

WESTERN DIGITAL CORP
Form 10-Q
February 06, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 29, 2017

Or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission file number: 1-8703

WESTERN DIGITAL CORPORATION
(Exact Name of Registrant as Specified in Its Charter)

Delaware 33-0956711
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

5601 Great Oaks Parkway 95119
San Jose, California
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (408) 717-6000

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of the close of business on January 30, 2018, 297,560,299 shares of common stock, par value \$0.01 per share, were outstanding.

WESTERN DIGITAL CORPORATION
INDEX

| | PAGE NO. |
|--|-------------|
| PART I. FINANCIAL INFORMATION | |
| Item 1. Financial Statements (unaudited) | |
| Condensed Consolidated Balance Sheets — As of December 29, 2017 and June 30, 2017 | <u>4</u> |
| Condensed Consolidated Statements of Operations — Three and Six Months Ended December 29, 2017 and December 30, 2016 | <u>5</u> |
| Condensed Consolidated Statements of Comprehensive Loss — Three and Six Months Ended December 29, 2017 and December 30, 2016 | <u>6</u> |
| Condensed Consolidated Statements of Cash Flows — Six Months Ended December 29, 2017 and December 30, 2016 | <u>7</u> |
| Notes to Condensed Consolidated Financial Statements | <u>8</u> |
| Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations | <u>48</u> |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | <u>63</u> |
| Item 4. Controls and Procedures | <u>64</u> |
| PART II. OTHER INFORMATION | |
| Item 1. Legal Proceedings | <u>65</u> |
| Item 1A. Risk Factors | <u>65</u> |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds | <u>93</u> |
| Item 3. Defaults Upon Senior Securities | <u>93</u> |
| Item 4. Mine Safety Disclosures | <u>93</u> |
| Item 5. Other Information | <u>93</u> |
| Item 6. Exhibits | <u>93</u> |

Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms “we,” “us,” “our,” the “Company,” “WDC” and “Western Digital” refer to Western Digital Corporation and its subsidiaries, unless we state, or the context indicates, otherwise.

WDC, a Delaware corporation, is the parent company of our data storage business. Our principal executive offices are located at 5601 Great Oaks Parkway, San Jose, California 95119. Our telephone number is (408) 717-6000, and our website is www.wdc.com. The information on our website is not incorporated in this Quarterly Report on Form 10-Q.

Western Digital, WD, SanDisk, Tegile, and Upthere are registered trademarks or trademarks of Western Digital or its affiliates in the U.S. and/or other countries. All other trademarks, registered trademarks and/or service marks, indicated or otherwise, are the property of their respective owners.

Table of Contents

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements within the meaning of the federal securities laws. Any statements that do not relate to historical or current facts or matters are forward-looking statements. You can identify some of the forward-looking statements by the use of forward-looking words, such as “may,” “will,” “could,” “would,” “project,” “believe,” “anticipate,” “expect,” “estimate,” “continue,” “potential,” “plan,” “forecast,” and the like, or the use of future tense. Statements concerning current conditions may also be forward-looking if they imply a continuation of current conditions.

Examples of forward-looking statements include, but are not limited to, statements concerning:

- expectations concerning the integration of, and anticipated benefits from, our acquisition of SanDisk Corporation;
- expectations regarding the integration of our HGST and WD subsidiaries following the decision by the Ministry of Commerce of the People’s Republic of China in October 2015;
- expectations regarding our Flash Ventures joint venture with Toshiba Memory Corporation;
- our quarterly cash dividend policy;
- expectations regarding our product development and technology plans;
- expectations regarding the outcome of legal proceedings in which we are involved;
- expectations regarding the impact of the Tax Cuts and Jobs Act enacted on December 22, 2017 on the Company;
- expectations regarding the repatriation of funds from our foreign operations;
- our beliefs regarding tax benefits and the timing of future payments, if any, relating to the unrecognized tax benefits, and the adequacy of our tax provisions;
- expectations regarding capital investments and sources of funding for those investments;
- expectations regarding the outcome and anticipated benefits of the announced Refinancing Transactions (as defined below); and
- our beliefs regarding the sufficiency of our available liquidity to meet our working capital, debt, dividend and capital expenditure needs.

Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. You are urged to carefully review the disclosures we make concerning risks and other factors that may affect our business and operating results, including those made in Part II, Item 1A of this Quarterly Report on Form 10 Q, and any of those made in our other reports filed with the Securities and Exchange Commission. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. We do not intend, and undertake no obligation, to publish revised forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

WESTERN DIGITAL CORPORATION
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (in millions, except par value)
 (Unaudited)

| | December 29, 2017 | June 30, 2017 |
|---|----------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 6,272 | \$6,354 |
| Short-term investments | 23 | 24 |
| Accounts receivable, net | 2,052 | 1,948 |
| Inventories | 2,281 | 2,341 |
| Other current assets | 485 | 389 |
| Total current assets | 11,113 | 11,056 |
| Property, plant and equipment, net | 3,054 | 3,033 |
| Notes receivable and investments in Flash Ventures | 1,845 | 1,340 |
| Goodwill | 10,076 | 10,014 |
| Other intangible assets, net | 3,230 | 3,823 |
| Other non-current assets | 522 | 594 |
| Total assets | \$ 29,840 | \$29,860 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 1,921 | \$2,144 |
| Accounts payable to related parties | 250 | 206 |
| Accrued expenses | 1,191 | 1,069 |
| Accrued compensation | 523 | 506 |
| Accrued warranty | 194 | 186 |
| Current portion of long-term debt | 274 | 233 |
| Total current liabilities | 4,353 | 4,344 |
| Long-term debt | 11,777 | 12,918 |
| Other liabilities | 2,438 | 1,180 |
| Total liabilities | 18,568 | 18,442 |
| Commitments and contingencies (Notes 6, 8, 10 and 13) | | |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value; authorized — 5 shares; issued and outstanding — none | — | — |
| Common stock, \$0.01 par value; authorized — 450 shares; issued — 312 shares; outstanding — 297 shares and 294 shares, respectively | $\frac{3}{3}$ 297 | 3 |
| Additional paid-in capital | 4,410 | 4,506 |
| Accumulated other comprehensive loss | (46 |) (58) |
| Retained earnings | 8,250 | 8,633 |
| Treasury stock — common shares at cost; 15 shares and 18 shares, respectively | (1,345 |) (1,666) |
| Total shareholders' equity | 11,272 | 11,418 |
| Total liabilities and shareholders' equity | \$ 29,840 | \$29,860 |

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of ContentsWESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in millions, except per share amounts)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|----------|------------------|------------|
| | December 30, | | December 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Revenue, net | \$5,336 | \$ 4,888 | \$10,517 | \$ 9,602 |
| Cost of revenue | 3,323 | 3,355 | 6,591 | 6,734 |
| Gross profit | 2,013 | 1,533 | 3,926 | 2,868 |
| Operating expenses: | | | | |
| Research and development | 629 | 585 | 1,221 | 1,224 |
| Selling, general and administrative | 381 | 358 | 745 | 754 |
| Employee termination, asset impairment, and other charges | 48 | 45 | 100 | 113 |
| Total operating expenses | 1,058 | 988 | 2,066 | 2,091 |
| Operating income | 955 | 545 | 1,860 | 777 |
| Interest and other income (expense): | | | | |
| Interest income | 14 | 5 | 30 | 10 |
| Interest expense | (197) | (205) | (402) | (441) |
| Other income (expense), net | 2 | (24) | (4) | (296) |
| Total interest and other expense, net | (181) | (224) | (376) | (727) |
| Income before taxes | 774 | 321 | 1,484 | 50 |
| Income tax expense | 1,597 | 86 | 1,626 | 181 |
| Net income (loss) | \$(823) | \$ 235 | \$(142) | \$ (131) |
| Income (loss) per common share | | | | |
| Basic | \$(2.78) | \$ 0.82 | \$(0.48) | \$ (0.46) |
| Diluted | \$(2.78) | \$ 0.80 | \$(0.48) | \$ (0.46) |
| Weighted average shares outstanding: | | | | |
| Basic | 296 | 286 | 295 | 285 |
| Diluted | 296 | 294 | 295 | 285 |
| Cash dividends declared per share | \$0.50 | \$ 0.50 | \$1.00 | \$ 1.00 |

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of ContentsWESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in millions)

(Unaudited)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | December 31, 2017 | December 31, 2016 | December 31, 2017 | December 31, 2016 |
| Net income (loss) | \$(823) | \$ 235 | \$(142) | \$ (131) |
| Other comprehensive income (loss), before tax: | | | | |
| Actuarial pension gain | — | 1 | — | 6 |
| Foreign currency translation adjustment | 6 | (186) | 2 | (169) |
| Net unrealized gain (loss) on derivative contracts | 10 | (136) | 14 | (140) |
| Net unrealized loss on available-for-sale securities | — | — | (1) | — |
| Total other comprehensive income (loss), before tax | 16 | (321) | 15 | (303) |
| Income tax benefit (expense) related to items of other comprehensive income (loss), before tax | (3) | 9 | (3) | 3 |
| Other comprehensive income (loss), net of tax | 13 | (312) | 12 | (300) |
| Total comprehensive loss | \$(810) | \$ (77) | \$(130) | \$ (431) |

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

-WESTERN DIGITAL CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)

(Unaudited)

| | Six Months Ended | |
|--|-------------------|-------------------|
| | December 31, 2017 | December 31, 2016 |
| Cash flows from operating activities | | |
| Net loss | \$(142) | \$ (131) |
| Adjustments to reconcile net loss to net cash provided by operations: | | |
| Depreciation and amortization | 1,068 | 1,022 |
| Stock-based compensation | 196 | 201 |
| Deferred income taxes | (129) | 117 |
| Loss on disposal of assets | 12 | 10 |
| Write-off of issuance costs and amortization of debt discounts | 23 | 258 |
| Loss on convertible debt and related instruments | — | 5 |
| Non-cash portion of employee termination, asset impairment and other charges | — | 13 |
| Other non-cash operating activities, net | 16 | 42 |
| Changes in: | | |
| Accounts receivable, net | (99) | (540) |
| Inventories | 65 | 52 |
| Accounts payable | (276) | 180 |
| Accounts payable to related parties | 44 | 6 |
| Accrued expenses | 95 | 59 |
| Accrued compensation | 17 | 194 |
| Other assets and liabilities, net | 1,425 | 12 |
| Net cash provided by operations | 2,315 | 1,500 |
| Cash flows from investing activities | | |
| Purchases of property, plant and equipment | (416) | (330) |
| Proceeds from the sale of property, plant and equipment | 10 | 1 |
| Acquisitions, net of cash acquired | (99) | — |
| Purchases of investments | (57) | (239) |
| Proceeds from sale of investments | 29 | 55 |
| Proceeds from maturities of investments | 16 | 279 |
| Investments in Flash Ventures | — | (20) |
| Notes receivable issuances to Flash Ventures | (621) | (309) |
| Notes receivable proceeds from Flash Ventures | 112 | 259 |
| Strategic investments and other, net | 19 | (12) |
| Net cash used in investing activities | (1,007) | (316) |
| Cash flows from financing activities | | |
| Issuance of stock under employee stock plans | 99 | 90 |
| Taxes paid on vested stock awards under employee stock plans | (67) | (40) |
| Excess tax benefits from employee stock plans | — | 56 |
| Proceeds from acquired call option | — | 61 |
| Dividends paid to shareholders | (295) | (284) |
| Settlement of debt hedge contracts | 28 | — |
| Repayment of debt | (4,114) | (8,254) |
| Proceeds from debt | 2,963 | 3,992 |
| Debt issuance costs | (5) | (7) |

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| | | |
|---|----------|----------|
| Net cash used in financing activities | (1,391) | (4,386) |
| Effect of exchange rate changes on cash | 1 | (9) |
| Net decrease in cash and cash equivalents | (82) | (3,211) |
| Cash and cash equivalents, beginning of year | 6,354 | 8,151 |
| Cash and cash equivalents, end of period | \$6,272 | \$ 4,940 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | \$140 | \$ 43 |
| Cash paid for interest | \$308 | \$ 299 |
| Supplemental disclosure of non-cash investing and financing activities: | | |
| Accrual of cash dividend declared | \$149 | \$ 144 |

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

7

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Organization and Basis of Presentation

Western Digital Corporation (“Western Digital” or “the Company”) is a leading developer, manufacturer and provider of data storage devices and solutions that address the evolving needs of the information technology (“IT”) industry and the infrastructure that enables the proliferation of data in virtually every industry. The Company’s broad portfolio of technology and products address the following key markets: Client Devices; Data Center Devices and Solutions; and Client Solutions. The Company also generates license and royalty revenue related to its intellectual property (“IP”), which is included in each of these three categories.

The accounting policies followed by the Company are set forth in Part II, Item 8, Note 1 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10 K for the fiscal year ended June 30, 2017. In the opinion of management, all adjustments necessary to fairly state the Condensed Consolidated Financial Statements have been made. All such adjustments are of a normal, recurring nature. Certain information and footnote disclosures normally included in the Consolidated Financial Statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10 K for the fiscal year ended June 30, 2017. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

Fiscal Year

The Company’s fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Fiscal years 2018, which ends on June 29, 2018, and 2017, which ended on June 30, 2017, are both comprised of 52 weeks, with all quarters presented consisting of 13 weeks.

Use of Estimates

Company management has made estimates and assumptions relating to the reporting of certain assets and liabilities in conformity with U.S. GAAP. These estimates and assumptions have been applied using methodologies that are consistent throughout the periods presented. However, actual results could differ materially from these estimates.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Note 2. Recently Adopted Accounting Pronouncements

In August 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-15, “Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”). ASU 2016-15 provides amendments that address eight specific cash flow classification issues for which there exists diversity in practice: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies; distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The Company adopted ASU 2016-15 in the second quarter of 2018 on a modified retrospective basis as required by the standard. The Company’s adoption of ASU 2016-15 did not have a material effect on the Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”). ASU 2016-09 simplifies several aspects of the accounting for stock-based payment transactions and states that, among other things, all excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit in the income statement and an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. The Company adopted this standard in the first quarter of 2018 using the modified retrospective approach. This adoption resulted in a one-time net increase to beginning retained earnings of \$70 million, consisting of a \$58 million cumulative adjustment for the previously unrecognized windfall tax benefits related to previous vesting and exercises of stock-based awards, and a \$19 million cumulative adjustment related to the change in accounting policy for estimated forfeitures and share cancellations, partially offset by a decrease of \$7 million for the related tax impacts of change in forfeiture policy. In addition, under the new standard, the Company will prospectively reflect the tax deficiencies and benefits as an operating activity, rather than as a financing activity under the previous standard, in the Company’s Consolidated Statements of Cash Flows. For the three and six months ended December 29, 2017, the Company recognized excess tax benefits of \$5 million and \$27 million, respectively, as a component of its income tax expense.

In March 2016, the FASB issued ASU No. 2016-07, “Investments- Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting” (“ASU 2016-07”). ASU 2016-07 eliminates the requirement to apply the equity method of accounting retrospectively when a reporting entity obtains significant influence over a previously held investment. The Company adopted this standard in the second quarter of 2018. The Company’s adoption of ASU 2016-07 did not have a material impact on its Consolidated Financial Statements.

In July 2015, the FASB issued ASU No. 2015 11, “Inventory (Topic 330) - Simplifying the Measurement of Inventory” (“ASU 2015 11”), which dictates that an entity should measure inventory within the scope of this update at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The Company adopted this standard in the first quarter of 2018. The Company’s adoption of ASU 2015 11 did not have a material impact on its Consolidated Financial Statements.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 3. Supplemental Financial Statement Data

Inventories

| | December 31, 2017 | June 30, 2017 |
|-----------------------------------|-------------------|---------------|
| | (in millions) | |
| Inventories: | | |
| Raw materials and component parts | \$634 | \$646 |
| Work-in-process | 667 | 632 |
| Finished goods | 980 | 1,063 |
| Total inventories | \$2,281 | \$2,341 |

Property, plant and equipment, net

| | December 31, 2017 | June 30, 2017 |
|--------------------------------------|-------------------|---------------|
| | (in millions) | |
| Property, plant, and equipment: | | |
| Land and buildings | \$1,913 | \$1,855 |
| Machinery and equipment | 7,011 | 6,815 |
| Computer equipment and software | 433 | 404 |
| Furniture and fixtures | 50 | 49 |
| Leasehold improvements | 253 | 259 |
| Construction-in-process | 175 | 144 |
| Property, plant and equipment, gross | 9,835 | 9,526 |
| Accumulated depreciation | (6,781) | (6,493) |
| Property, plant, and equipment, net | \$3,054 | \$3,033 |

Goodwill

| | Carrying Amount (in millions) |
|---|-------------------------------|
| Balance at June 30, 2017 | \$10,014 |
| Goodwill recorded in connection with acquisitions | 61 |
| Foreign currency translation adjustment | 1 |
| Balance at December 29, 2017 | \$10,076 |

On September 15, 2017, the Company acquired substantially all the assets of Tegile Systems, Inc., a provider of flash and persistent-memory storage solutions for enterprise data center applications. On August 25, 2017, the Company acquired substantially all the assets of Uptere, Inc., a cloud services company. These acquisitions are primarily intended to help meet the evolving needs of customers, while driving long-term growth for the Company's existing data center and client solution products over the long term.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

The aggregate purchase price of acquisitions during the six months ended December 29, 2017 was \$99 million in cash, with net assets acquired primarily consisting of developed technology and other intangibles assets, of which \$61 million was allocated to goodwill. Goodwill is primarily attributable to the benefits the Company expects to derive from diversifying product offerings to its Data Center Devices and Solutions and Client Solutions end markets as well as the acquired workforce. Goodwill is expected to be deductible for tax purposes because the acquisitions were structured as asset acquisitions but accounted for as business combinations. Concurrent with these acquisitions, the Company received \$36 million in proceeds on previously outstanding notes receivable due from these acquired entities.

During the six months ended December 29, 2017, the Company incurred \$6 million of transaction expenses related to these acquisitions, which are primarily included within Selling, General and Administrative expenses in the Condensed Consolidated Statements of Operations. Revenues and earnings related to these acquisitions was not material.

Intangible assets

| | December 30, 2017 | | June 30, 2017 | |
|-------------------------------------|----------------------|----------|------------------|--|
| | (in millions) | | | |
| Finite-lived intangible assets | \$5,814 | \$5,160 | | |
| In-process research and development | 80 | 696 | | |
| Accumulated amortization | (2,664) | (2,033) | | |
| Intangible assets, net | \$3,230 | \$3,823 | | |

As part of prior acquisitions, the Company recorded at the time of the acquisition acquired in-process research and development (“IPR&D”) for projects in progress that had not yet reached technological feasibility. IPR&D is initially accounted for as an indefinite-lived intangible asset. Once a project reaches technological feasibility, the Company reclassifies the balance to existing technology and begins to amortize the intangible asset over its estimated useful life. During the three months ended December 29, 2017, two IPR&D projects reached technological feasibility totaling \$616 million and commenced amortization over an estimated useful life of 4 years.

