internet. We can already see the standards of living rise up, and we can see this trend already starting as personal computers are becoming more easily available in lesser developed parts of the world.

Computers are simply becoming more affordable and necessary in today's life. Western Digital understands this and wants to take advantage of this when looking into emerging markets.

Acquisitions to Increase Margins:

As far as Western Digital is concerned acquisitions are a quick and efficient way to get a larger share of the market. Acquisitions are a major driver of the data storage industry and Western Digital is looking at all the opportunities that will allow improve their margins and them to stay competitive. With the acquisition of HGST in 2012 and now SanDisk in the 2015-2016 year we can see that they are sticking to that game plan which worked for them in the past generally increase their company and market value.

Focus on Hard Disk Drives:

Western digital also believes in making and mastering the traditional hard drives to use as their staple. They strive on creating it their most popular product, and so far they have with creating some very attractive innovations to their hard drive disks in the recent year, the most noted being the energy-efficient drives. By doing so Western Digital plans on maintaining high sales and margins in years to come. They also believe that the cost per unit of storage for solid state drives are too expensive at this current state in technology which is no entirely wrong when considering that they also have a much higher rate of failures than traditional hard drive disks.

Risk Management

Western Digital's risk management is primarily based on them being keep a solid customer base with their hard disk drives and to make smart mergers and or acquisitions to increase their market share. Western Digital must be able to adjust to development, demands for other industry standards, and react accordingly to market changes. This includes everything from popular demand of cloud storage all the way to embedded storage product standards and price points. However WD has done a fantastic job so far with predicting industry changes and meeting consumer demands while also providing reliable products. If WD can continue to forecast accurately the less risk and cost adjustment WD will have to do later. This consistent and accurate forecasting has created WD the market leader they are and has destroyed other competitors in this aggressively changing technology market. Preventative steps must also be put into place to lessen the damage taken by exchange risks. To do this WD has entered into forward and cross currency swap contracts, which reduce the impact of currency fluctuations on foreign assets and liabilities.

Industry Outlook

Competitive Environment

When looking at the storage technology sector Western Digital is definitely a favored product by most customers online. When comparing Western Digital's financials to their competitors it also shows they are definitely the best data storage company, currently, worth an investment. Western Digital has also done a fantastic job with maintaining and increasing its market share with their strategy of acquisitions. They are also willing to make the aggressive move and to move into Eastern emerging markets. Reliability is also, naturally in the storage solutions market, paramount, and SanDisk strives to create products that are reliable and affordable.

Western Digital has also been able to grow its market share in this competitive environment by successfully developing new products. Along with these developments they are also good at announcements, and successful product introductions. Creating the name brand they are today.

SanDisk's Competitors

Seagate Technology (STX)



Seagate Technology specializes in data storage products and is very similar- therefore a big competitor to SanDisk. Seagate has a heavy emphasis on The Cloud, and offers data protection and security data storage and is developing 3D NAND technology at a commercial level.

SanDisk (SanDisk)



SanDisk designs, develops manufactures, and markets data storage solutions all around the world. focused their products towards data centers, computing, mobile, and consumer electronics and are recognized worldwide for their memory based products.

EMC Corp. (EMC)



EMC offers data storage, information security, virtualization, analytics, cloud computing and other products and services that enable businesses to store, manage, protect, and analyze data. World's largest provider of data storage systems.

NetApp (NTAP)



NetApp is an American computer storage and data management company that supplies hardware and software. They differ from other competitors because they work more with data management than storage even though they have recently started selling hard disk drives.

Micron (MU)



Micron is an American computer technology company that makes many forms of semiconductor devices, including RAM, Flash memory, and Solid State Drives. They are ranked among the top 5 semiconductor producing companies in the world and are one of the many companies trying to enter the data storage space.

SWOT Analysis

Strengths

Considerably energy-efficient hard drives, which are attractive to the causal laptop user to data centers.

Improvements of their already popular SSDs, and their price points. Now with SanDisk on their team their SDDs should be the very best on the market.

As SSD technology improves they will completely replace current hard disk drives.

Very good reputation among customers, known for their reliability and quality over competitors.

Weaknesses

Price competition add together with rapid technology changes.

Margin erosion.

High Research and Development costs.

Opportunities

Very resent yet completed acquisition of SanDisk, making SanDisk a wholly owned subsidiary of Western Digital.

Improvement of the newly blossoming cloud markets.

Innovation in their energy saving products, SSD hard drives, and VelociRapor (fast 2.5 inch Drive).

Increasing demand of PC and game software

Risks

Price war between competitors, especially when WDC is still sorting out their new acquisition.

Unsuccessful acquisition of HGST.

Recent acquisition will pressure other competitors, like Seagate, to make alliances as well.

Dynamically changing field.

Financial Statement Analysis

Net Income

Net income for Western Digital has been fluctuating with the recent acquisitions they have been making but that is to be expected when undergoing so many changes. A pattern with their net income seems to be arising where it will dip the year around an acquisition as we can see in 2013 and now in 2015 however I am not worried about this trend because they always seem to gain their lost ground. They also have been able to maintain most of their net income their reliable and quality Hard Disk Drives.

Balance Sheets

So far the total assets has not changed significantly in the past five years, however the research and development have slowly been increasing over the past five years. Another noticeable trend is that their net income has also been steadily increasing.