Product warranty liability

Changes in the warranty accrual were as follows:

| | Three Months Ended December 29, 2017 | | Six Months Ended December 29, 2017 | | December 30, 2016 | | December 30, 2016 | |
|--|--|--------|--|--------|----------------------|--|----------------------|--|
| | (in millions) | | | | | | | |
| Warranty accrual, beginning of period | \$302 | \$ 277 | \$311 | \$ 279 | | | | |
| Charges to operations | 46 | 44 | 90 | 91 | | | | |
| Utilization | (43) | (35) | (81) | (80) | | | | |
| Changes in estimate related to pre-existing warranties | (1) | 27 | (16) | 23 | | | | |
| Warranty accrual, end of period | \$304 | \$ 313 | \$304 | \$ 313 | | | | |

The long-term portion of the warranty accrual classified in Other liabilities was \$110 million and \$125 million as of December 29, 2017 and June 30, 2017, respectively.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Other liabilities

| | December 30, 2017 2017 (in millions) | |
|-------------------------------------|--|---------|
| Non-current income taxes payable | \$1,425 | \$— |
| Other non-current liabilities | 1,013 | 1,180 |
| Total other non-current liabilities | \$2,438 | \$1,180 |

Accumulated other comprehensive income (loss)

Other comprehensive loss (“OCI”), net of tax refers to expenses, gains and losses that are recorded as an element of shareholders’ equity but are excluded from net income. The following table illustrates the changes in the balances of each component of Accumulated other comprehensive income (loss) (“AOCI”):

| | Actuarial Pension Gains (Losses) | Foreign Currency Translation Gains (Losses) | Unrealized Gains (Losses) on Available for Sale Securities | Unrealized Gains (Losses) on Derivative Contracts | Total Accumulated Comprehensive Income (Loss) |
|---|---|---|--|--|--|
| | (in millions) | | | | |
| Balance at June 30, 2017 | \$(18) | \$ (39) | \$ 2 | \$ (3) | \$ (58) |
| Other comprehensive income (loss) before reclassifications | — | 2 | (1) | 15 | 16 |
| Amounts reclassified from accumulated other comprehensive income | — | — | — | (1) | (1) |
| Income tax expense related to items of other comprehensive income | — | — | — | (3) | (3) |
| Net current-period other comprehensive income | — | 2 | (1) | 11 | 12 |
| Balance at December 29, 2017 | \$(18) | \$ (37) | \$ 1 | \$ 8 | \$ (46) |

During the three and six months ended December 29, 2017, there were no material reclassifications out of AOCI. The following table illustrates the significant amounts of each component reclassified out of AOCI to the Condensed Consolidated Statements of Operations:

| AOCI Component | Three Months Ended December 30, 2017 | | Six Months Ended December 30, 2017 | | Statement of Operations Line Item |
|--|---|-------|---|-------|--------------------------------------|
| | 2017 | 2016 | 2017 | 2016 | |
| | (in millions) | | | | |
| Unrealized holding gain (loss) on designated hedging activities: | | | | | |
| Foreign exchange contracts | \$4 | \$ 16 | \$ 1 | \$ 40 | Cost of revenue |
| Foreign exchange contracts | — | — | — | 2 | Research and development |
| Unrealized holding gain on designated hedging activities | 4 | 16 | 1 | 42 | |
| Total reclassifications for the period | \$4 | \$ 16 | \$ 1 | \$ 42 | |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 4. Fair Value Measurements and Investments

The Company's total cash, cash equivalents and marketable securities was as follows:

| | December 31, 2017 | |
|--|-------------------|----------|
| | 2017 | 2017 |
| | (in millions) | |
| Cash and cash equivalents | \$6,272 | \$ 6,354 |
| Short-term marketable securities | 23 | 24 |
| Long-term marketable securities (included within other non-current assets) | 94 | 94 |
| Total cash, cash equivalents and marketable securities | \$6,389 | \$ 6,472 |

Financial Instruments Carried at Fair Value

Financial assets and liabilities that are remeasured and reported at fair value at each reporting period are classified and disclosed in one of the following three levels:

Level 1. Quoted prices in active markets for identical assets or liabilities.

Level 2. Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3. Inputs that are unobservable for the asset or liability and that are significant to the fair value of the assets or liabilities.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

The following tables present information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of December 29, 2017 and June 30, 2017, and indicate the fair value hierarchy of the valuation techniques utilized to determine such values:

| | December 29, 2017 | | | |
|-------------------------------------|-------------------|---------|---------|----------|
| | Level 1 | Level 2 | Level 3 | Total |
| | (in millions) | | | |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$3,016 | \$— | \$— | —\$3,016 |
| Certificates of deposit | — | 7 | — | 7 |
| Total cash equivalents | 3,016 | 7 | — | 3,023 |
| Short-term investments: | | | | |
| Corporate notes and bonds | — | 15 | — | 15 |
| Asset-backed securities | — | 4 | — | 4 |
| Municipal notes and bonds | — | 1 | — | 1 |
| Equity securities | 3 | — | — | 3 |
| Total short-term investments | 3 | 20 | — | 23 |
| Long-term investments: | | | | |
| U.S. Treasury securities | 5 | — | — | 5 |
| U.S. Government agency securities | — | 5 | — | 5 |
| International government securities | — | 1 | — | 1 |
| Corporate notes and bonds | — | 66 | — | 66 |
| Asset-backed securities | — | 6 | — | 6 |
| Municipal notes and bonds | — | 11 | — | 11 |
| Total long-term investments | 5 | 89 | — | 94 |
| Foreign exchange contracts | — | 11 | — | 11 |
| Interest rate swap contract | — | 8 | — | 8 |
| Total assets at fair value | \$3,024 | \$135 | \$— | —\$3,159 |
| Liabilities: | | | | |
| Foreign exchange contracts | \$— | \$7 | \$— | —\$7 |
| Total liabilities at fair value | \$— | \$7 | \$— | —\$7 |

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

| | June 30, 2017 | | | |
|-------------------------------------|---------------|-------|-------|---------|
| | Level | Level | Level | Total |
| | 1 | 2 | 3 | |
| | (in millions) | | | |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$2,836 | \$— | \$ — | \$2,836 |
| Certificates of deposit | — | 10 | — | 10 |
| Total cash equivalents | 2,836 | 10 | — | 2,846 |
| Short-term investments: | | | | |
| Corporate notes and bonds | — | 11 | — | 11 |
| Asset-backed securities | — | 7 | — | 7 |
| Municipal notes and bonds | — | 2 | — | 2 |
| Equity securities | 4 | — | — | 4 |
| Total short-term investments | 4 | 20 | — | 24 |
| Long-term investments: | | | | |
| U.S. Treasury securities | 5 | — | — | 5 |
| U.S. Government agency securities | — | 5 | — | 5 |
| International government securities | — | 1 | — | 1 |
| Corporate notes and bonds | — | 67 | — | 67 |
| Asset-backed securities | — | 7 | — | 7 |
| Municipal notes and bonds | — | 9 | — | 9 |
| Total long-term investments | 5 | 89 | — | 94 |
| Foreign exchange contracts | — | 16 | — | 16 |
| Total assets at fair value | \$2,845 | \$135 | \$ — | \$2,980 |
| Liabilities: | | | | |
| Foreign exchange contracts | \$— | \$8 | \$ — | \$8 |
| Interest rate swap contract | — | 1 | — | 1 |
| Exchange options | — | — | 1 | 1 |
| Total liabilities at fair value | \$— | \$9 | \$ 1 | \$10 |

During the three and six months ended December 29, 2017, the Company had no transfers of financial assets and liabilities between Level 1 and Level 2.

Available-for-Sale Securities

The cost basis of the Company's investments classified as available-for-sale securities, individually and in the aggregate, approximated its fair value as of December 29, 2017 and June 30, 2017. The cost basis and fair value of the Company's investments classified as available-for-sale securities as of December 29, 2017, by remaining contractual maturity, were as follows:

| | Cost | Fair |
|---|---------------|-------|
| | Basis | Value |
| | (in millions) | |
| Due in less than one year (short-term investments) | \$24 | \$ 23 |
| Due in one to five years (included in other non-current assets) | 94 | 94 |

Total \$118 \$ 117

The Company determined available-for-sale securities had no material other-than-temporary impairments in the three and six months ended December 29, 2017 or December 30, 2016.

15

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Financial Instruments Not Carried at Fair Value

For financial instruments where the carrying value (which includes principal adjusted for any unamortized issuance costs, and discounts or premiums) differs from fair value (which is based on quoted market prices), the following table represents the related carrying value and fair value for each of the Company's outstanding financial instruments. Each of the financial instruments presented below was categorized as Level 2 for all periods presented, based on the frequency of trading immediately prior to the end of the second quarter of 2018 and the fourth quarter of 2017, respectively.

| | December 29, 2017 | | June 30, 2017 | |
|-----------------------------------|----------------------|---------------|-------------------|---------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| | (in millions) | | | |
| Secured Notes | \$1,838 | \$2,026 | \$1,835 | \$2,062 |
| Unsecured Notes | 3,252 | 3,892 | 3,244 | 3,956 |
| Term Loan A | 3,978 | 4,040 | 4,074 | 4,130 |
| U.S. Term Loan B-2 | — | — | 2,968 | 2,989 |
| U.S Term Loan B-3 | 2,952 | 2,966 | — | — |
| Euro Term Loan B-2 ⁽¹⁾ | — | — | 1,000 | 1,010 |
| Convertible Debt 2020 | 31 | 33 | 30 | 34 |
| Total | \$12,051 | \$12,957 | \$13,151 | \$14,181 |

⁽¹⁾ Euro Term Loan B-2 outstanding principal amount as of June 30, 2017 was based upon the Euro to U.S. dollar exchange rate as of that respective date.

Cost Method Investments

From time to time, the Company enters into certain strategic investments for the promotion of business and strategic objectives. The Company reports these investments under the cost method of accounting as it does not have a significant influence over the operations of these investees. These investments consist of debt and equity securities of privately-held companies which do not have a readily determinable fair value and are carried at historical cost. The Company assesses these securities for indications of other-than-temporary impairments. There were no impairment charges during the three months ended December 29, 2017 and \$6 million of impairment charges for the six months ended December 29, 2017, which were included in Other income (expense), net in the Condensed Consolidated Statements of Operations. As of December 29, 2017 and June 30, 2017, these investments aggregated \$57 million and \$91 million, respectively, and are reported under Other non-current assets in the Condensed Consolidated Balance Sheets.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Note 5. Derivative Instruments and Hedging Activities

As of December 29, 2017, the Company had outstanding foreign exchange forward contracts which were designated as either cash flow hedges or non-designated hedges. The contract maturity dates of these foreign exchange forward contracts do not exceed 12 months. In addition, the Company had outstanding interest rate swaps which were designated as cash flow hedges. The Company determined the ineffectiveness associated with its cash flow hedges to be immaterial to the Condensed Consolidated Financial Statements for the three and six months ended December 29, 2017 and December 30, 2016.

As of December 29, 2017, the amount of existing net gains related to cash flow hedges recorded in AOCI that are expected to be reclassified into earnings over the next twelve months was \$8 million. In addition, as of December 29, 2017, the Company did not have any foreign exchange forward contracts with credit-risk-related contingent features.

A change in the fair value of non-designated hedges is recognized in earnings in the period incurred and is reported as a component of Other income (expense), net. The changes in fair value on these contracts were immaterial to the Condensed Consolidated Financial Statements for the three and six months ended December 29, 2017 and December 30, 2016.

Derivative Instruments

The fair value and balance sheet location of the Company's derivative instruments were as follows:

| | Derivative Assets | |
|--|-------------------------|------------------|
| | Other current assets | |
| | December 29, 2017 | June 30, 2017 |
| | (in millions) | |
| Foreign exchange forward contracts, designated | \$ 6 | \$ 6 |
| Foreign exchange forward contracts, not designated | 5 | 10 |
| Interest rate swaps, designated | 8 | — |
| Total derivatives | \$ 19 | \$ 16 |

| | Derivative Liabilities | |
|--|---------------------------|------------------|
| | Accrued expenses | |
| | December 29, 2017 | June 30, 2017 |
| | (in millions) | |
| Foreign exchange forward contracts, designated | \$ 4 | \$ 2 |
| Foreign exchange forward contracts, not designated | 3 | 6 |
| Interest rate swaps, designated | — | 1 |
| Total derivatives | \$ 7 | \$ 9 |

Netting Arrangements

Under certain provisions and conditions within agreements with counterparties to the Company's foreign exchange forward contracts, subject to applicable requirements, the Company has the right of offset associated with the Company's foreign exchange forward contracts and is allowed to net settle transactions of the same currency with a single net amount payable by one party to the other. As of December 29, 2017 and June 30, 2017, the effect of rights of offset was not material and the Company did not offset or net the fair value amounts of derivative instruments in its Condensed Consolidated Balance Sheets.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Effect of Derivative Contracts on the Condensed Consolidated Statements of Operations

The impact of derivative contracts designated as hedging instruments on the Condensed Consolidated Financial Statements was as follows:

| | Amount of Gain (Loss) Recognized in AOCI Three Months Ended December 30, 2017 | Amount of Gain (Loss) Recognized in AOCI Six Months Ended December 30, 2017 | Amount of Gain (Loss) Recognized in AOCI Three Months Ended December 30, 2016 | Amount of Gain (Loss) Recognized in AOCI Six Months Ended December 30, 2016 |
|--|---|--|---|--|
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | \$7 \$ (119) | \$7 \$ (97) | | |
| Interest rate swaps | 7 — | 8 — | | |
| Total | \$14 \$ (119) | \$15 \$ (97) | | |

(in millions)

| | Amount of Gain (Loss) Reclassified from AOCI into Earnings Three Months Ended December 30, 2017 | Amount of Gain (Loss) Reclassified from AOCI into Earnings Six Months Ended December 30, 2017 | Amount of Gain (Loss) Reclassified from AOCI into Earnings Three Months Ended December 30, 2016 | Amount of Gain (Loss) Reclassified from AOCI into Earnings Six Months Ended December 30, 2016 |
|--|---|---|---|---|
| Derivatives designated as hedging instruments: | | | | |
| Foreign exchange forward contracts | \$4 \$ 16 | \$ 1 \$ 42 | | |
| Total | \$4 \$ 16 | \$ 1 \$ 42 | | |

(in millions)

The total net realized transaction and foreign exchange forward contract currency gains and losses were not material to the Condensed Consolidated Financial Statements for the three and six months ended December 29, 2017 and December 30, 2016.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 6. Debt

Debt consisted of the following as of December 29, 2017 and June 30, 2017:

| | December 29, 2017 | June 30, 2017 |
|--|----------------------|------------------|
| | (in millions) | |
| Variable interest rate Term Loan A maturing 2021 | \$4,022 | \$4,125 |
| Variable interest rate U.S. Term Loan B-2 maturing 2023 | — | 2,970 |
| Variable interest rate U.S. Term Loan B-3 maturing 2023 | 2,955 | — |
| Variable interest rate Euro Term Loan B-2 maturing 2023 ⁽¹⁾ | — | 1,001 |
| 7.375% senior secured notes due 2023 | 1,875 | 1,875 |
| 10.500% senior unsecured notes due 2024 | 3,350 | 3,350 |
| Convertible senior notes | 35 | 35 |
| Total debt | 12,237 | 13,356 |
| Issuance costs and debt discounts | (186) | (205) |
| Subtotal | 12,051 | 13,151 |
| Less current portion of long-term debt | (274) | (233) |
| Long-term debt | \$11,777 | \$12,918 |

⁽¹⁾ Euro Term Loan B-2 outstanding principal amount as of June 30, 2017 was based upon the Euro to U.S. dollar exchange rate as of that respective date.

On November 29, 2017, the Company entered into an amendment to the credit agreement entered into on April 29, 2016 (as amended, the “Credit Agreement”), to increase the size of its existing \$1.0 billion revolving credit facility by \$500 million to \$1.5 billion. The term of the revolving credit facility remained unchanged and will mature on April 29, 2021. As of December 29, 2017, there were no borrowings under the revolving credit facility.

On November 17, 2017, the Company settled in full the principal amounts of the Euro Term Loan B-2, plus accrued interest, using cash on hand. On November 8, 2017, the Company borrowed \$2.96 billion under a new U.S. dollar-denominated term loan (“U.S. Term Loan B-3”) under its Credit Agreement and used the proceeds of this new loan to prepay in full the U.S. Term Loan B-2 previously outstanding under the Credit Agreement. The U.S. Term Loan B-3 has an interest rate equal to, at the Company’s option, either an adjusted LIBOR rate, subject to a 0.00% floor, plus 2.00% or a base rate plus 1.00% (3.57% as of December 29, 2017). Principal payments on U.S. Term Loan B-3 of 0.25% are due quarterly and began on December 29, 2017 with the balance due on April 29, 2023. The U.S. Term Loan B-3 issuance costs are amortized to interest expense over the term of the loan and as of December 29, 2017, issuance costs of \$3 million remain unamortized. In connection with the settlements of the U.S. Term Loan B-2 and Euro Term Loan B-2, the Company recognized an aggregate loss on debt extinguishment of \$2 million consisting of unamortized issuance costs.

The Credit Agreement requires the Company to comply with certain financial covenants, such as a leverage ratio and an interest coverage ratio. As of December 29, 2017, the Company was in compliance with all financial covenants. In addition, the documents governing substantially all of the Company’s outstanding debt, including the Credit Agreement, require the Company to comply with customary covenants that limit or restrict the Company’s and its subsidiaries’ ability to incur liens and indebtedness; make certain restricted payments, acquisitions, investments, loans and guarantees; and enter into certain transactions with affiliates, mergers and consolidations.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 7. Pension and Other Post-Retirement Benefit Plans

The Company has pension and other post-retirement benefit plans in various countries. The Company's principal pension plans are in Japan. All pension and other post-retirement benefit plans outside of the Company's Japanese defined benefit pension plan (the "Japanese Plan") are immaterial to the Condensed Consolidated Financial Statements. The expected long-term rate of return on the Japanese Plan assets is 2.5%.

Obligations and Funded Status

The following table presents the unfunded status of the benefit obligations for the Japanese Plan:

| | December 31, 2017 | |
|---------------------------|-------------------|--------|
| | 2017 | 2017 |
| | (in millions) | |
| Benefit obligations | \$ 249 | \$ 249 |
| Fair value of plan assets | 192 | 189 |
| Unfunded status | \$ 57 | \$ 60 |

The following table presents the unfunded amounts related to the Japanese Plan as recognized on the Company's Condensed Consolidated Balance Sheets:

| | December 31, 2017 | |
|-------------------------|-------------------|-------|
| | 2017 | 2017 |
| | (in millions) | |
| Current liabilities | \$ 1 | \$ 1 |
| Non-current liabilities | 56 | 59 |
| Net amount recognized | \$ 57 | \$ 60 |

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Note 8. Commitments, Contingencies and Related Parties

Flash Ventures

The Company's business ventures with Toshiba Memory Corporation ("TMC") consist of three separate legal entities: Flash Partners Ltd. ("Flash Partners"), Flash Alliance Ltd. ("Flash Alliance"), and Flash Forward Ltd. ("Flash Forward"), collectively referred to as "Flash Ventures".

In connection with a settlement agreement with Toshiba, in December 2017, the Company entered into a facility agreement ("Y6 Facility Agreement") with TMC related to the construction and operation of a new 300-millimeter wafer fabrication facility in Yokkaichi, Japan, referred to as "Fab 6", which is primarily intended to provide cleanroom space to continue the transition of existing 2D NAND manufacturing capacity to BiCS 3D NAND manufacturing capacity. Under the Y6 Facility Agreement, the Company is committed to 50% of Fab 6's start-up costs, as well as 50% of the joint ventures' portion of an upcoming investment in manufacturing equipment for Fab 6. See also Note 13, Legal Proceedings.

The following table presents the notes receivable from, and equity investments in, Flash Ventures as of December 29, 2017 and June 30, 2017:

| | December 29, 2017 | |
|--|-------------------|---------|
| | 2017 | 2017 |
| | (in millions) | |
| Notes receivable, Flash Partners | \$737 | \$264 |
| Notes receivable, Flash Alliance | 101 | 119 |
| Notes receivable, Flash Forward | 429 | 379 |
| Investment in Flash Partners | 187 | 187 |
| Investment in Flash Alliance | 279 | 279 |
| Investment in Flash Forward | 112 | 112 |
| Total notes receivable and investments in Flash Ventures | \$1,845 | \$1,340 |

During the three and six months ended December 29, 2017, the Company made net payments to Flash Ventures of \$1.2 billion and \$2.0 billion, respectively, for purchased flash-based memory wafers and net loans.