Statement of Cash Flows

For Western Digital they have been making fantastic gains on their cash flow sheets up until 2015 where they could not beat their net income from 2014 however I am not too worried for what this means for Western Digital as a whole. This dip in Net income pattern can also be seen in the 2013 to what seems to be similar pattern repeating itself. Western Digital did fantastically well from 2011 to 2012 then had a considerable dip in 2013, however made a remarkable recovery in 2014. This small dip in Net income in the 2015 year could simply mean nothing more than the dip before the rise. Other than that overall Western Digital has keep consistent values in the other areas of the Statements of Cash flow.

Current Events

- Western Digital Announces Joint Venture with China-based technology company Unisplendour Corp. Limited. - 11/9/2015
- Seagate profit and revenue tumble in their latest quarter earnings - 10/30/2015
- Western Digital Announces Financial Results For The First Quarter Fiscal 2016 - 10/26/2015
- Western Digital Announces Acquisition Of SanDisk for 19 Billion - 10/21/2015
- SanDisk Shares jump on late-stage acquisition talk report - 10/19/2015

Valuation

Beta

Three different Betas were calculated, a Daily, Weekly, and a Monthly Beta. Beta used to calculate the final values in the work book was 1.54. This value came from matching up Weekly average close to the Weekly average close of the S&P 500. I chose the Weekly Beta over the Daily or Monthly beta, because the Weekly Beta value was the median value between the low Beta value of the daily Beta and the higher value of monthly Beta.

Cost of Debt

As for the Cost of Debt Western Digital did not have any bonds issued for the Cost of Debt to be grabbed from so naturally we could take the Cost of Debt from the recently acquired company SanDisk. However the Cost of Debt presented from SanDisk was so low, (0.5%), I felt that it was unfairly skew my projection. To counter act this I took then took the weighted average from the Cost of Debt from all the relative companies used. This was the best alternative to the situation and when calculated I came up on 2.64 as the Cost of Debt. 2.64% was then used when doing calculations in the workbook.

Cost of Capital

The cost of capital, 10.91% was found using the capital to asset pricing model.

Discounted Cash Flow Model

For the DCF I used a three stage growth model. I when calculated I have the stage 1 a growth rate of 3%. The growth rate created in the DCF Growth Rates page was 12% however I believe this was misleading. I took the more conservative position of 3 percent because in the most recent years, 2014 and 2015, Western Digital's Net Sales have been shrinking. Even though years 2012 and 2013 had growth rates of 31% and 23% I did not imagine Western Digital's Net Sales to hit 12% from -4% last year. For the second and third stage of net sales growth rates I increased them at 1% per each stage to give me a conservative view of 4% for stage two and 5% for stage 3. This is because I believe that Western Digital is a strong company who has done mergers well in the past and I actually believe that they will beat my projected growth rates. I weighted this equally as I did the rest at 33%.

Relative Valuation Model

For the relative valuation model, I used the competitors listed: Seagate Technology SanDisk, EMC Corporation, NetApp, and Micron. I then assigned weights for each company based on market cap, price to earnings, price to sales, price to book and their price to earnings growth. Their main products were also considered when deciding weights.

This gave me an intrinsic value of \$100.91 which was the most overvalued evaluation of the three created making Western Digital overvalued by 58.72%. This price was created when looking at the prices of the other relatives. When looking at the other relatives Western Digital is at a massive discount. However, I do not think Western Digital is overpriced by 58.72%, it would simply impractical to claim that Western Digital is accurately overpriced by 58.72% with the information at hand. I also think it should be mentioned that Western Digital is a solid company that has performed consistently well in the past and has a very good consumer to customer relation with their products. It is clear when reading customer reviews that Western Digital prioritize reliability and quality with their products. I weighted this equally as I did the rest at 33%.

Historical Valuation Model

The historical valuation model used 2016E Diluted EPS of \$5.97. This gave me an intrinsic value of \$69.61. After looking at the whole entire picture I believe that this is a very accurate evaluation of what I imagine Western Digital's current value to be. I believe this evaluation was forecasted accurately because it is able to grab the average and the median of the valuations for the long term of Western Digital. I believe this brings a more accurate picture because in the past 5 years Western Digital has made two very large acquisitions, (one with HGST, and now with SNDK), and I believe that is why we see such fluctuations in the other areas of calculations that could make less accurate projections. I also believe the recent acquisitions have thrown off the calculations for an accurate projection and that is why I believe a steady long term view of Western Digital is the best view to be considering. I weighted this equally as I did the rest at 33%

Recommendation

I recommend a strong **BUY** for Western Digital. This is because Western Digital and I am optimistic for Western Digital's future. Western Digital's announcement of their acquisition of SanDisk will also be a key driver for their stock in the future, as they will have a greater market share in the SSD market place, and a clear avenue into Apples product line, (As SanDisk is currently the staple storage drive used in Mac computers). Western Digital also believe that growth will be done with moving to eastern markets such as China, and SanDisk's collaboration with Toshiba will get them closer to the eastern markets they want to penetrate. Western Digital will also be receiving all the intellectual information held by SanDisk which will allow them to catch up in their weak areas, mainly being Solid State Drives, (Coincidentally the product line that SanDisk has sought after to specialize in). With strong growth projected in Asia as well as increases in demand for enterprise storage in America Western Digital has the opportunity to take advantage of their acquisition and grow the company even more.

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