The Company makes, or will make, loans to Flash Ventures to fund equipment investments for new process technologies and additional wafer capacity. The Company aggregates its Flash Ventures' notes receivable into one class of financing receivables due to the similar ownership interest and common structure in each Flash Venture entity. For all reporting periods presented, no loans were past due and no loan impairments were recorded. The Company's notes receivable from each Flash Ventures entity, denominated in Japanese yen, are secured by equipment owned by that Flash Ventures entity.

The Company assesses financing receivable credit quality through financial and operational reviews of the borrower and creditworthiness, including credit rating agency ratings, of significant investors of the borrower, where material or known. Impairments, when required for credit worthiness, are recorded in Other income (expense), net in the Condensed Consolidated Statements of Operations. There were no such impairments in the three and six months ended December 29, 2017 and December 30, 2016.

As of December 29, 2017 and June 30, 2017, the Company had accounts payable balances due to Flash Ventures of \$250 million and \$206 million, respectively.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

The Company's maximum reasonably estimable loss exposure (excluding lost profits) as a result of its involvement with Flash Ventures, based upon the Japanese yen to U.S. dollar exchange rate at December 29, 2017, is presented below. Investments in Flash Ventures are denominated in Japanese yen and the maximum possible loss exposure excludes any cumulative translation adjustment due to revaluation from the Japanese yen to the U.S. dollar.

December 29,
 2017

| | |
|---------------------------------|----------|
| Notes receivable | \$ 1,267 |
| Equity investments | 578 |
| Operating lease guarantees | 941 |
| Inventory and prepayments | 268 |
| Maximum estimable loss exposure | \$ 3,054 |

The Company is committed to purchase its provided three-month forecast of Flash Ventures' NAND wafer supply, which generally equals 50% of Flash Ventures' output. The Company is not able to estimate its total wafer purchase commitment obligation beyond its rolling three-month purchase commitment because the price is determined by reference to the future cost of producing the semiconductor wafers. In addition, the Company is committed to fund 49.9% to 50.0% of each Flash Ventures entity's investments to the extent that each Flash Ventures entity's operating cash flow is insufficient to fund these investments.

Off-Balance Sheet Liabilities

Flash Ventures sells and leases back from a consortium of financial institutions a portion of its tools and has entered into equipment lease agreements of which the Company guarantees half of the total outstanding obligations. The lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the lease agreements contain acceleration clauses for certain events of default related to the guarantors, including the Company.

The following table presents the Company's portion of the remaining guarantee obligations under the Flash Ventures' lease facilities in both Japanese yen and U.S. dollar-equivalent, based upon the Japanese yen to U.S. dollar exchange rate as of December 29, 2017.

| | Lease Amounts |
|-----------------------------|-----------------------------|
| | (Japanese yen, in billions) |
| | (U.S. dollar, in millions) |
| Total guarantee obligations | ¥106 \$ 941 |

The following table details the breakdown of the Company's remaining guarantee obligations between the principal amortization and the purchase option exercise price at the end of the term of the Flash Ventures lease agreements, in annual installments as of December 29, 2017 in U.S. dollars, based upon the Japanese yen to U.S. dollar exchange rate as of December 29, 2017:

| Annual Installments | Payment of Principal | Purchase Option Exercise | Guarantee Amount |
|---------------------|----------------------|--------------------------|------------------|
|---------------------|----------------------|--------------------------|------------------|

| | Amortization | Final Lease Terms | Proration |
|-----------------------------|---------------|-------------------|-----------|
| | (in millions) | | |
| Year 1 | \$267 | \$ — | \$ 267 |
| Year 2 | 178 | 34 | 212 |
| Year 3 | 163 | 85 | 248 |
| Year 4 | 80 | 98 | 178 |
| Year 5 | 15 | 21 | 36 |
| Total guarantee obligations | \$703 | \$ 238 | \$ 941 |

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

The Company and TMC have agreed to mutually contribute to, and indemnify each other and Flash Ventures for, environmental remediation costs or liability resulting from Flash Ventures' manufacturing operations in certain circumstances. The Company has not made any indemnification payments, nor recorded any indemnification receivables, under any such agreements. As of December 29, 2017, no amounts have been accrued in the Condensed Consolidated Financial Statements with respect to these indemnification agreements.

23

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 9. Shareholders' Equity

Stock-based Compensation Expense

The following tables present the Company's stock-based compensation for equity-settled awards by type and financial statement line as well as the related tax benefit included in the Company's Condensed Consolidated Statements of Operations:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | December 29, 2017 | December 30, 2016 | December 29, 2017 | December 30, 2016 |
| | (in millions) | | | |
| Options | \$6 | \$ 11 | \$13 | \$ 23 |
| Restricted and performance stock units | 88 | 90 | 171 | 169 |
| Employee stock purchase plan | 5 | 1 | 12 | 9 |
| Subtotal | 99 | 102 | 196 | 201 |
| Tax benefit | (10) | (29) | (34) | (54) |
| Total | \$89 | \$ 73 | \$162 | \$ 147 |

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------------------|-------------------|-------------------|
| | December 29, 2017 | December 30, 2016 | December 29, 2017 | December 30, 2016 |
| | (in millions) | | | |
| Cost of revenue | \$13 | \$ 11 | \$26 | \$ 24 |
| Research and development | 45 | 43 | 89 | 87 |
| Selling, general and administrative | 41 | 43 | 81 | 85 |
| Employee termination, asset impairment, and other charges | — | 5 | — | 5 |
| Subtotal | 99 | 102 | 196 | 201 |
| Tax benefit | (10) | (29) | (34) | (54) |
| Total | \$89 | \$ 73 | \$162 | \$ 147 |

Compensation cost related to unvested stock options, restricted stock unit awards ("RSU"), performance-based restricted stock unit awards ("PSU") and the Company's Employee Stock Purchase Plan ("ESPP") will generally be amortized on a straight-line basis over the remaining average service period. The following table presents the unamortized compensation cost and weighted average service period of all unvested outstanding awards as of December 29, 2017.

| | Unamortized Compensation Costs | Weighted Average Service Period |
|-------------------------------------|--------------------------------|---------------------------------|
| | (in millions) | (years) |
| Options | \$ 38 | 2.1 |
| RSUs and PSUs ⁽¹⁾ | 600 | 2.2 |
| ESPP | 15 | 0.6 |
| Total unamortized compensation cost | \$ 653 | |

(1) Weighted average service period assumes the performance metrics are met for the PSUs.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Plan Activities

Stock Options

The following table summarizes stock option activity under the Company's incentive plans:

| | Number of Shares (in millions) | Weighted Average Exercise Price Per Share | Weighted Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value (in millions) |
|---|--|---|--|--|
| Options outstanding at June 30, 2017 | 7.4 | \$ 58.14 | | |
| Exercised | (1.0) | 43.16 | | \$ 46 |
| Canceled or expired | (0.2) | 63.44 | | |
| Options outstanding at December 29, 2017 | 6.2 | \$ 60.39 | 4.1 | \$ 145 |
| Exercisable at December 29, 2017 | 3.6 | \$ 64.14 | 3.4 | \$ 77 |

RSU and PSU

The following table summarizes RSU and PSU activity under the Company's incentive plans:

| | Number of Shares (in millions) | Weighted Average Grant Date Fair Value | Aggregate Intrinsic Value at Vest Date (in millions) |
|--|---|--|---|
| RSUs and PSUs outstanding at June 30, 2017 | 13.7 | \$ 45.01 | |
| Granted | 4.0 | 84.95 | |
| Vested | (2.4) | 53.31 | \$ 206 |
| Forfeited | (0.7) | 47.75 | |
| RSUs and PSUs outstanding at December 29, 2017 | 14.6 | \$ 53.41 | |

RSUs and PSUs are generally settled in an equal number of shares of the Company's common stock at the time of vesting of the units.

Stock Repurchase Program

The Company's Board of Directors (the "Board") has authorized \$5.00 billion for the repurchase of the Company's common stock. The stock repurchase program is effective until February 3, 2020. The Company did not repurchase any shares of common stock during the three months ended December 29, 2017. The remaining amount available to be purchased under the Company's stock repurchase program as of December 29, 2017 was \$2.10 billion.

Dividends to Shareholders

On September 13, 2012, the Company announced that the Board had authorized the adoption of a quarterly cash dividend policy. Under the cash dividend policy, holders of the Company's common stock receive dividends when and as declared by the Board.

On November 1, 2017, the Board declared a cash dividend of \$0.50 per share of the Company's common stock. The cash dividend aggregating \$149 million was paid on January 16, 2018 to the Company's shareholders of record as of December 29, 2017. On January 27, 2018, the Board declared a cash dividend of \$0.50 per share to shareholders of record as of March 30, 2018, which will be paid on April 16, 2018. The Company may modify, suspend or cancel its cash dividend policy in any manner and at any time.

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Note 10. Income Tax Expense

The Tax Cuts and Jobs Act (“2017 Act”) was enacted on December 22, 2017. The 2017 Act includes a broad range of tax reform proposals affecting businesses, including a reduction in the U.S. federal corporate tax rate from 35% to 21%, a one-time mandatory deemed repatriation tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign earnings.

For the three and six months ended December 29, 2017, the Company has not finalized the accounting for the tax effects of the enactment of the 2017 Act. However, consistent with applicable SEC guidance, the Company has made a reasonable estimate of the effects on the Company’s existing deferred tax balances and the one-time mandatory deemed repatriation tax required by the 2017 Act and has recognized a provisional income tax expense of \$1.66 billion for the one-time mandatory deemed repatriation tax and a provisional income tax benefit of \$88 million related to the re-measurement of deferred tax assets and liabilities for the three and six months ended December 29, 2017. For other elements of tax expense noted below, or where the Company has not made an election, the Company has not been able to make a reasonable estimate and continues to account for such items based on the provisions of the tax laws that were in effect immediately prior to the 2017 Act. As the Company finalizes the accounting for the tax effects of the enactment of the 2017 Act during a one-year measurement period permitted by applicable SEC guidance, the Company expects to reflect adjustments to the recorded provisional amounts and record additional tax effects of the 2017 Act.

Additional information regarding the significant provisions of the 2017 Act that are expected to impact the Company is provided below.

Re-measurement of deferred taxes

The provisional income tax benefit of \$88 million recorded for the three and six months ended December 29, 2017 related to the re-measurement of the Company’s deferred tax balance is based on the rates at which the deferred tax assets and liabilities are expected to reverse in the current and future fiscal years, which are generally 29% and 22%, respectively. However, the Company is still analyzing certain aspects of the 2017 Act and refining the calculations, which could potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts. The Company is also analyzing the impact of the 2017 Act to the existing valuation allowance assessments from both a federal and state tax perspective, which could potentially affect the realizability of the existing deferred tax assets. In calculating the provisional amount, the Company utilized an estimate of the expected reversals of certain tax assets and liabilities, which will be revised in future quarters during the one-year measurement period as additional information becomes available.

Mandatory deemed repatriation tax

In connection with the transition from a global to a territorial U.S. tax system, companies are required to pay a mandatory deemed repatriation tax. The tax is to be computed using the Company’s total foreign post-1986 earnings and profits that were previously deferred from U.S. income taxes. This tax is based on the amount of foreign earnings held in cash and other specified assets which are taxed at 15.5% and 8%, respectively, and is payable over an 8-year period. For the three and six months ended December 29, 2017, the Company recorded a provisional amount for the mandatory deemed repatriation tax liability of \$1.66 billion for foreign subsidiaries and \$132 million of this amount is classified as a current tax liability. The calculation of the mandatory deemed repatriation tax liability is provisional

and based upon preliminary estimates of post-1986 earnings and profits. In addition, the mandatory deemed repatriation tax is based on a provisional amount of foreign earnings held in cash and other specified assets, which the Company expects will require additional clarifying guidance from U.S. Treasury. As such, the provisional amount may change during the one-year measurement period when the Company finalizes the calculation of post-1986 foreign earnings and profits and the amount of foreign earnings held in cash or other specified assets.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Although the mandatory deemed repatriation tax has removed U.S. federal taxes on distributions to the U.S., the Company continues to evaluate the expected manner of recovery to determine whether or not to continue to assert indefinite reinvestment on a part or all the foreign undistributed earnings. This requires the Company to re-evaluate the existing short and long-term capital allocation policies in light of the 2017 Act and calculate the tax cost that is incremental to the deemed repatriation tax, (e.g. foreign withholding, state income taxes, and additional U.S. tax on currency transaction gains or losses) of repatriating cash to the U.S. While the provisional tax expense for the three and six months ended December 29, 2017 is based upon an assumption that foreign undistributed earnings are indefinitely reinvested, the Company's plan may change upon the completion of long-term capital allocation plans in light of the 2017 Act and completion of the calculation of the incremental tax effects on the repatriation of foreign undistributed earnings. In the event the Company determines not to continue to assert the permanent reinvestment of part or all of foreign undistributed earnings, such a determination could result in the accrual and payment of additional foreign, state and local taxes.

Deferred taxes on foreign earnings

As a result of the shift to a territorial system for U.S. taxation, the new minimum tax on certain foreign earnings ("global intangible low-tax income") provision of the 2017 Act imposes a tax on foreign earnings and profits in excess of a deemed return on tangible assets of foreign subsidiaries. This provision is effective for tax years beginning on or after January 1, 2018 which for the Company would be the fiscal year beginning on June 30, 2018 (fiscal year 2019). The Company has not progressed sufficiently in the analysis of this provision to make an election either to account for the effects of this provision either as a component of future income tax expense in the period the tax arises or as a component of deferred taxes on the related investments. Accordingly, no deferred tax assets and liabilities have been established for timing differences between foreign U.S. GAAP income and foreign earnings and profits which would be expected to reverse under the new minimum tax in future years. Additionally, the Company has not yet completed the calculation of post-1986 foreign earnings and profits for the mandatory repatriation tax, which would be the starting point for the measurement of deferred tax assets and liabilities in order to record any provisional amounts.

The following table presents the Company's income tax expense and the effective tax rate, which reflect provisional amounts related to the mandatory deemed repatriation tax and re-measurement of deferred tax assets and liabilities pursuant to the 2017 Act as discussed above:

| | Three Months Ended | | Six Months Ended | |
|---------------------|--------------------|--------|-------------------|--------|
| | December 29, 2017 | | December 30, 2016 | |
| | 2017 | 2016 | 2017 | 2016 |
| | (in millions) | | | |
| Income before taxes | \$ 774 | \$ 321 | \$ 1,484 | \$ 50 |
| Income tax expense | \$ 1,597 | \$ 86 | \$ 1,626 | \$ 181 |
| Effective tax rate | 206 | % 27 | % 110 | % 362 |

Under the 2017 Act, the reduction of the U.S. federal corporate tax rate from 35% to 21% is effective January 1, 2018 requiring companies to use a blended rate for its fiscal 2018 tax year by applying a pro-rated percentage of the number of days before and after the January 1, 2018 effective date. This results in the use of an estimated annual effective rate of approximately 28% for the Company's U.S. federal corporate tax rate for fiscal year 2018. The reduction in the U.S. federal corporate tax rate from 35% to the blended tax rate of 28% for fiscal year 2018 is estimated to have reduced the Company's income tax expense by \$7 million for the three and six months ended December 29, 2017. For fiscal

year 2019 and beyond, the Company will utilize the enacted U.S. federal corporate tax rate of 21%.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

The primary drivers for the difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are related to the net charge of \$1.66 billion for the one-time mandatory deemed repatriation tax, offset in part by an income tax benefit related to the re-measurement of deferred taxes as required by the 2017 Act. Excluding these items, the effective tax rate for the three and six months ended December 29, 2017 would be approximately 4%. The primary drivers for the remaining difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are the current year generation of tax credits, and tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates during fiscal years 2018 through 2030 and windfall tax benefits related to vesting and exercises of stock-based awards. The windfall tax benefits are a result of the adoption of ASU 2016-09, which requires the Company to now recognize \$5 million and \$27 million of windfall tax benefits related to vesting and exercises of stock-based awards as a component of its income tax expense for the three and six months ended December 29, 2017, respectively. The windfall tax benefits for the three and six months ended December 30, 2016 were recorded within stockholders' equity.

Income tax expense for the six months ended December 30, 2016 was attributable to discrete effects consisting of income tax expense from the integration of SanDisk Corporation ("SanDisk") of \$90 million and a valuation allowance on acquired tax attributes of \$109 million, partially offset by income tax benefit from deductible debt issuance costs, debt discounts and prepayment fees from the debt extinguishment of \$96 million. The primary drivers for the difference between the effective tax rate for the six months ended December 30, 2016 and the U.S. Federal statutory rate of 35% are these discrete items, the current year generation of tax credits and tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates during fiscal years 2018 through 2030.

During the six months ended December 29, 2017, the Company recorded a net increase of \$7 million in its liability for unrecognized tax benefits (excluding accrued interest and penalties). As of December 29, 2017, the Company's liability for unrecognized tax benefits (excluding accrued interest and penalties) was approximately \$529 million. Accrued interest and penalties related to unrecognized tax benefits as of December 29, 2017 was approximately \$94 million.

The Internal Revenue Service ("IRS") previously completed its field examination of the Company's federal income tax returns for fiscal years 2006 through 2009 and proposed certain adjustments. The Company received Revenue Agent Reports from the IRS that seek to increase the Company's U.S. taxable income which would result in additional federal tax expense totaling \$795 million, subject to interest. The issues in dispute relate primarily to transfer pricing with the Company's foreign subsidiaries and intercompany payable balances. The Company disagrees with the proposed adjustments and in September 2015, filed a protest with the IRS Appeals Office and received the IRS rebuttal in July 2016. Meetings with the IRS Appeals Office began in March 2017. The Company believes that its tax positions are properly supported and will vigorously contest the position taken by the IRS. In September 2015, the IRS commenced an examination of the Company's fiscal years 2010 through 2012.

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax examinations cannot be predicted with certainty. If any issues addressed in the Company's tax examinations are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of December 29, 2017, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company's liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the

examination of the Company's tax returns.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 11. Net Income (Loss) Per Common Share

The following table presents the computation of basic and diluted income (loss) per common share:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------------------------|-------------------|-------------------|-------------------|
| | December 31, 2017 | December 31, 2016 | December 31, 2017 | December 31, 2016 |
| | (in millions, except per share data) | | | |
| Net income (loss) | \$(823) | \$ 235 | \$(142) | \$ (131) |
| Weighted average shares outstanding: | | | | |
| Basic | 296 | 286 | 295 | 285 |
| Employee stock options, RSUs, PSUs and ESPP | — | 8 | — | — |
| Diluted | 296 | 294 | 295 | 285 |
| Income (loss) per common share | | | | |
| Basic | \$(2.78) | \$ 0.82 | \$(0.48) | \$ (0.46) |
| Diluted | \$(2.78) | \$ 0.80 | \$(0.48) | \$ (0.46) |
| Anti-dilutive potential common shares excluded ⁽¹⁾ | 12 | 5 | 12 | 13 |

⁽¹⁾ For purposes of computing diluted income (loss) per common share, certain potentially dilutive securities have been excluded from the calculation because their effect would have been anti-dilutive.

The Company computes basic income (loss) per common share using net income (loss) and the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is computed using net income (loss) and the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include dilutive outstanding employee stock options, RSUs and PSUs, and rights to purchase shares of common stock under the Company's ESPP.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Note 12. Employee Termination, Asset Impairment and Other Charges

The Company recorded the following charges related to employee terminations benefits, asset impairment, and other charges:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-------------------|-------------------|-------------------|
| | December 31, 2017 | December 31, 2016 | December 29, 2017 | December 31, 2016 |
| | (in millions) | | | |
| Employee termination and other charges: | | | | |
| Restructuring Plan 2016 | \$ 32 | \$ 19 | \$ 77 | \$ 46 |
| Closure of Foreign Manufacturing Facility | — | 2 | — | 6 |
| Business Realignment | 16 | 7 | 23 | 44 |
| Total employee termination and other charges | 48 | 28 | \$ 100 | \$ 96 |
| Stock-based compensation accelerations and adjustments | | | | |
| Business Realignment | — | 3 | — | 4 |
| Total stock-based compensation accelerations and adjustments | — | 4 | — | 4 |
| Asset impairment: | | | | |
| Closure of Foreign Manufacturing Facility | — | 13 | — | 13 |
| Total asset impairment | — | 13 | — | 13 |
| Total employee termination and other charges, and stock-based compensation accelerations and adjustments | \$ 48 | \$ 45 | \$ 100 | \$ 113 |

Restructuring Plan 2016

In 2016, the Company initiated a set of actions relating to the restructuring plan associated with the integration of substantial portions of its HGST and WD subsidiaries (“Restructuring Plan 2016”). Restructuring Plan 2016 consists of asset and footprint reduction, product road map consolidation and organization rationalization. In addition to the amounts recognized under Restructuring Plan 2016 as presented above, the Company recognized \$8 million and \$30 million of accelerated depreciation on facility assets in cost of revenue during the six months ended December 29, 2017 and December 31, 2016, respectively.

The following table presents an analysis of the components of the activity against the reserve during the six months ended December 29, 2017:

| | Employee Termination Benefits | Contract Termination and Other | Total |
|----------------------------------|-------------------------------|--------------------------------|-------|
| | (in millions) | | |
| Accrual balance at June 30, 2017 | \$ 11 | \$ 2 | \$ 13 |
| Charges | 58 | 19 | 77 |
| Cash payments | (49) | (10) | (59) |

| | | | |
|---|-------|-------|-------|
| Accrual balance at December 29, 2017 | \$ 20 | \$ 11 | \$ 31 |
|---|-------|-------|-------|

30

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Business Realignment

The Company periodically incurs charges as part of the integration process of recent acquisitions and to realign its operations with anticipated market demand. The following table presents an analysis of the components of the activity against the reserve:

| | Employee Termination Benefits (in millions) | Contract Termination and Other | Total |
|---|--|--------------------------------------|-------|
| Accrual balance at June 30, 2017 | \$ 18 | \$ 5 | \$ 23 |
| Charges | 17 | 6 | 23 |
| Cash payments | (14) | (4) | (18) |
| Accrual balance at December 29, 2017 | \$ 21 | \$ 7 | \$ 28 |

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Note 13. Legal Proceedings

Unless otherwise stated below, for each of the matters described below, the Company has either recorded an accrual for losses that are probable and reasonably estimable or has determined that, while a loss is reasonably possible (including potential losses in excess of the amounts accrued by the Company), a reasonable estimate of the amount of loss or range of possible losses with respect to the claim or in excess of amounts already accrued by the Company cannot be made. The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

Solely for purposes of this note, "WD" refers to Western Digital Corporation or one or more of its subsidiaries excluding HGST prior to the closing of the Company's acquisition of HGST on March 8, 2012 (the "HGST Closing Date") and SanDisk prior to the closing of the Company's acquisition of SanDisk on May 12, 2016 (the "SanDisk Closing Date"); "HGST" refers to Hitachi Global Storage Technologies Holdings Pte. Ltd. or one or more of its subsidiaries as of the HGST Closing Date; "SanDisk" refers to SanDisk Corporation or one or more of its subsidiaries as of the SanDisk Closing Date; and "the Company" refers to Western Digital Corporation and all of its subsidiaries on a consolidated basis including HGST and SanDisk.

Intellectual Property Litigation

In June 2008, Convolve, Inc. ("Convolve") filed a complaint with the U.S. District Court for the Eastern District of Texas against WD, HGST, and two other companies alleging infringement of U.S. Patent Nos. 6,314,473 and 4,916,635. The complaint sought unspecified monetary damages and injunctive relief. In October 2008, Convolve amended its complaint to allege infringement of only the '473 patent. The '473 patent allegedly relates to interface technology to select between certain modes of a disk drive's operations relating to speed and noise. In July 2011, a verdict was rendered against WD and HGST in an amount that is not material to the Company's financial position, results of operations or cash flows, for which the Company previously recorded an accrual. In March 2015, WD and HGST filed notices of appeal with the U.S. District Court for the Federal Circuit ("Federal Circuit"). In April 2015, Convolve filed a motion for reconsideration of the final judgment. In June 2017, the District Court vacated the judgment against WD and HGST with respect to infringement, willfulness, and damages and denied Convolve's motion for reconsideration. In December 2017, WD and HGST filed an amended notice of appeal with the Federal Circuit with respect to validity. In January 2018, WD, HGST and Convolve entered into a settlement agreement resolving the litigation and agreeing to seek dismissal of all claims and actions between the parties.

In May 2016, Lambeth Magnetic Structures, LLC ("Lambeth") filed a complaint with the U.S. District Court for the Western District of Pennsylvania against WD and certain of its subsidiaries alleging infringement of U.S. Patent No. 7,128,988. The complaint seeks unspecified monetary damages and injunctive relief. The '988 patent, entitled "Magnetic Material Structures, Devices and Methods," allegedly relates to a magnetic material structure for hard disk drive devices. The Company intends to defend itself vigorously in this matter.

Antitrust

In July 2010, Samsung Electronics Co., Ltd. ("Samsung") filed an action against Panasonic Corporation ("Panasonic") and SD-3C LLC ("SD-3C") with the U.S. District Court for the Northern District of California, alleging that the defendants violated federal antitrust laws and California antitrust and unfair competition laws relating to the licensing practices and operations of SD-3C. The complaint seeks damages, restitution, injunctive and declaratory relief, and fees and

costs. SanDisk is not a defendant in this case, but it established SD-3C along with Panasonic and Toshiba Corporation (“Toshiba”), and the complaint includes various factual allegations concerning SanDisk. As a member of SD-3C, SanDisk could be responsible for a portion of any monetary award. Other requested relief, if granted, could result in a loss of revenue to SanDisk. In November 2015, the defendants filed a motion to dismiss. In September 2016, the District Court stayed the litigation pending the outcome of an ongoing arbitration between Samsung and Toshiba. The District Court denied the motion to dismiss without prejudice to refile after the stay is lifted. The arbitration between Samsung and Toshiba was concluded in May 2017. In October 2017, the District Court issued an order directing Samsung and Toshiba to seek clarification from the arbitration panel regarding certain aspects of its decision.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

In March 2011, a complaint was filed against SanDisk, SD-3C, Panasonic, Panasonic Corporation of North America, Toshiba and Toshiba America Electronic Components, Inc. with the U.S. District Court for the Northern District of California. The lawsuit purports to be on behalf of a nationwide class of indirect purchasers of SD cards. The complaint asserts claims under federal antitrust laws and California antitrust and unfair competition laws, as well as common law claims. The complaint seeks damages, restitution, injunctive relief, and fees and costs. The plaintiffs allege that the defendants conspired to artificially inflate the royalty costs associated with manufacturing SD cards, which in turn allegedly caused the plaintiffs to pay higher prices for SD cards. The allegations are similar to and incorporate allegations in *Samsung Electronics Co., Ltd. v. Panasonic Corp., et al.*, described above. In November 2015, the defendants filed a motion to dismiss the plaintiffs' federal law claims. In October 2016, the District Court granted the defendants' motion with leave to amend and the defendants filed a motion to dismiss the plaintiffs' remaining claims. Discovery is presently stayed until after completion of the pleading stage. The Company intends to defend itself vigorously in this matter.

Securities

Beginning in March 2015, SanDisk and two of its officers, Sanjay Mehrotra and Judy Bruner, were named in three putative class action lawsuits filed with the U.S. District Court for the Northern District of California. Two complaints are allegedly brought on behalf of a class of purchasers of SanDisk's securities between October 2014 and March 2015, and one is brought on behalf of a purported class of purchasers of SanDisk's securities between April 2014 and April 2015. The complaints generally allege violations of federal securities laws arising out of alleged misstatements or omissions by the defendants during the alleged class periods. The complaints seek, among other things, damages and fees and costs. In July 2015, the District Court consolidated the cases and appointed Union Asset Management Holding AG and KBC Asset Management NV as lead plaintiffs. The lead plaintiffs filed an amended complaint in August 2015. In January 2016, the District Court granted the defendants' motion to dismiss and dismissed the amended complaint with leave to amend. In February 2016, the District Court issued an order appointing as new lead plaintiffs Bristol Pension Fund; City of Milford, Connecticut Pension & Retirement Board; Pavers and Road Builders Pension, Annuity and Welfare Funds; the Newport News Employees' Retirement Fund; and Massachusetts Laborers' Pension Fund (collectively, the "Institutional Investor Group"). In March 2016, the Institutional Investor Group filed an amended complaint. In June 2016, the District Court granted the defendants' motion to dismiss and dismissed the amended complaint with leave to amend. In July 2016, the Institutional Investor Group filed a further amended complaint. In June 2017, the District Court denied the defendants' motion to dismiss. The Company intends to defend itself vigorously in this matter.

Toshiba Matters

In December 2017, the Company entered into a Confidential Settlement and Mutual Release Agreement (the "Toshiba Settlement Agreement") with Toshiba and TMC. Under the Toshiba Settlement Agreement, the parties agreed to withdraw and seek dismissal of the litigation and arbitration proceedings discussed below. Further information about the Toshiba Settlement Agreement is set forth below under "Settlement Agreement."

Proceedings

In July 2017, the Company received a petition for provisional disposition that was filed by Toshiba and TMC in the Tokyo District Court. The petition alleged that the Company engaged in acts of defamation and wrongful acquisition and use of trade secrets in violation of the Unfair Competition Prevention Act. The petition requested injunctive relief.

In August 2017, the Company received a complaint filed by Toshiba and TMC in the Tokyo District Court seeking a permanent injunction and damages of 120 billion Japanese yen. The complaint was based on the same allegations as the petition for provisional disposition.

In May 2017, several of the Company's SanDisk subsidiaries (the "SanDisk Subsidiaries") filed a request for arbitration with the ICC International Court of Arbitration seeking an order requiring Toshiba to unwind the transfer of its interests in Flash Ventures to its affiliate, TMC, and injunctive relief preventing Toshiba from further breaching the Flash Ventures agreements in violation of the SanDisk Subsidiaries' consent rights. In June 2017, the SanDisk Subsidiaries sought preliminary injunctive relief in the Superior Court of the State of California for the County of San Francisco in aid of that arbitration. Among other things, SanDisk asked the Superior Court to prevent Toshiba from transferring its interests in Flash Ventures until the SanDisk Subsidiaries could seek injunctive relief in the arbitration to prevent a transfer.

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

In July 2017, SanDisk LLC filed a request for arbitration with the ICC International Court of Arbitration against Toshiba seeking damages and injunctive relief for, among other things, blocking certain employees of SanDisk's affiliates from accessing shared databases regarding Flash Ventures and from refusing to ship certain engineering wafers and samples to SanDisk's affiliates in breach of the agreements governing the joint venture (the "Access Restrictions"). SanDisk LLC also sought injunctive relief, a preliminary injunction and a temporary restraining order, in aid of that arbitration from the Superior Court of the State of California for the County of San Francisco. In July 2017, SanDisk LLC amended its request for arbitration to, among other things, add TMC as a defendant.

In September 2017, the SanDisk Subsidiaries filed a request for arbitration with the ICC International Court of Arbitration against Toshiba in relation to Toshiba's announced decision to invest unilaterally in manufacturing equipment for the Fab 6 clean room at the joint venture operations in Yokkaichi, Japan. The SanDisk Subsidiaries sought, among other things, a permanent injunction preventing Toshiba from making unilateral investments in capacity expansions and conversions for 3 dimensional ("3D") NAND technology, which we refer to as BiCS 3D NAND-flash memory, including investments in manufacturing equipment for Fab 6, without first complying with its obligations with respect to giving the SanDisk Subsidiaries the opportunity to make comparable investments.

Settlement Agreement

In December 2017, the Company, the SanDisk Subsidiaries, Toshiba and TMC entered into the Toshiba Settlement Agreement pursuant to which the parties agreed to withdraw and seek dismissal of the proceedings above and mutually release each other from all claims relating to, among other things, (i) the transfer of Toshiba's equity interests in Flash Ventures to TMC, (ii) the Access Restrictions, (iii) TMC's decision to invest unilaterally in Phase I of Fab 6 and (iv) the sale of TMC to K.K. Pangea ("Pangea"), which will be owned, as of the closing of the sale, by certain members of a consortium of investors led by Bain Capital (as defined below). In addition, the Company agreed to consent to the transfer of Toshiba's interests in Flash Ventures to TMC, the assignment of all agreements relating to Flash Ventures by Toshiba to TMC and the sale of TMC to Pangea. Toshiba and TMC have also agreed to end the Access Restrictions. For a period of three years following the closing of the sale of TMC to Pangea, the Company's consent shall be required for any issuance or transfer of equity securities, voting rights or control in TMC by TMC, Toshiba, Bain Capital or their respective affiliates to certain restricted parties, subject to certain limited exceptions. Pursuant to the Toshiba Settlement Agreement, the Company and the SanDisk Subsidiaries also entered into certain other agreements with TMC related to the operation of Flash Ventures, including an agreement regarding the construction and operation of Fab 6 and the extension of the term of Flash Alliance.

In December 2017, the Company and the SanDisk Subsidiaries also entered into a Confidential Settlement Agreement and Mutual Release with Bain Capital Private Equity, L.P., BCPE Pangea Cayman, L.P., BCPE Pangea Cayman2, Ltd., Bain Capital Fund XII, L.P., Bain Capital Asia Fund III, L.P. and Pangea (together, "Bain Capital") on terms substantially similar to the terms of the Toshiba Settlement Agreement, subject to certain transfer restrictions on Bain Capital.

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Copyright

In December 2011, the German Central Organization for Private Copying Rights (Zentralstelle für private Überspielungsrechte) (“ZPÜ”), an organization consisting of several copyright collecting societies, instituted arbitration proceedings against WD’s German subsidiary (“WD Germany”) before the Copyright Arbitration Board (“CAB”) claiming copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce in Germany by WD Germany from January 2008 through December 2010. In February 2013, WD Germany filed a declaratory relief action against ZPÜ in the Higher Regional Court of Munich (the “Higher Court”), seeking an order from the Higher Court to determine the copyright levy issue. In May 2013, ZPÜ filed a counter-claim against WD Germany with the Higher Court, seeking copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce from January 2008 through December 2010 based on tariffs published by ZPÜ in November 2011. In January 2015, the Higher Court ruled in favor of ZPÜ. In its ruling, the Higher Court declared that WD Germany must pay certain levies on certain products which it sold in Germany between January 2008 and December 2010. The judgment specified levy amounts on certain products sold from January 2008 through December 2010 and directed WD Germany to disclose applicable sales data to ZPÜ. The exact amount of the judgment had not been determined. ZPÜ and WD Germany filed appeals with the German Federal Court of Justice in February 2015. In March 2017, the German Federal Court of Justice rendered a judgment affirming ZPÜ’s claim concerning the disclosure of WD Germany’s sales data regarding HDDs sold between January 2008 and December 2010. The German Federal Court of Justice also set aside the Higher Court’s decision on the levy amounts and referred the case back to the Higher Court for further fact finding and decision on the levy amounts. The Company intends to defend itself vigorously in this matter.

In December 2014, ZPÜ submitted a pleading to the CAB seeking copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce in Germany by WD Germany between January 2012 and December 2013. The Company intends to defend itself vigorously in this matter.

The Company has recorded an accrual for German copyright levies in an amount that is not material to the Company’s financial position, results of operations or cash flows; however, it is reasonably possible that the Company could incur losses totaling up to \$177 million, inclusive of amounts accrued, if it does not prevail in this matter.

Other Matters

In the normal course of business, the Company is subject to other legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of probable monetary liability or financial impact with respect to these other matters is subject to many uncertainties, management believes that any monetary liability or financial impact to the Company from these other matters, individually and in the aggregate, would not be material to the Company’s financial condition, results of operations or cash flows. However, any monetary liability and financial impact to the Company from these other matters could differ materially from the Company’s expectations.

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Note 14. Separate Financial Information of Guarantor Subsidiaries

The Company's 10.500% senior unsecured notes due 2024 ("Unsecured Notes") are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis, subject to certain customary guarantor release conditions, by the WD Guarantors (or the "Guarantor Subsidiaries"). The guarantee by a Guarantor Subsidiary will be released in the event of (i) the designation of a Guarantor Subsidiary as an unrestricted subsidiary under the indenture governing the Unsecured Notes, (ii) the release of a Guarantor Subsidiary from its guarantee of indebtedness under the Credit Agreement or other indebtedness that would have required the Guarantor Subsidiary to guarantee the Unsecured Notes, (iii) the sale, issuance or other disposition of capital stock of a Guarantor Subsidiary such that it is no longer a restricted subsidiary under the indenture governing the Unsecured Notes, (iv) the sale of all or substantially all of a Guarantor Subsidiary's assets, (v) the Company's exercise of its defeasance options under the indenture governing the Unsecured Notes, (vi) the dissolution or liquidation of a Guarantor Subsidiary or (vii) the sale of all the equity interest in a Guarantor Subsidiary. The Company's other domestic subsidiaries and its foreign subsidiaries (collectively, the "Non-Guarantor Subsidiaries") do not guarantee the Unsecured Notes. The following condensed consolidating financial information reflects the summarized financial information of Western Digital Corporation ("Parent"), the Guarantor Subsidiaries on a combined basis, and the Non-Guarantor Subsidiaries on a combined basis.

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Balance Sheet
 As of December 29, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|--|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$22 | \$ 1,187 | \$ 5,063 | \$ — | \$ 6,272 |
| Short-term investments | — | — | 23 | — | 23 |
| Accounts receivable, net | — | 1,207 | 845 | — | 2,052 |
| Intercompany receivables | 1,760 | 3,670 | 1,997 | (7,427) | — |
| Inventories | — | 1,076 | 1,481 | (276) | 2,281 |
| Other current assets | 5 | 181 | 264 | 35 | 485 |
| Total current assets | 1,787 | 7,321 | 9,673 | (7,668) | 11,113 |
| Property, plant and equipment, net | — | 1,100 | 1,954 | — | 3,054 |
| Notes receivable and investments in Flash Ventures | — | — | 1,845 | — | 1,845 |
| Goodwill | — | 387 | 9,689 | — | 10,076 |
| Other intangible assets, net | — | 44 | 3,186 | — | 3,230 |
| Investments in consolidated subsidiaries | 19,030 | 18,314 | — | (37,344) | — |
| Loans due from consolidated affiliates | 3,306 | 16 | — | (3,322) | — |
| Other non-current assets | 51 | 612 | 461 | (602) | 522 |
| Total assets | \$24,174 | \$ 27,794 | \$ 26,808 | \$ (48,936) | \$ 29,840 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current liabilities: | | | | | |
| Accounts payable | \$— | \$ 227 | \$ 1,694 | \$ — | \$ 1,921 |
| Accounts payable to related parties | — | — | 250 | — | 250 |
| Intercompany payables | 609 | 4,500 | 2,318 | (7,427) | — |
| Accrued expenses | 273 | 457 | 426 | 35 | 1,191 |
| Accrued compensation | — | 340 | 183 | — | 523 |
| Accrued warranty | — | 5 | 189 | — | 194 |
| Current portion of long-term debt | 274 | — | — | — | 274 |
| Total current liabilities | 1,156 | 5,529 | 5,060 | (7,392) | 4,353 |
| Long-term debt | 11,746 | — | 31 | — | 11,777 |
| Loans due to consolidated affiliates | — | 492 | 2,830 | (3,322) | — |
| Other liabilities | — | 2,523 | 517 | (602) | 2,438 |
| Total liabilities | 12,902 | 8,544 | 8,438 | (11,316) | 18,568 |
| Total shareholders' equity | 11,272 | 19,250 | 18,370 | (37,620) | 11,272 |
| Total liabilities and shareholders' equity | \$24,174 | \$ 27,794 | \$ 26,808 | \$ (48,936) | \$ 29,840 |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Balance Sheet
 As of June 30, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|--|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| ASSETS | | | | | |
| Current assets: | | | | | |
| Cash and cash equivalents | \$ 18 | \$ 1,212 | \$ 5,124 | \$ — | \$ 6,354 |
| Short-term investments | — | — | 24 | — | 24 |
| Accounts receivable, net | — | 1,247 | 701 | — | 1,948 |
| Intercompany receivables | 1,225 | 2,528 | 622 | (4,375) | — |
| Inventories | — | 1,133 | 1,494 | (286) | 2,341 |
| Other current assets | 4 | 158 | 221 | 6 | 389 |
| Total current assets | 1,247 | 6,278 | 8,186 | (4,655) | 11,056 |
| Property, plant and equipment, net | — | 1,124 | 1,909 | — | 3,033 |
| Notes receivable and investments in Flash Ventures | — | — | 1,340 | — | 1,340 |
| Goodwill | — | 331 | 9,683 | — | 10,014 |
| Other intangible assets, net | — | 11 | 3,812 | — | 3,823 |
| Investments in consolidated subsidiaries | 19,082 | 17,588 | — | (36,670) | — |
| Loans due from consolidated affiliates | 4,700 | 16 | — | (4,716) | — |
| Other non-current assets | 51 | 723 | 419 | (599) | 594 |
| Total assets | \$25,080 | \$ 26,071 | \$ 25,349 | \$ (46,640) | \$ 29,860 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
| Current liabilities: | | | | | |
| Accounts payable | \$— | \$ 257 | \$ 1,887 | \$ — | \$ 2,144 |
| Accounts payable to Flash Ventures | — | — | 206 | — | 206 |
| Intercompany payables | 270 | 4,039 | 66 | (4,375) | — |
| Accrued expenses | 270 | 360 | 439 | — | 1,069 |
| Accrued compensation | — | 313 | 193 | — | 506 |
| Accrued warranty | — | 4 | 182 | — | 186 |
| Current portion of long-term debt | 233 | — | — | — | 233 |
| Total current liabilities | 773 | 4,973 | 2,973 | (4,375) | 4,344 |
| Long-term debt | 12,889 | — | 29 | — | 12,918 |
| Loans due to consolidated affiliates | — | 546 | 4,170 | (4,716) | — |
| Other liabilities | — | 1,243 | 530 | (593) | 1,180 |
| Total liabilities | 13,662 | 6,762 | 7,702 | (9,684) | 18,442 |
| Total shareholders' equity | 11,418 | 19,309 | 17,647 | (36,956) | 11,418 |
| Total liabilities and shareholders' equity | \$25,080 | \$ 26,071 | \$ 25,349 | \$ (46,640) | \$ 29,860 |

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Statement of Operations

For the three months ended December 29, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Revenue, net | \$— | \$ 3,764 | \$ 5,173 | \$ (3,601) | \$ 5,336 |
| Cost of revenue | — | 3,256 | 3,703 | (3,636) | 3,323 |
| Gross profit | — | 508 | 1,470 | 35 | 2,013 |
| Operating expenses: | | | | | |
| Research and development | — | 400 | 229 | — | 629 |
| Selling, general and administrative | 1 | 276 | 104 | — | 381 |
| Intercompany operating expense (income) | — | (430) | 430 | — | — |
| Employee termination, asset impairment, and other charges | — | 10 | 38 | — | 48 |
| Total operating expenses | 1 | 256 | 801 | — | 1,058 |
| Operating income (loss) | (1) | 252 | 669 | 35 | 955 |
| Interest and other income (expense): | | | | | |
| Interest income | 66 | 2 | 12 | (66) | 14 |
| Interest expense | (197) | (4) | (62) | 66 | (197) |
| Other income (expense), net | — | (4) | 6 | — | 2 |
| Total interest and other expense, net | (131) | (6) | (44) | — | (181) |
| Income (loss) before taxes | (132) | 246 | 625 | 35 | 774 |
| Equity in earnings from subsidiaries | (725) | 593 | — | 132 | — |
| Income tax expense (benefit) | (34) | 1,601 | 30 | — | 1,597 |
| Net income (loss) | \$(823) | \$ (762) | \$ 595 | \$ 167 | \$(823) |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Statement of Operations
 For the six months ended December 29, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Revenue, net | \$— | \$ 7,474 | \$ 10,254 | \$ (7,211) | \$ 10,517 |
| Cost of revenue | — | 6,456 | 7,350 | (7,215) | 6,591 |
| Gross profit | — | 1,018 | 2,904 | 4 | 3,926 |
| Operating expenses: | | | | | |
| Research and development | — | 781 | 440 | — | 1,221 |
| Selling, general and administrative | 3 | 534 | 208 | — | 745 |
| Intercompany operating expense (income) | — | (830) | 830 | — | — |
| Employee termination, asset impairment, and other charges | — | 21 | 79 | — | 100 |
| Total operating expenses | 3 | 506 | 1,557 | — | 2,066 |
| Operating income (loss) | (3) | 512 | 1,347 | 4 | 1,860 |
| Interest and other income (expense): | | | | | |
| Interest income | 147 | 4 | 26 | (147) | 30 |
| Interest expense | (401) | (10) | (138) | 147 | (402) |
| Other income (expense), net | (8) | 7 | (3) | — | (4) |
| Total interest and other income (expense), net | (262) | 1 | (115) | — | (376) |
| Income (loss) before taxes | (265) | 513 | 1,232 | 4 | 1,484 |
| Equity in earnings from subsidiaries | 32 | 1,185 | — | (1,217) | — |
| Income tax expense (benefit) | (91) | 1,655 | 62 | — | 1,626 |
| Net income (loss) | \$(142) | \$ 43 | \$ 1,170 | \$ (1,213) | \$(142) |

Table of Contents

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

(Unaudited)

Condensed Consolidating Statement of Operations

For the three months ended December 30, 2016

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Revenue, net | \$— | \$ 3,786 | \$ 4,245 | \$ (3,143) | \$ 4,888 |
| Cost of revenue | — | 3,085 | 3,495 | (3,225) | 3,355 |
| Gross profit | — | 701 | 750 | 82 | 1,533 |
| Operating expenses: | | | | | |
| Research and development | — | 372 | 213 | — | 585 |
| Selling, general and administrative | 3 | 252 | 103 | — | 358 |
| Intercompany operating expense (income) | — | (218) | 218 | — | — |
| Employee termination, asset impairment, and other charges | — | 9 | 36 | — | 45 |
| Total operating expenses | 3 | 415 | 570 | — | 988 |
| Operating income (loss) | (3) | 286 | 180 | 82 | 545 |
| Interest and other income (expense): | | | | | |
| Interest income | 86 | — | 2 | (83) | 5 |
| Interest expense | (203) | — | (85) | 83 | (205) |
| Other expense, net | (2) | (5) | (17) | — | (24) |
| Total interest and other expense, net | (119) | (5) | (100) | — | (224) |
| Income (loss) before taxes | (122) | 281 | 80 | 82 | 321 |
| Equity in earnings from subsidiaries | 270 | 19 | — | (289) | — |
| Income tax expense (benefit) | (87) | 116 | 57 | — | 86 |
| Net income | \$235 | \$ 184 | \$ 23 | \$ (207) | \$ 235 |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Statement of Operations
 For the six months ended December 30, 2016

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Revenue, net | \$— | \$ 7,484 | \$ 8,538 | \$ (6,420) | \$ 9,602 |
| Cost of revenue | — | 6,150 | 7,048 | (6,464) | 6,734 |
| Gross profit | — | 1,334 | 1,490 | 44 | 2,868 |
| Operating expenses: | | | | | |
| Research and development | — | 813 | 411 | — | 1,224 |
| Selling, general and administrative | 4 | 526 | 224 | — | 754 |
| Intercompany operating expense (income) | — | (569) | 569 | — | — |
| Employee termination, asset impairment, and other charges | — | 58 | 55 | — | 113 |
| Total operating expenses | 4 | 828 | 1,259 | — | 2,091 |
| Operating income (loss) | (4) | 506 | 231 | 44 | 777 |
| Interest and other income (expense): | | | | | |
| Interest income | 180 | 1 | 9 | (180) | 10 |
| Interest expense | (431) | (5) | (185) | 180 | (441) |
| Other expense, net | (274) | (4) | (18) | — | (296) |
| Total interest and other expense, net | (525) | (8) | (194) | — | (727) |
| Income (loss) before taxes | (529) | 498 | 37 | 44 | 50 |
| Equity in earnings from subsidiaries | 217 | (208) | — | (9) | — |
| Income tax expense (benefit) | (181) | 121 | 241 | — | 181 |
| Net income (loss) | \$(131) | \$ 169 | \$ (204) | \$ 35 | \$(131) |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Statement of Comprehensive Income (Loss)
 For the three months ended December 29, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Net income (loss) | \$ (823) | \$ (762) | \$ 595 | \$ 167 | \$ (823) |
| Other comprehensive income, before tax: | | | | | |
| Foreign currency translation adjustment | 6 | 5 | 5 | (10) | 6 |
| Net unrealized gain on derivative contracts | 10 | 3 | 3 | (6) | 10 |
| Net unrealized gain on available-for-sale securities | — | — | — | — | — |
| Total other comprehensive income, before tax | 16 | 8 | 8 | (16) | 16 |
| Income tax benefit (expense) related to items of other comprehensive income | (3) | — | 1 | (1) | (3) |
| Other comprehensive income, net of tax | 13 | 8 | 9 | (17) | 13 |
| Total comprehensive income (loss) | \$ (810) | \$ (754) | \$ 604 | \$ 150 | \$ (810) |

Condensed Consolidating Statement of Comprehensive Income (Loss)
 For the six months ended December 29, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Net income (loss) | \$ (142) | \$ 43 | \$ 1,170 | \$ (1,213) | \$ (142) |
| Other comprehensive income, before tax: | | | | | |
| Actuarial pension gain | — | — | — | — | — |
| Foreign currency translation adjustment | 2 | 1 | 1 | (2) | 2 |
| Net unrealized gain on derivative contracts | 14 | 6 | 6 | (12) | 14 |
| Net unrealized loss on available-for-sale securities | (1) | (1) | (1) | 2 | (1) |
| Total other comprehensive income, before tax | 15 | 6 | 6 | (12) | 15 |
| Income tax benefit (expense) related to items of other comprehensive income | (3) | — | (1) | 1 | (3) |
| Other comprehensive income, net of tax | 12 | 6 | 5 | (11) | 12 |
| Total comprehensive income (loss) | \$ (130) | \$ 49 | \$ 1,175 | \$ (1,224) | \$ (130) |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Statement of Comprehensive Income (Loss)
 For the three months ended December 30, 2016

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Net income | \$235 | \$ 184 | \$ 23 | \$ (207) | \$ 235 |
| Other comprehensive loss, before tax: | | | | | |
| Actuarial pension gain | 1 | 1 | 1 | (2) | 1 |
| Foreign currency translation adjustment | (186) | (186) | (210) | 396 | (186) |
| Net unrealized loss on derivative contracts | (136) | (136) | (132) | 268 | (136) |
| Total other comprehensive loss, before tax | (321) | (321) | (341) | 662 | (321) |
| Income tax benefit related to items of other comprehensive loss | 9 | 10 | 9 | (19) | 9 |
| Other comprehensive loss, net of tax | (312) | (311) | (332) | 643 | (312) |
| Total comprehensive loss | \$(77) | \$(127) | \$(309) | \$ 436 | \$(77) |

Condensed Consolidating Statement of Comprehensive Income (Loss)
 For the six months ended December 30, 2016

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|---|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Net income (loss) | \$(131) | \$ 169 | \$ (204) | \$ 35 | \$(131) |
| Other comprehensive loss, before tax: | | | | | |
| Actuarial pension gain | 6 | 6 | 6 | (12) | 6 |
| Foreign currency translation adjustment | (169) | (169) | (192) | 361 | (169) |
| Net unrealized loss on derivative contracts | (140) | (140) | (136) | 276 | (140) |
| Total other comprehensive loss, before tax | (303) | (303) | (322) | 625 | (303) |
| Income tax benefit related to items of other comprehensive loss | 3 | 3 | 1 | (4) | 3 |
| Other comprehensive loss, net of tax | (300) | (300) | (321) | 621 | (300) |
| Total comprehensive loss | \$(431) | \$(131) | \$(525) | \$ 656 | \$(431) |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Statement of Cash Flows
 For the six months ended December 29, 2017

| | Parent | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Total Company |
|--|---------------|---------------------------|-------------------------------|--------------|------------------|
| | (in millions) | | | | |
| Cash flows from operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$(279) | \$ 108 | \$ 2,560 | \$ (74) | \$ 2,315 |
| Cash flows from investing activities | | | | | |
| Purchases of property, plant and equipment | — | (113) | (303) | — | (416) |
| Proceeds from the sale of property, plant and equipment | — | — | 10 | — | 10 |
| Acquisitions, net of cash acquired | — | (93) | (6) | — | (99) |
| Purchases of investments | — | (11) | (46) | — | (57) |
| Proceeds from sale of investments | — | — | 29 | — | 29 |
| Proceeds from maturities of investments | — | — | 16 | — | 16 |
| Notes receivable issuances to Flash Ventures | — | — | (621) | — | (621) |
| Notes receivable proceeds from Flash Ventures | — | — | 112 | — | 112 |
| Strategic investments and other, net | — | (1) | 20 | — | 19 |
| Intercompany loan from consolidated affiliates | 1,395 | — | — | (1,395) | — |
| Advances from (to) parent and consolidated affiliates | 65 | (65) | — | — | — |
| Net cash provided by (used in) investing activities | 1,460 | (283) | (789) | (1,395) | (1,007) |
| Cash flows from financing activities | | | | | |
| Issuance of stock under employee stock plans | 99 | — | — | — | 99 |
| Taxes paid on vested stock awards under employee stock plans | (67) | — | — | — | (67) |
| Dividends paid to shareholders | (295) | — | — | — | (295) |
| Settlement of debt hedge contracts | 28 | — | — | — | 28 |
| Repayment of debt | (4,114) | — | — | — | (4,114) |
| Proceeds from debt | 2,963 | — | — | — | 2,963 |
| Debt issuance costs | (5) | — | — | — | (5) |
| Intercompany loan to consolidated affiliates | — | (54) | (1,341) | 1,395 | — |
| Change in investment in consolidated subsidiaries | 214 | 204 | (492) | 74 | — |
| Net cash provided by (used in) financing activities | (1,177) | 150 | (1,833) | 1,469 | (1,391) |
| Effect of exchange rate changes on cash | — | — | 1 | — | 1 |
| Net increase (decrease) in cash and cash equivalents | 4 | (25) | (61) | — | (82) |
| Cash and cash equivalents, beginning of year | 18 | 1,212 | 5,124 | — | 6,354 |
| Cash and cash equivalents, end of period | \$22 | \$ 1,187 | \$ 5,063 | \$ — | \$ 6,272 |

Table of Contents

WESTERN DIGITAL CORPORATION
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
 (Unaudited)

Condensed Consolidating Statement of Cash Flows
 For the six months ended December 30, 2016

| | Parent | Guarantor | Non-Guarantor | Eliminations | Total |
|--|---------------|-----------|---------------|--------------|----------|
| | (in millions) | | | | Company |
| Cash flows from operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$(256) | \$ 211 | \$ 1,443 | \$ 102 | \$ 1,500 |
| Cash flows from investing activities | | | | | |
| Purchases of property, plant and equipment | — | (136) | (194) | — | (330) |
| Proceeds from the sale of property, plant and equipment | — | — | 1 | — | 1 |
| Purchases of investments | — | — | (239) | — | (239) |
| Proceeds from sale of investments | — | — | 55 | — | 55 |
| Proceeds from maturities of investments | — | — | 279 | — | 279 |
| Investments in Flash Ventures | — | — | (20) | — | (20) |
| Notes receivable issuances to Flash Ventures | — | — | (309) | — | (309) |
| Notes receivable proceeds from Flash Ventures | — | — | 259 | — | 259 |
| Strategic investments and other, net | — | — | (12) | — | (12) |
| Intercompany loans from consolidated affiliates | 770 | 40 | — | (810) | — |
| Advances from (to) consolidated affiliates | 293 | (285) | — | (8) | — |
| Net cash provided by (used in) investing activities | 1,063 | (381) | (180) | (818) | (316) |
| Cash flows from financing activities | | | | | |
| Issuance of stock under employee stock plans | 90 | — | — | — | 90 |
| Taxes paid on vested stock awards under employee stock plans | (40) | — | — | — | (40) |
| Excess tax benefits from employee stock plans | 56 | — | — | — | 56 |
| Proceeds from acquired call option | — | — | 61 | — | 61 |
| Dividends paid to shareholders | (284) | — | — | — | (284) |
| Repayment of debt | (4,767) | (2,995) | (492) | — | (8,254) |
| Proceeds from debt | 3,992 | — | — | — | 3,992 |
| Debt issuance costs | (7) | — | — | — | (7) |
| Intercompany loan to consolidated affiliates | — | (5,966) | 5,156 | 810 | — |
| Change in investment in consolidated subsidiaries | 199 | 8,808 | (8,913) | (94) | — |
| Net cash used in financing activities | (761) | (153) | (4,188) | 716 | (4,386) |
| Effect of exchange rate changes on cash | — | — | (9) | — | (9) |
| Net increase (decrease) in cash and cash equivalents | 46 | (323) | (2,934) | — | (3,211) |
| Cash and cash equivalents, beginning of year | — | 1,206 | 6,945 | — | 8,151 |
| Cash and cash equivalents, end of period | \$46 | \$ 883 | \$ 4,011 | \$ — | \$ 4,940 |

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)
(Unaudited)

Note 15. Subsequent Events

In January 2018, the Company announced its planned issuance of \$2.30 billion aggregate principal amount of 4.750% senior unsecured notes due 2026 (the “2026 Notes”) and \$1.00 billion aggregate principal amount of 1.5% convertible senior notes due 2024 (the “2024 Convertible Notes”). The 2024 Convertible Notes will be convertible into cash, shares of the Company’s common stock or a combination thereof, at an initial conversion price of approximately \$121.91 per share. The issuance of the 2026 Notes and 2024 Convertible Notes is subject to customary closing conditions.

On January 29, 2018, the Company commenced a cash tender offer with respect to any and all of its outstanding \$3.35 billion aggregate principal amount of 10.500% senior unsecured notes due 2024 (the “2024 Unsecured Notes”). The consideration offered for the 2024 Unsecured Notes is a total consideration of \$1,167.25 per \$1,000 principal amount, which includes the tender offer consideration of \$1,137.25 and an early tender premium of \$30.00. On January 30, 2018, the Company delivered a notice of conditional redemption with respect to the 2024 Unsecured Notes, with a March 1, 2018 redemption date. The redemption of the 2024 Unsecured Notes is conditioned upon the issuance of the 2026 Notes. On January 30, 2018, the Company also delivered a notice of conditional redemption with respect to its outstanding \$1.88 billion aggregate principal amount of 7.375% senior secured notes due 2023 (the “2023 Secured Notes”), with a March 1, 2018 redemption date. The redemption of the 2023 Secured Notes is conditioned upon the issuance of the 2024 Convertible Notes and/or an increase in the Company’s Term Loan A credit facility that collectively generates proceeds in excess of \$2 billion.

Since December 29, 2017, the Company also resumed its stock repurchase program and has repurchased approximately \$151 million of its common stock in privately negotiated transactions, at a purchase price per share equal to \$87.08 per share, with available cash on hand.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis contains forward-looking statements within the meaning of the federal securities laws, and should be read in conjunction with the disclosures we make concerning risks and other factors that may affect our business and operating results. You should read this information in conjunction with the unaudited Condensed Consolidated Financial Statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited Consolidated Financial Statements and notes thereto and Part II, Item 8, contained in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017. See also "Forward-Looking Statements" immediately prior to Part I, Item 1 in this Quarterly Report on Form 10-Q.

Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters. As used herein, the terms "we," "us," "our," and the "Company" refer to Western Digital Corporation and its subsidiaries.

Our Company

We are a leading developer, manufacturer and provider of data storage devices and solutions that address the evolving needs of the information technology ("IT") industry and the infrastructure that enables the proliferation of data in virtually every industry. Our broad portfolio of technology and products address the following key markets: Client Devices; Data Center Devices and Solutions; and Client Solutions. We also generate license and royalty revenue related to our intellectual property ("IP"), which is included in each of these three categories.

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Fiscal years 2018, which ends on June 29, 2018, and 2017, which ended on June 30, 2017, are both comprised 52 weeks, with all quarters presented consisting of 13 weeks.

Key Developments

Refinancing Transactions

In January 2018, we announced our planned issuance of \$2.30 billion aggregate principal amount of 4.750% senior unsecured notes due 2026 (the "2026 Notes") and \$1.00 billion aggregate principal amount of 1.5% convertible senior notes due 2024 (the "2024 Convertible Notes"). We intend to use the net proceeds of these offerings, together with available cash on hand and, with respect to the 2024 Convertible Notes, approximately \$1 billion of proceeds from an anticipated increase in the size of our existing Term Loan A (the "TLA Increase"), to fund a cash tender offer and/or redemption of all of our currently outstanding 10.500% senior unsecured notes due 2024 (the "2024 unsecured notes") and the redemption of all of our currently outstanding 7.375% senior secured notes due 2023 (the "2023 secured notes"). The offering of the 2026 Notes and 2024 Convertible Notes, the TLA Increase, the tender offer and/or redemption of the 2024 unsecured notes and the redemption of the 2023 secured notes are collectively referred to as the "Refinancing Transactions".

The Refinancing Transactions are expected to be completed in the third quarter of fiscal year 2018, subject to customary closing conditions.

In connection with the Refinancing Transactions, we have announced that we intend to repurchase up to \$500 million of our common stock in privately negotiated or open market transactions. Since December 29, 2017, we have repurchased approximately \$151 million of our common stock in privately negotiated transactions, at a purchase price per share equal to \$87.08 per share, with available cash on hand.

Table of Contents

Tax Reform

On December 22, 2017, the President of the United States of America signed the Tax Cuts and Jobs Act (the “2017 Act”), which includes a broad range of tax reform proposals affecting businesses, including a reduction in the U.S. federal corporate tax rate from 35% to 21%, a one-time mandatory deemed repatriation tax on earnings of certain foreign subsidiaries that were previously tax deferred, and new taxes on certain foreign earnings. As a result of the 2017 Act, we have made a reasonable estimate of the effects on the Company’s existing deferred tax balances and the one-time mandatory deemed repatriation tax required by the 2017 Act and have recognized a provisional income tax expense of \$1.66 billion for the one-time mandatory deemed repatriation tax and a provisional income tax benefit of \$88 million related to the re-measurement of deferred tax assets and liabilities for the three and six months ended December 29, 2017. For additional information regarding the 2017 Act, see Part I, Item 1, Note 10, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q. See also the discussion in “Results of Operations-Income Tax Expense” and “Liquidity and Capital Resources” below for information regarding the impact of the 2017 Act on the Company’s financial condition, results of operations and cash flows.

Ventures with TMC

Through our strategic partnership with Toshiba Memory Corporation (“TMC”), which consists of three separate legal entities: Flash Partners Ltd., Flash Alliance Ltd. and Flash Forward Ltd., collectively referred to as “Flash Ventures”, we and TMC currently operate three business ventures in 300-millimeter NAND-flash manufacturing facilities in Yokkaichi, Japan, which provide us leading-edge, cost-competitive NAND wafers for our end products.

In September 2017, Toshiba Corporation (“Toshiba”), of which TMC is a wholly owned subsidiary, announced it had entered into a definitive agreement to sell TMC, including its interest in Flash Ventures, to a consortium led by SK Hynix Inc. and Bain Capital Private Equity, L.P., BCPE Pangea Cayman, L.P., BCPE Pangea Cayman2, Ltd., Bain Capital Fund XII, L.P., Bain Capital Asia Fund III, L.P. and Pangea (together, “Bain Capital”), that includes other competitors, as well as key customers. We previously asserted our consent rights under the terms of the Flash Ventures agreements with respect to the transactions involving, among other things, the transfer by Toshiba of its interests in Flash Ventures to TMC, and the proposed sale of TMC to a consortium of investors led by Bain Capital. In December 2017, we entered into a Confidential Settlement and Mutual Release Agreement (the “Toshiba Settlement Agreement”) with Toshiba and TMC pursuant to which the parties agreed to withdraw and seek dismissal of the litigation and arbitration proceedings related to the transfer of Toshiba’s interests in Flash Ventures and related matters. In addition to the settlement with Toshiba and TMC, we also entered into a settlement agreement with Bain Capital and certain other agreements with TMC related to the operation of Flash Ventures. See Part I, Item 1, Note 13, Legal Proceedings, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a further discussion of the litigation and arbitration proceedings between the parties and the Toshiba Settlement Agreement.

See Part I, Item 1, Note 8, Commitments, Contingencies and Related Parties, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q for additional information on Flash Ventures.

Y6 Facility Agreement

In connection with the Toshiba Settlement Agreement, in December 2017, we entered into a facility agreement (the “Y6 Facility Agreement”) with TMC regarding the construction and operation of a new 300-millimeter wafer fabrication facility in Yokkaichi, Japan, referred to as “Fab 6”. The primary purpose of Fab 6, which is located adjacent to the fabrication facilities in Yokkaichi currently utilized by Flash Ventures, is to provide cleanroom space to continue the transition of the parties’ existing 2D NAND manufacturing capacity to BiCS 3D NAND manufacturing capacity. The

Y6 Facility Agreement establishes terms for the manufacture of NAND in Fab 6 and amends the existing agreements governing Flash Ventures to provide for their use of Fab 6. We have agreed to fund 50% of Fab 6's start-up costs, as well as 50% of Flash Ventures' portion of an upcoming investment in manufacturing equipment for Fab 6. The Company's share of the initial commitment is expected to be approximately \$950 million, mostly for equipment investments and some start-up costs to be incurred primarily through calendar 2018.

Extension of Joint Venture Agreements

In connection with the Toshiba Settlement Agreement, in December 2017, we also entered into agreements with TMC to extend the term of Flash Alliance Ltd. to December 31, 2029 and the term of Flash Forward Ltd. to December 31, 2027. The term of Flash Partners Ltd. was previously extended to December 31, 2029.

Table of Contents

Debt Facilities

During the second quarter ended December 29, 2017, we settled certain debt facilities, entered into new debt facilities at lower rates and increased our revolving credit facility. The financing arrangement activities were as follows:

We settled our existing U.S dollar-denominated term B-2 loans (“U.S. Term Loan B-2”) with the proceeds of a new issuance of a \$2.96 billion U.S. dollar-denominated term loan (“U.S. Term Loan B-3”) at an interest rate lower than our U.S. Term Loan B-2 tranche.

We made a voluntary prepayment of the full principal amounts of our Euro-denominated term B-2 loans (“Euro Term Loan B-2”) using cash on hand.

We increased the size of our existing \$1 billion revolving credit facility by \$500 million to \$1.5 billion. The terms of our revolving credit facility remained unchanged.

For additional information regarding our debt facilities, see Part I, Item 1, Note 6, Debt, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Table of Contents

Results of Operations

Second Quarter and First Half Overview

The following table sets forth, for the periods presented, selected summary information from our Condensed Consolidated Statements of Operations by dollars and percentage of net revenue⁽¹⁾:

| | Three Months Ended | | | | \$ Change | % Change |
|---|-----------------------------------|---------|----------------------|---------|--------------|----------|
| | December 29, 2017 | | December 30, 2016 | | | |
| | (in millions, except percentages) | | | | | |
| Revenue, net | \$5,336 | 100.0 % | \$4,888 | 100.0 % | \$ 448 | 9.2 % |
| Cost of revenue | 3,323 | 62.3 | 3,355 | 68.6 | (32) | (1.0) |
| Gross profit | 2,013 | 37.7 | 1,533 | 31.4 | 480 | 31.3 |
| Operating Expenses: | | | | | | |
| Research and development | 629 | 11.8 | 585 | 12.0 | 44 | 7.5 |
| Selling, general and administrative | 381 | 7.1 | 358 | 7.3 | 23 | 6.4 |
| Employee termination, asset impairment, and other charges | 48 | 0.9 | 45 | 0.9 | 3 | 6.7 |
| Total operating expenses | 1,058 | 19.8 | 988 | 20.2 | 70 | 7.1 |
| Operating income | 955 | 17.9 | 545 | 11.1 | 410 | 75.2 |
| Interest and other income (expense): | | | | | | |
| Interest income | 14 | 0.3 | 5 | 0.1 | 9 | 180.0 |
| Interest expense | (197) | (3.7) | (205) | (4.2) | 8 | (3.9) |
| Other income (expense), net | 2 | — | (24) | (0.5) | 26 | (108.3) |
| Total interest and other expense, net | (181) | (3.4) | (224) | (4.6) | 43 | (19.2) |
| Income before taxes | 774 | 14.5 | 321 | 6.6 | 453 | 141.1 |
| Income tax expense | 1,597 | 29.9 | 86 | 1.8 | 1,511 | 1,757.0 |
| Net income (loss) | \$(823) | (15.4) | \$235 | 4.8 | (1,058) | (450.2) |

⁽¹⁾ Percentages may not total due to rounding.

Table of Contents

| | Six Months Ended | | | | \$ | % Change | % Change |
|---|-----------------------------------|---------|----------------------|---------|----------|----------|----------|
| | December 29, 2017 | | December 30, 2016 | | | | |
| | (in millions, except percentages) | | | | | | |
| Revenue, net | \$10,517 | 100.0 % | \$9,602 | 100.0 % | \$ 915 | 9.5 | % |
| Cost of revenue | 6,591 | 62.7 | 6,734 | 70.1 | (143) | (2.1) |) |
| Gross profit | 3,926 | 37.3 | 2,868 | 29.9 | 1,058 | 36.9 | |
| Operating Expenses: | | | | | | | |
| Research and development | 1,221 | 11.6 | 1,224 | 12.7 | (3) | (0.2) |) |
| Selling, general and administrative | 745 | 7.1 | 754 | 7.9 | (9) | (1.2) |) |
| Employee termination, asset impairment, and other charges | 100 | 1.0 | 113 | 1.2 | (13) | (11.5) |) |
| Total operating expenses | 2,066 | 19.6 | 2,091 | 21.8 | (25) | (1.2) |) |
| Operating income | 1,860 | 17.7 | 777 | 8.1 | 1,083 | 139.4 | |
| Interest and other income (expense): | | | | | | | |
| Interest income | 30 | 0.3 | 10 | 0.1 | 20 | 200.0 | |
| Interest expense | (402) | (3.8) | (441) | (4.6) | 39 | (8.8) |) |
| Other income (expense), net | (4) | — | (296) | (3.1) | 292 | (98.6) |) |
| Total interest and other expense, net | (376) | (3.6) | (727) | (7.6) | 351 | (48.3) |) |
| Income before taxes | 1,484 | 14.1 | 50 | 0.5 | 1,434 | 2,868.0 | |
| Income tax expense | 1,626 | 15.5 | 181 | 1.9 | 1,445 | 798.3 | |
| Net income (loss) | \$(142) | (1.4) | \$(131) | (1.4) | \$ (11) | 8.4 | |

(1) Percentages may not total due to rounding.

The following table sets forth, for the periods presented, summary information regarding net revenues by geography and end market:

| | Three Months Ended | | Six Months Ended | |
|---|--|----------------------|----------------------|----------------------|
| | December 29, 2017 | December 30, 2016 | December 29, 2017 | December 30, 2016 |
| | (in millions, except exabytes and percentages) | | | |
| Revenue, net | \$5,336 | \$ 4,888 | \$10,517 | \$ 9,602 |
| Revenues by Geography (%) ⁽¹⁾ | | | | |
| Americas | 25 | % 26 | % 26 | % 26 |
| Europe, Middle East and Africa | 19 | 19 | 18 | 18 |
| Asia | 56 | 55 | 56 | 56 |
| Revenues by End Market (%) ⁽²⁾ | | | | |
| Client Devices | 50 | % 49 | % 51 | % 50 |
| Data Center Devices & Solutions | 27 | 29 | 27 | 29 |
| Client Solutions | 24 | 22 | 23 | 21 |
| Exabytes Shipped | 95 | 78 | 182 | 158 |

(1) Percentages for the prior year have been revised to conform to the current year presentation.

(2) Percentages may not total due to rounding.

Table of Contents

Net Revenue

Net revenue for the three and six months ended December 29, 2017 increased \$448 million, or 9.2%, and \$915 million, or 9.5%, respectively, as compared to the same periods in prior year. The increase in net revenue for the three and six months ended December 29, 2017, compared to the same periods in the prior year, primarily reflects a favorable flash memory demand environment and growth of our diversified product portfolio. For the three and six months ended December 29, 2017, Client Devices revenue increased 9.5% and 11.1%, respectively, year-over-year, primarily driven by growth in mobility, client solid state drives (“SSD”) and surveillance products. Our revenue for Data Center Devices and Solutions for the three and six months ended December 29, 2017 increased 2.9% and 1.6%, respectively, year-over-year, driven primarily by a significant increase in sales from our capacity enterprise hard disk drives (“HDD”), partially offset by an expected decline in sales from our performance enterprise HDDs. Client Solutions revenue for the three and six months ended December 29, 2017 increased 16.6% and 16.5%, respectively, year-over-year, primarily as a result of the strength and reach of our valuable global retail brands.

Our top 10 customers accounted for 42% and 41% of our net revenue for the three and six months ended December 29, 2017, respectively, and 43% and 42% of our net revenue for the three and six months ended December 30, 2016, respectively. For the three and six months ended December 29, 2017 and December 30, 2016, no single customer accounted for 10% or more of our net revenue.

Changes in the net revenue by geography generally reflect normal fluctuations in market demand and competitive dynamics.

Consistent with standard industry practice, we have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. For the three and six months ended December 29, 2017, these programs represented 12% and 13% of gross revenues, respectively. For each of the three and six months ended December 30, 2016, these programs represented 13% of gross revenues. The amounts attributed to our sales incentive and marketing programs generally vary according to several factors including industry conditions, list pricing strategies, seasonal demand, competitor actions, channel mix and overall availability of products. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue.

Gross Profit and Gross Margin

Gross profit for the three and six months ended December 29, 2017 increased \$480 million, or 31.3%, and \$1.058 billion, or 36.9%, respectively, as compared to the same period in the prior year. The increase in gross profit for the three and six months ended December 29, 2017 reflects the increase in revenue discussed above and improvements in our gross margin. The increase in gross margin for the three and six months ended December 29, 2017 was primarily due to a favorable demand environment for flash-based products, improvements in our production costs from technology transitions and a higher mix of flash-based product revenue. Gross profit was negatively impacted by amortization expense on acquired intangible assets, stock-based compensation, charges related to the implementation of cost-saving initiatives and other charges, which aggregated \$293 million, or 5.5%, of revenue, for the three months ended December 29, 2017, and \$259 million, or 5.3%, of revenue, for the three months ended December 30, 2016.

Gross profit was negatively impacted by amortization expense on acquired intangible assets, stock-based compensation, charges related to the implementation of cost-saving initiatives and other charges, which aggregated \$572 million, or 5.4%, of revenue, for the six months ended December 29, 2017, and \$523 million, or 5.4%, of revenue, for the six months ended December 30, 2016.

Operating Expenses

The increase in research and development (“R&D”) expense for the three months ended December 29, 2017 of \$44 million, or 7.5%, from the same period in the prior year, was primarily due to on-going investments in future capabilities and operating expenses of recent acquisitions. The three months ended December 29, 2017 also included aggregate charges of \$48 million related to stock-based compensation expenses, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other charges, compared to \$49 million for the three months ended December 30, 2016 related to such charges.

Table of Contents

R&D expense for the six months ended December 29, 2017 remained relatively consistent with the same period in the prior year. This was primarily due to an increase in on-going investments in future capabilities and operating expenses of recent acquisitions, offset by variable compensation. The six months ended December 29, 2017 also included aggregate charges of \$95 million related to stock-based compensation expenses, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other charges, compared to \$102 million for the six months ended December 30, 2016 related to such charges.

Selling, general and administrative (“SG&A”) expense for the three months ended December 29, 2017 increased \$23 million, or 6.4%, from the same period in the prior year, primarily due to operating expenses of recent acquisitions and an increase in legal expenses. Both the three months ended December 29, 2017 and December 30, 2016 also included aggregate charges of \$97 million related to stock-based compensation expenses, amortization expense on acquired intangible assets, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other discrete charges.

SG&A expense for the six months ended December 29, 2017 remained relatively consistent from the same period in the prior year. This was primarily due to an increase in operating expenses of recent acquisitions and legal expenses, offset by lower variable compensation. The six months ended December 29, 2017 also included aggregate charges of \$187 million related to stock-based compensation expenses, amortization expense on acquired intangible assets, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other charges, compared to \$216 million for the six months ended December 30, 2016 related to such charges.

Employee termination and other charges for the three and six months ended December 29, 2017 primarily related to further actions associated with the integration and business realignment of substantial portions of our business. For additional information regarding employee termination, asset impairment and other charges, see Part I, Item 1, Note 12, Employee Termination, Asset Impairment and Other Charges, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Interest and Other Income (Expense)

Total interest and other income (expense), net for the three months ended December 29, 2017 decreased \$43 million from the same period in the prior year, primarily due to higher foreign exchange losses and other charges of \$26 million in the prior year, lower interest expense of \$8 million resulting from reductions in the principal amount of debt and higher interest income of \$9 million related to increased investments.

Total interest and other income (expense), net for the six months ended December 29, 2017 decreased \$351 million from the same period in the prior year, primarily due to the loss on extinguishment of debt of \$292 million recognized in the prior year, lower interest expense of \$39 million resulting from reductions in the principal amount of debt and higher interest income of \$20 million related to increased investments.

Income Tax Expense

The following table sets forth income tax information from our Consolidated Statement of Operations by dollar and effective tax rate.

| | Three Months Ended | | Six Months Ended | |
|---------------------|-----------------------------------|--------------|------------------|--------------|
| | December 29, | December 30, | December 29, | December 30, |
| | 2017 | 2016 | 2017 | 2016 |
| | (in millions, except percentages) | | | |
| Income before taxes | \$ 774 | \$ 321 | \$ 1,484 | \$ 50 |
| Income tax expense | 1,597 | 86 | \$ 1,626 | \$ 181 |

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Effective tax rate 206 % 27 % 110 % 362 %

Under the 2017 Act, the U.S. federal corporate tax rate is reduced from 35% to 21% and is effective January 1, 2018 resulting in the use of an estimated annual effective rate of approximately 28% for our U.S. federal corporate tax rate for fiscal year 2018. The reduction in the U.S. federal corporate tax rate from 35% to the blended tax rate of 28% for fiscal year 2018 is estimated to have reduced our income tax expense by \$7 million for the three and six months ended December 29, 2017. For fiscal year 2019 and beyond, we will utilize the enacted U.S. federal corporate tax rate of 21%.

Table of Contents

Consistent with applicable Securities and Exchange Commission (“SEC”) guidance, we made a reasonable estimate of the effects on our existing deferred tax balances and the one-time mandatory deemed repatriation tax required by the 2017 Act and have recognized a provisional income tax expense of \$1.66 billion for the one-time mandatory deemed repatriation tax and a provisional income tax benefit of \$88 million related to the re-measurement of deferred tax assets and liabilities for the three and six months ended December 29, 2017. Both items are included as a component of income tax expense from continuing operations in the Condensed Consolidated Statements of Operations. For other elements of tax expense noted in Part I, Item 1, Note 10, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q, or where we have not made an election, we have not been able to make a reasonable estimate and continue to account for such items based on the provisions of the tax laws that were in effect immediately prior to the 2017 Act. As we finalize the accounting for the tax effects of the enactment of the 2017 Act during a one-year measurement period permitted by applicable SEC guidance, we expect to reflect adjustments to the recorded provisional amounts and record additional tax effects of the 2017 Act.

The primary drivers for the difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are related to the net charge of \$1.66 billion for the one-time mandatory deemed repatriation tax, offset in part by an income tax benefit related to the re-measurement of deferred taxes as required by the 2017 Act. Excluding these items, the effective tax rate for the three and six months ended December 29, 2017 would be approximately 4%. The primary drivers for the remaining difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are the current year generation of tax credits, and tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates during fiscal years 2018 through 2030 and windfall tax benefits related to vesting and exercises of stock-based awards. The windfall tax benefits are a result of the adoption of ASU 2016-09, which requires us to now recognize \$5 million and \$27 million of windfall tax benefits related to vesting and exercises of stock-based awards as a component of our income tax expense for the three and six months ended December 29, 2017, respectively. The windfall tax benefits for the three and six months ended December 30, 2016 were recorded within stockholders’ equity.

Income tax expense for the six months ended December 30, 2016 was attributable to discrete effects consisting of income tax expense from the integration of SanDisk Corporation (“SanDisk”) of \$90 million and a valuation allowance on acquired tax attributes of \$109 million, partially offset by income tax benefit from deductible debt issuance costs, debt discounts and prepayment fees from the debt extinguishment of \$96 million. The primary drivers for the difference between the effective tax rate for the six months ended December 30, 2016 and the U.S. Federal statutory rate of 35% are these discrete items, the current year generation of tax credits and tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates during fiscal years 2018 through 2030.

The 2017 Act is expected to have an unfavorable impact on our effective tax rate for fiscal year 2018 due to the mandatory deemed repatriation tax offset in part by the re-measurement of deferred taxes and the reduction in the corporate tax rate. In future years, certain additional provisions of the 2017 Act, such as a minimum tax on foreign earnings, will also apply to us and, as a result, we generally expect our effective tax rate to increase from the rate expected for fiscal year 2018 (excluding the mandatory deemed repatriation tax and the re-measurement of deferred taxes). Our estimate of the effective tax rate increase is subject to our assertion as to whether foreign undistributed earnings are indefinitely reinvested and to other calculations and elections during the measurement period. Our total tax expense in future fiscal years will also vary as a result of discrete items such as excess tax benefits or deficiencies.

For additional information regarding income tax expense (benefit), see Part I, Item 1, Note 10, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Table of Contents

Liquidity and Capital Resources

The following table summarizes our statements of cash flows:

| | Six Months Ended | |
|---|-------------------|-------------------|
| | December 29, 2017 | December 30, 2016 |
| | (in millions) | |
| Net cash provided by (used in): | | |
| Operating activities | \$2,315 | \$ 1,500 |
| Investing activities | (1,007) | (316) |
| Financing activities | (1,391) | (4,386) |
| Effect of exchange rate changes on cash | 1 | (9) |
| Net decrease in cash and cash equivalents | \$(82) | \$(3,211) |

We believe our cash, cash equivalents and cash generated from operations as well as our available credit facilities will be sufficient to meet our working capital, debt, stock repurchases, dividend and capital expenditure needs for at least the next twelve months. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A, Risk Factors, in this Quarterly Report on Form 10 Q.

During 2018, we expect cash used for purchases of property, plant and equipment and net activity in notes receivable and equity investments relating to Flash Ventures to be approximately \$1.50 billion to \$1.90 billion. The total expected cash to be used could vary depending on the timing and completion of various capital projects and the availability, timing and terms of related financing. As described above, we also expect that if the Refinancing Transactions and share repurchase are completed, our total debt outstanding will decrease by approximately \$1.00 billion and our available cash on hand will decrease by approximately \$2.40 billion compared to December 29, 2017. See above in “Key Developments - Refinancing Transactions” for additional information

Pursuant to the 2017 Act, we are required to pay a one-time deemed repatriation tax related to the undistributed earnings of our foreign subsidiaries. For the three and six months ended December 29, 2017, we recorded a provisional amount for the mandatory deemed repatriation tax liability of \$1.66 billion, which is payable over an 8-year period as further discussed below under “Short and Long-term Liquidity-Contractual Obligations and Commitments.” The provisional amount included in the Condensed Consolidated Financial Statements of Operations may change when we finalize the calculation of our post-1986 foreign earnings and profits that were previously deferred from U.S. income taxes and the amount of foreign earnings held in cash or other specified assets. For additional information regarding our total tax liability for the mandatory repatriation tax, see Part I, Item 1, Note 10, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

A total of \$4.90 billion and \$4.99 billion of our cash and cash equivalents was held outside of the U.S. as of December 29, 2017 and June 30, 2017, respectively. Although the mandatory deemed repatriation tax has removed U.S. federal taxes on distributions to the U.S., we continue to evaluate the expected manner of recovery to determine whether or not to assert indefinite reinvestment on a part or all the foreign undistributed earnings. This requires us to re-evaluate the existing short and long-term capital allocation policies in light of the 2017 Act and calculate the tax cost, that is incremental to the U.S. deemed repatriation tax, (e.g. foreign withholding, state income taxes, and additional U.S. tax on currency transaction gains or losses) of repatriating cash to the U.S. While the current tax expense is based upon an assumption that foreign undistributed earnings are indefinitely reinvested, our plan may change upon the completion of long-term capital allocation plans in light of the 2017 Act and completion of the calculation of the incremental tax effects on the repatriation of foreign undistributed earnings. In the event we determine not to continue to assert the permanent reinvestment of part or all of our foreign undistributed earnings such

a determination could result in the accrual and payment of additional foreign, state and local taxes.

Operating Activities

Cash flow from operating activities primarily consists of net income, adjusted for non-cash charges, plus or minus changes in other operating assets and liabilities. This represents our principal source of cash. Net cash provided by changes in other operating assets and liabilities was \$1.27 billion for the six months ended December 29, 2017, as compared to net cash used for changes in other operating assets and liabilities of \$37 million for the six months ended December 30, 2016.

Table of Contents

Changes in our other operating assets and liabilities is largely affected by our working capital requirements which is dependent on the effective management of our cash conversion cycle. Our cash conversion cycle measures how quickly we can convert our products into cash through sales. The cash conversion cycles were as follows:

| | December 29, 2017 | | December 30, 2016 | |
|---------------------------|----------------------|---|----------------------|---|
| | (in days) | | | |
| Days sales outstanding | 35 | | 38 | |
| Days in inventory | 62 | | 56 | |
| Days payables outstanding | (59 |) | (59 |) |
| Cash conversion cycle | 38 | | 35 | |

Changes in days sales outstanding (“DSOs”) are generally due to the linearity of shipments. Changes in days in inventory (“DIOs”) are generally related to the timing of inventory builds. Changes in days payables outstanding (“DPOs”) are generally related to production volume and the timing of purchases during the period. From time to time, we modify the timing of payments to our vendors. We make modifications primarily to manage our vendor relationships and to manage our cash flows, including our cash balances. Generally, we make the payment term modifications through negotiations with our vendors or by granting to, or receiving from, our vendors’ payment term accommodations.

For the six months ended December 29, 2017, DSO decreased by 3 days over the prior year, primarily reflecting routine variations in the timing of customer receipts. DIO increased by 6 days over the prior year, primarily reflecting short-term build-up of inventory to support expected demand. DPO primarily reflects routine variations in timing of purchases and payments and remained consistent over the prior year.

Investing Activities

Net cash used in investing activities for the six months ended December 29, 2017 primarily consisted of \$416 million of capital expenditures, a net \$509 million increase in notes receivable issuances to Flash Ventures, and \$99 million for acquisitions. Net cash used in investing activities for the six months ended December 30, 2016 primarily consisted of \$330 million of capital expenditures and a \$70 million net increase in notes receivable issuances to and investments in Flash Ventures.

Our cash equivalents are primarily invested in money market funds that invest in U.S. Treasury securities and U.S. Government agency securities as well as bank certificates of deposit. In addition, we invest directly in U.S. Treasury securities, U.S. and International Government agency securities, certificates of deposit, asset-backed securities and corporate and municipal notes and bonds.

Financing Activities

Net cash used in financing activities for the six months ended December 29, 2017 primarily consisted of \$4.11 billion in debt repayments and \$295 million to pay dividends on our common stock, partially offset by proceeds of \$2.96 billion from debt issuances, a net \$32 million in employee stock plans, and \$28 million from the settlement of debt hedge contracts. Net cash used in financing activities for the six months ended December 30, 2016 consisted of \$8.25 billion to repay debt, and \$284 million to pay dividends on our common stock, partially offset by \$3.99 billion of proceeds from debt, net of issuance costs, \$61 million of proceeds from call options, and a net \$106 million provided by employee stock plans.

Off-Balance Sheet Arrangements

Other than the commitments related to Flash Ventures, facility lease commitments incurred in the normal course of business and certain indemnification provisions (see “Contractual Obligations and Commitments” below), we do not have any other material off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any other obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in the Condensed Consolidated Financial Statements. Additionally, we do not have an interest in, or relationships with, any special-purpose entities. For additional information regarding our off-balance sheet arrangements, see Part I, Item 1, Note 8, Commitments, Contingencies and Related Parties, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Table of Contents

Short and Long-term Liquidity

Contractual Obligations and Commitments

The following is a summary of our known contractual cash obligations and commercial commitments as of December 29, 2017:

| | Total | 1 Year (Remaining 6 months of 2018) | 2-3 Years (2019-2020) | 4-5 Years (2021-2022) | More than 5 Years (Beyond 2022) |
|---|---------------|--|--------------------------|--------------------------|---|
| | (in millions) | | | | |
| Long-term debt, including current portion | \$12,237 | \$ 118 | \$ 816 | \$ 3,256 | \$ 8,047 |
| Interest on debt | 3,879 | 365 | 1,441 | 1,268 | 805 |
| Flash Ventures and other related commitments ⁽¹⁾ | 7,698 | 1,755 | 3,796 | 1,766 | 381 |
| Operating leases | 158 | 23 | 77 | 39 | 19 |
| Purchase obligations | 1,184 | 1,161 | 23 | — | |
| Mandatory Repatriation Tax | 1,657 | — | 265 | 265 | 1,127 |
| Total | \$26,813 | \$ 3,422 | \$ 6,418 | \$ 6,594 | \$ 10,379 |

Includes reimbursement for depreciation and lease payments on owned and committed equipment, funding commitments for loans and equity investments and reimbursement for other committed expenses, including R&D. ⁽¹⁾ Funding commitments assume no additional operating lease guarantees. Additional operating lease guarantees can reduce funding commitments.

Debt

See Part I, Item 1, Note 6, Debt, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q for information regarding our indebtedness, including information about new borrowings and repayments, increased availability under our revolving credit facility and the principal repayment terms, interest rates, covenants and other key terms of our outstanding indebtedness.

Interest Rate Swap

We have entered into interest rate swap agreements to moderate our exposure to fluctuations in interest rates underlying our variable rate debt. For a description of our current interest rate swaps, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk and Part I, Item 1, Note 5, Derivative Instruments and Hedging Activities, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Flash Ventures

Flash Ventures sells and leases back from a consortium of financial institutions a portion of its tools and has entered into equipment lease agreements of which we guarantee half of the total outstanding obligations. The lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the lease agreements contain acceleration clauses for certain events of default related to the guarantors, including us. As of December 29, 2017, we were in compliance with all covenants under these Japanese lease facilities. See Part I, Item 1, Note 8, Commitments, Contingencies and Related Parties, of the Notes to Condensed Consolidated Financial Statements included in this

Quarterly Report on Form 10-Q for information regarding Flash Ventures.

Foreign Exchange Contracts

We purchase foreign exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. For a description of our current foreign exchange contract commitments, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk and Part I, Item 1, Note 5, Derivative Instruments and Hedging Activities, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Table of Contents

Indemnifications

In the ordinary course of business, we may provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of our breach of agreements, products or services to be provided by us, environmental compliance or from IP infringement claims made by third parties. In addition, we have entered into indemnification agreements with our directors and certain of our officers that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We maintain director and officer insurance, which may cover certain liabilities arising from our obligation to indemnify our directors and officers in certain circumstances.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. Historically, we have not incurred material costs as a result of obligations under these agreements.

Mandatory Repatriation Tax

The following is a summary of our estimated provisional mandatory deemed repatriation tax obligations which are payable in the following fiscal years ending (in millions):

| | |
|---------------|---------|
| June 28, 2019 | \$132 |
| July 3, 2020 | 133 |
| July 2, 2021 | 132 |
| July 1, 2022 | 133 |
| June 30, 2023 | 132 |
| June 28, 2024 | 249 |
| June 27, 2025 | 332 |
| July 3, 2026 | 414 |
| Total | \$1,657 |

The 2017 Act allows for the provisional mandatory deemed repatriation tax of \$1.66 billion to be payable over an 8-year period without interest. The payments are due with 8% of the tax to be paid in each of the first five years, 15% in the 6th year, 20% in the 7th year, and 25% in the 8th year. For additional information regarding our provisional estimate of the total tax liability for the mandatory repatriation tax, see Part I, Item 1, Note 10, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Unrecognized Tax Benefits

As of December 29, 2017, the liability for unrecognized tax benefits (excluding accrued interest and penalties) was approximately \$529 million. Accrued interest and penalties related to unrecognized tax benefits as of December 29, 2017 was approximately \$94 million. Of these amounts, approximately \$502 million could result in potential cash payments. We are not able to provide a reasonable estimate of the timing of future tax payments related to these obligations. For additional information regarding our total tax liability for unrecognized tax benefits, see Part I, Item 1, Note 10, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Cash Dividend

Since the first quarter of 2013, we have issued a quarterly cash dividend. On November 1, 2017, we declared a cash dividend of \$0.50 per share of our common stock to our shareholders of record as of December 29, 2017. The cash dividend of \$149 million was paid on January 16, 2018.

On January 27, 2018, we declared a cash dividend of \$0.50 per share of our common stock to our shareholders of record as of March 30, 2018, which will be paid on April 16, 2018. We may modify, suspend, or cancel our cash dividend policy in any manner and at any time.

Table of Contents

Recently Issued Accounting Pronouncements Not Yet Adopted

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities ("ASU 2017-12"). ASU 2017-12 simplifies hedge accounting through changes to both designation and measurement requirements. For hedges that qualify as highly effective, the new standard eliminates the requirement to separately measure and record hedge ineffectiveness, resulting in better alignment between the presentation of the effects of the hedging instrument and the hedged item in the financial statements. ASU 2017-12 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted in any interim period after issuance of the update. We are currently evaluating the impact this update will have on our Consolidated Financial Statements.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2017-09"). ASU 2017-09 provides clarification when a change to the terms or conditions of a share-based payment award must be accounted for as a modification. The new guidance requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. This ASU is effective prospectively for annual periods beginning after December 15, 2017, which for us is the first quarter of 2019. Early adoption is permitted within the first interim period. The adoption of this standard is not expected to have a material impact on our Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-07, "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" ("ASU 2017-07"). ASU 2017-07 requires that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The new standard is effective for fiscal years beginning after December 15, 2017, which for us is the first quarter of 2019. Early adoption is permitted within the first interim period. We are currently evaluating the impact ASU 2017-07 will have on our Consolidated Financial Statements.

In February 2017, the FASB issued ASU No. 2017-05, "Other Income-Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets" ("ASU 2017-05"). ASU 2017-05 clarifies the scope and application of Accounting Standards Codification ("ASC") 610-20 on the sale or transfer of nonfinancial assets, including real estate, and in substance nonfinancial assets to noncustomers, including partial sales. An entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of the related asset. The ASU also clarifies that an in substance nonfinancial asset is an asset or group of assets for which substantially all of the fair value consists of nonfinancial assets and the group or subsidiary is not a business. In addition, the amendment requires an entity to derecognize a distinct nonfinancial asset or in substance nonfinancial asset in a partial sale transaction when the entity does not retain a controlling financial interest in the legal entity that holds the asset and an entity transfers control of the asset. Once control is transferred, any non-controlling interest received is required to be measured at fair value. The effective date of the new standard is aligned with the requirements in the new revenue standard ASU No. 2014-09, which for us is the first quarter of 2019. The Company is in the process of evaluating the impact that adoption of this guidance may have on our Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”). ASU 2017-04 simplifies the test for goodwill impairment by removing Step 2 from the goodwill impairment test. Companies will now perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value not to exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The new standard is effective for goodwill impairment tests in fiscal years beginning after December 15, 2019, which for us is the first quarter of 2021. Early adoption is permitted for goodwill impairment tests performed after January 1, 2017. The adoption of this standard is not expected to have a material impact on our Consolidated Financial Statements.

Table of Contents

In January 2017, the FASB issued ASU No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (“ASU 2017-01”). ASU 2017-01 narrows the definition of a “business”. This standard provides guidance to assist entities with evaluating when a set of transferred assets and activities is a business. The new standard is effective for fiscal years beginning after December 15, 2017, which for us is the first quarter of 2019. The new standard must be applied prospectively to transactions occurring within the period of adoption. The adoption of this standard is not expected to have a material impact on our Consolidated Financial Statements.

In October 2016, the FASB issued ASU No. 2016-16, “Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory” (“ASU 2016-16”). ASU 2016-16 removes the prohibition in the FASB Accounting Standards Codification (“ASC”) Topic 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The new standard is intended to reduce the complexity of accounting principles generally accepted in the United States (“U.S. GAAP”) and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving IP. The new standard is effective for fiscal years beginning after December 15, 2017, which for us is the first quarter of 2019. Early adoption is permitted. We are currently evaluating the impact ASU 2016-16 will have on our Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). ASU 2016-13 seeks to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments, including trade receivables, and other commitments to extend credit held by a reporting entity at each reporting date. The amendments require an entity to replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects current expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, which for us is the first quarter of 2021. We are currently evaluating the impact this update will have on our Consolidated Financial Statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). ASU 2016-02 supersedes ASC 840 “Leases”. The amendments in this update require, among other things, that lessees recognize the following for all leases (unless a policy election is made by class of underlying asset to exclude short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Currently, lessees and lessors must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. However, the FASB issued a proposal pending resolution that would allow entities to apply the provisions of ASC 842 at the effective date without adjusting comparative periods. The amendments are effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. We are also in the process of identifying changes to our processes, internal controls and systems configurations that would result from the new lease standard. Our implementation efforts are progressing as planned. We expect to adopt this standard in the first quarter of 2020. We continue to evaluate the impact ASU 2016-02 will have on our Consolidated Financial Statements.

In January 2016, the FASB issued ASU No. 2016-01, “Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities” (“ASU 2016-01”). ASU 2016-01 provides guidance related to accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments, including the requirement to measure certain equity investments at fair value with changes in fair value recognized in net income. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, which

for us is the first quarter of 2019. Early adoption is not permitted. We are currently evaluating the impact ASU 2016-01 will have on our Consolidated Financial Statements.

Table of Contents

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASC Topic 606”), which amends the guidance in former ASC Topic 605, “Revenue Recognition”, to provide a single, comprehensive revenue recognition model for all contracts with customers. ASC Topic 606 requires an entity to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration to which an entity expects to be entitled in exchange for those goods or services. The new standard also requires entities to enhance disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The standard is effective beginning the first quarter of fiscal 2019, with early adoption permitted. The standard may be applied retrospectively to all prior periods presented (“full retrospective method”), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (“modified retrospective method”). Based on our preliminary plan, we intend to adopt the new standard beginning with the first quarter of 2019 using the modified retrospective method; however, we continue to assess this in connection with our entire project plan.

We expect the implementation of the new standard to impact the recognition of our revenue as follows:

Substantially all of our current revenue is from the sale of hardware products. We do not expect any material changes to the timing or amount of revenue for these types of sales under the new standard.

For sales-based royalties, we will need to estimate and recognize revenue in the period the royalty-bearing sales occur as opposed to the existing treatment of recognizing revenue in the period the royalty report is received. This change will result in the acceleration of revenue recognition by one fiscal quarter as well as fluctuations between the estimated and actual reported sales-based royalties which we do not expect to be material.

For software and IP licenses, we are still assessing the impact and timing to revenue from the implementation of the new standard. However, we do not currently expect the new standard to have a material impact on our revenue for these types of arrangements.

Our revenue disclosures are expected to expand and may require judgment in certain areas.

As we are completing our assessment, we are also identifying and preparing to implement changes to our processes, internal controls and systems configurations from the implementation of the new revenue standard. We do not currently expect any significant changes to our other accounting policies from the adoption of the new revenue standard. Our implementation efforts are progressing as planned.

For a description of recently adopted accounting pronouncements, including the respective dates of adoption and effects on our results of operations and financial condition, see Part I, Item 1, Note 2, Recently Adopted Accounting Pronouncements, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Critical Accounting Policies and Estimates

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements in accordance with U.S. GAAP. The preparation of the financial statements requires the use of judgments and estimates that affect the reported amounts of revenues, expenses, assets, liabilities and shareholders’ equity. We have adopted accounting policies and practices that are generally accepted in the industry in which we operate. If these estimates differ significantly from actual results, the impact to the Condensed Consolidated Financial Statements may be material.

There have been no material changes in our critical accounting policies and estimates from those disclosed in our Annual Report on Form 10 K for our fiscal year ended June 30, 2017. Please refer to Part II, Item 7 of our Annual

Report on Form 10 K for the fiscal year ended June 30, 2017 for a discussion of our critical accounting policies and estimates.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Disclosure About Foreign Currency Risk

Although the majority of our transactions are in U.S. dollars, some transactions are based in various foreign currencies. We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for product costs and operating expenses denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on our results of operations. The contract maturity dates do not exceed 12 months. We do not purchase foreign exchange contracts for speculative or trading purposes. For additional information, see Part I, Item 1, Note 4, Fair Value Measurements and Investments and Note 5, Derivative Instruments and Hedging Activities of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

As of December 29, 2017, we had outstanding the foreign exchange contracts presented in the following table. The designated foreign exchange contracts are entered to protect the U.S. dollar value of our product cost and operating expenses. Changes in fair values of the non-designated foreign exchange contracts would be largely offset in other income (expense) by corresponding changes in the fair values of the foreign currency denominated monetary assets and liabilities.

| Designated Hedges (cash flow hedges) | Contract Amount | Weighted-Average Contract Rate ⁽¹⁾ | Mark to Market Unrealized Gain (Loss) |
|--|--|--|---|
| | (in millions, except weighted-average contract rate) | | |
| Japanese yen | \$426 | 111.39 | \$ (2) |
| Malaysian ringgit | 96 | 4.17 | 3 |
| Philippine peso | 41 | 51.18 | 1 |
| Singapore dollar | 2 | 1.41 | — |
| Thai baht | 125 | 32.77 | 1 |
| Total designated forward contracts | \$690 | | \$ 3 |
| Non-Designated Hedges | Contract Amount | Weighted-Average Contract Rate ⁽¹⁾ | Unrealized Gain (Loss) |
| | (in millions, except weighted-average contract rate) | | |
| British pound sterling | \$43 | 0.74 | \$ — |
| Euro | 88 | 0.84 | — |
| Japanese yen | 1,273 | 112.11 | — |
| Malaysian ringgit | 78 | 4.13 | 2 |
| Philippine peso | 79 | 50.19 | — |
| Singapore dollar | 43 | 1.34 | — |
| Thai baht | 280 | 32.63 | — |
| Total non-designated forward contracts | \$1,884 | | \$ 2 |

⁽¹⁾ Expressed in units of foreign currency per U.S. dollar.

During the three and six months ended December 29, 2017 and December 30, 2016, total net realized transaction and foreign exchange contract currency gains and losses were not material to our Condensed Consolidated Financial Statements.

Notwithstanding our efforts to mitigate some foreign exchange risks, we do not hedge all of our foreign currency exposures, and there can be no assurance that our mitigating activities related to the exposures that we hedge will adequately protect us against risks associated with foreign currency fluctuations.

Table of Contents

Disclosure About Other Market Risks

Variable Interest Rate Risk

Borrowings under our Term Loan A and our revolving credit facility bear interest at a rate per annum, at our option, of either an adjusted London Interbank Offered Rate (“LIBOR”) (subject to a 0.0% floor) plus an applicable margin of 1.75% or at a base rate plus an applicable margin of 0.75% (3.32% as of December 29, 2017). The applicable margin for the borrowings under our Term Loan A and our revolving credit facility will range, depending on our leverage, from 1.50% to 2.25% for LIBOR loans and from 0.50% to 1.25% for base rate loans.

Borrowings under the U.S. Term Loan B-3 tranche bear interest at a rate per annum, at our option, of an adjusted LIBOR, subject to a 0.00% floor, plus 2.00% or a base rate plus 1.00% (3.57% as of December 29, 2017).

We have generally held a balance of fixed and variable rate debt. At December 29, 2017, 57% of the par value of our debt was at variable rates. To balance the portfolio, we entered into a pay-fixed interest rate swap on \$1.00 billion notional amount, which effectively converts a portion of our term loan to fixed rates through May 2020. As of December 29, 2017, we had \$6.98 billion of variable rate debt. After giving effect to the \$1.00 billion of interest rate swaps, we effectively had \$5.98 billion of long-term debt subject to variations in interest rates and a one percent increase in the variable rate of interest, subject to each loan’s specific floor, would increase annual interest expense by \$60 million.

For additional information regarding our term loans and our interest rate swaps, see Part I, Item 1, Note 6, Debt, of the Notes to the Condensed Consolidated Financial Statements included in this quarterly report on Form 10-Q and Part II, Item 8, Note 6, Debt, to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2017.

Item 4. Controls and Procedures

As required by Rule 13a-15(b) promulgated by the SEC under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

We are implementing an enterprise resource planning (“ERP”) system on a worldwide basis, which is expected to improve the efficiency of certain financial and related transaction processes. The gradual implementation is expected to occur in phases over the next several years. We have completed the implementation of certain processes, including the consolidation process, and have revised and updated the related controls. These changes did not materially affect our internal control over financial reporting. As we implement the remaining functionality under this ERP system over the next several years, we will continue to assess the impact on our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a description of our legal proceedings, see Part I, Item 1, Note 13, Legal Proceedings, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated by reference in response to this item.

Item 1A. Risk Factors

Our business, financial condition and operating results can be affected by a number of risks and uncertainties, whether currently known or unknown, any one or more of which could, directly or indirectly, cause our actual results of operations and financial condition to vary materially from past, or from anticipated future, results of operations and financial condition. The risks and uncertainties discussed below are not the only ones facing our business, but do represent those risks and uncertainties that we believe are material to us. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also adversely affect our business, financial condition, results of operations or the market price of our common stock.

The risks and uncertainties discussed below update and supersede the risks and uncertainties previously disclosed in Part II, Item 1A of our Quarterly Report on Form 10-Q for the quarterly period ended September 29, 2017. Other than the changes to the risk factors below titled, “We rely substantially on our business ventures with Toshiba’s wholly owned subsidiary, Toshiba Memory Corporation (“TMC”), for the supply of NAND-flash memory and the development of NAND-flash technology, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results,” “If we are unable to successfully integrate the systems and operations of HGST, our business and financial condition may be adversely affected,” and “Changes in tax laws could increase our worldwide tax rate and materially affect our financial position and results of operations,” we do not believe any of the changes constitute material changes to the risk factors previously disclosed in such prior Quarterly Report on Form 10-Q.

Adverse global economic conditions and credit market uncertainty could harm our business, results of operations and financial condition.

Adverse global economic conditions and uncertain conditions in the credit market have had, and in the future could have, a significant adverse effect on our company and on the storage industry as a whole. Several factors contribute to these conditions and this uncertainty, including, but not limited to, volatility in the equity, credit and other financial markets and real estate markets, slower growth in certain geographic regions, lower levels of consumer liquidity, risk of default on sovereign debt, higher interest rates, materials and component cost increases, political uncertainty and other macroeconomic factors, such as the June 2016 referendum by British voters to exit the European Union, commonly referred to as “Brexit,” and changes to policies, rules and regulations which may be proposed or implemented by the U.S. President and his administration. Some of the risks and uncertainties we face as a result of these conditions include the following:

Volatile Demand and Supplier Risk. Our direct and indirect customers may delay or reduce their purchases of our products and systems containing our products. In addition, many of our customers rely on credit financing to purchase our products. If negative conditions in the global credit markets prevent our customers’ access to credit, product orders may decrease, which could result in lower revenue. Likewise, if our suppliers, sub-suppliers and sub-contractors (collectively referred to as “suppliers”), or partners face challenges in obtaining credit, in selling their products or otherwise in operating their businesses, they may be unable to offer the materials we use to manufacture our products. These actions could result in reductions in our revenue and increased operating costs, which could adversely affect our business, results of operations and financial condition.

Restructuring Activities. If demand for our products slows as a result of a deterioration in economic conditions, we may undertake restructuring activities to realign our cost structure with softening demand. The occurrence of restructuring activities could result in impairment charges and other expenses, which could adversely impact our results of operations and financial condition.

Table of Contents

Credit Volatility and Loss of Receivables. We extend credit and payment terms to some of our customers. In addition to ongoing credit evaluations of our customers' financial condition, we seek to mitigate our credit risk from time to time by purchasing credit insurance on certain of our accounts receivable balances. As a result of the continued uncertainty and volatility in global economic conditions, however, we may find it increasingly difficult to be able to insure these accounts receivable. We could suffer significant losses if a customer whose accounts receivable we have not insured, or have underinsured, fails to pay us on their accounts receivable balances. Additionally, negative or uncertain global economic conditions increase the risk that if a customer we have insured fails to pay us on their accounts receivable, the financial condition of the insurance carrier for such customer account may have also deteriorated such that it cannot cover our loss. A significant loss of accounts receivable that we cannot recover through credit insurance would have a negative impact on our financial condition.

Impairment Charges. We test goodwill for impairment annually as of the first day of our fourth quarter and at other times if events have occurred or circumstances exist that indicate the carrying value of goodwill may no longer be recoverable. Negative or uncertain global economic conditions could result in circumstances, such as a sustained decline in our stock price and market capitalization or a decrease in our forecasted cash flows, indicating that the carrying value of our long-lived assets or goodwill may be impaired. If we are required to record a significant charge to earnings in our Consolidated Financial Statements because of an impairment of our long-lived assets or goodwill, our results of operations will be adversely affected.

We rely substantially on our business ventures with Toshiba's wholly owned subsidiary, Toshiba Memory Corporation ("TMC"), for the supply of NAND-flash memory and the development of NAND-flash technology, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results.

We are dependent on our ventures with Toshiba's wholly owned subsidiary, TMC, to develop and manufacture NAND-flash memory products for our NAND-flash memory supply, and therefore our business, financial condition and operating results, and our ability to realize the anticipated benefits from our acquisition of SanDisk Corporation ("SanDisk") in May 2016, pursuant to an Agreement and Plan of Merger (the "Merger"), is dependent on the continued success of Flash Ventures.

The majority of our NAND-flash memory is supplied by Flash Ventures, which limits our ability to respond to market demand and supply changes. A failure to accurately forecast demand could cause us to over-invest or under-invest in technology transitions or the expansion of captive memory capacity in Flash Ventures. Over-investment could result in excess supply, which could cause significant decreases in our product prices, significant excess, obsolete or lower of cost or net realizable value inventory write-downs or under-utilization charges, and the potential impairment of our investments in Flash Ventures. On the other hand, if we or TMC under-invest in captive memory capacity or technology transitions, if we grow capacity more slowly than the rest of the industry, if our technology transitions do not occur on the timeline that we expect, if we encounter unanticipated difficulties in implementing these transitions, or if we implement technology transitions more slowly than our competitors, we may not have enough captive supply of the right type of memory or at all to meet demand on a timely and cost effective basis and we may lose opportunities for revenue, gross margin and share as a result. If our NAND memory supply is limited, we may make strategic decisions with respect to the allocation of our supply among our products and customers, and these strategic allocation decisions may result in less favorable gross margin in the short term or damage certain customer relationships. Growth of our NAND-flash memory bit supply at a slower rate than the overall industry for an extended period of time would result in lowering our share which could limit our future opportunities and harm our financial results. We are also contractually obligated to pay for 50% of the fixed costs of Flash Ventures regardless of whether we purchase any wafers from Flash Ventures. Furthermore, purchase orders placed with Flash Ventures and under the foundry arrangements with TMC for up to three months are binding and cannot be canceled. Therefore, once our purchase decisions have been made, our production costs for flash memory are fixed, and we may be unable to reduce costs to match any subsequent declines in pricing or demand, which would harm our gross margin. Our limited ability

to react to fluctuations in flash memory supply and demand makes our financial results particularly susceptible to variations from our forecasts and expectations.

In addition, we partner with TMC on the development of NAND-flash technology, including the next technology transitions of NAND-flash, as well as other non-volatile memory technology in support of Flash Ventures.

Table of Contents

These ventures are subject to various risks that could harm the value of our investments, our revenue and costs, our future rate of spending, our technology plans and our future growth opportunities. Under the terms of our venture agreements with TMC, which govern the operations of Flash Ventures, we have limited power to unilaterally direct most of the activities that most significantly impact Flash Ventures' performance and we have limits to our ability to source or fabricate NAND-flash products outside of the Flash Ventures. The integration of SanDisk into our organization could complicate the process of reaching agreement with TMC in a timely and favorable manner. We may not always agree with TMC on our joint R&D roadmap or expansions or conversions of production capacity. In addition, Toshiba's financial position or TMC's shift in strategic priorities could adversely impact our business.

In March 2017, Toshiba announced significant losses related to its U.S. nuclear business and, in connection with its fiscal year 2016 financial statements, Toshiba advised that there were material events and conditions that raise substantial doubt about its ability to continue as a going concern. Subsequently, in September 2017, Toshiba announced it had entered into a definitive agreement to sell TMC, including its interests in Flash Ventures, to a consortium led by SK Hynix Inc. and Bain Capital (the "Bain Consortium") that includes other competitors, as well as key customers. We previously asserted our consent rights under the terms of the Flash Ventures agreements with respect to the transactions involving, among other things, the transfer by Toshiba of its interests in Flash Ventures to TMC and the proposed sale of TMC to the Bain Consortium. In December 2017, in connection with a global settlement agreement with Toshiba and TMC, we consented to the transfer of Toshiba's interests in Flash Ventures to TMC and the sale of TMC to the Bain Consortium. If the Bain Consortium or another third party acquires any of Toshiba's interests in Flash Ventures, it could lead to delays in decision-making, disputes, or changes in strategic direction that could adversely impact Flash Ventures and/or adversely affect our business prospects, results of operations and financial condition. The purchaser might not have the same interest that we do in protecting and growing Flash Ventures' business and might have conflicts of interest between itself and Flash Ventures or us. To the extent Toshiba retains its interests in TMC, a failure by Toshiba to stabilize its financial condition could cause TMC to become unable to, or otherwise fail to, timely fund investments in Flash Ventures or our joint development efforts or fulfill its payment obligations to suppliers, which could harm Flash Ventures' operations, our joint technology roadmap and supplier relationships. Reduced investment in manufacturing capacity or research and development, or other misalignment between us and Toshiba, TMC or a third party acquirer of TMC on strategic direction, could impact Flash Ventures' ability to stay at the forefront of technological advancement and/or our investment in Flash Ventures. Flash Ventures' competitiveness and/or our investment in Flash Ventures could also be harmed by a mishandling or misuse of IP or other competitively sensitive confidential information regarding Flash Ventures, such as its technology roadmap, business or investment plans, by a third party that might gain access to such information.

Flash Ventures requires significant investments by both TMC and us for technology transitions, including the transition to 3D NAND, and capacity expansions. Lease financings guaranteed by or on behalf of both TMC and us are not currently available to Flash Ventures on favorable terms and we are pursuing alternative forms of financing to fund our share of investments, which might not continue to be accessible. To the extent that lease financings for Flash Ventures are not available on favorable terms or at all, more cash would be required to fund investments. If TMC does not or we do not provide sufficient resources, or have adequate access to credit, to timely fund investments in Flash Ventures, our investments could be delayed or reduced.

As announced by Toshiba, TMC plans to construct a new wafer fabrication facility in Iwate, Japan to provide additional cleanroom space for the manufacture of 3D NAND, with site preparation scheduled to begin in February 2018. Although we intend to enter into agreements with TMC in due course to participate in the new Iwate facility, there is no certainty as to when, and on what terms, we will do so. If we are unable to extend our partnership with TMC to the Iwate facility on favorable terms, our future supply of captive NAND-flash memory could be adversely impacted, which could adversely affect our long-term business and financial results.

We are monitoring and evaluating other potential impacts of Toshiba's planned sale of TMC and financial condition on Flash Ventures and, in turn, on our own memory business and financial condition. These factors could adversely affect the value of our investments in Flash Ventures and our business prospects, results of operations and financial condition.

Table of Contents

Integrating SanDisk's operations with ours may be more difficult, costly or time consuming than expected and the anticipated benefits, synergies and cost savings of the Merger may not be realized.

The success of our acquisition of SanDisk, including anticipated benefits, synergies and cost savings, will depend, in part, on our ability to successfully combine and integrate the businesses and culture of SanDisk into our company. It is possible that the integration process will take longer than anticipated. In addition, the integration process could result in the loss of key employees, higher than expected costs, ongoing diversion of management attention, the disruption of our ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect our ability to maintain relationships with customers, vendors, partners and employees. If we experience difficulties with the integration process, the anticipated benefits of the Merger may not be realized fully or at all, or may take longer to realize than expected. In addition, the actual cost savings of the Merger could be less than anticipated. Additionally, the integration of SanDisk's operations into our operations may also increase the risk that our internal controls are found to be ineffective.

Achieving the benefits of the Merger will depend, in part, on our ability to integrate the business and operations of SanDisk successfully and efficiently with our business. The challenges involved in this integration, which will be complex and time-consuming, include, but are not limited to, the following:

- difficulties entering new markets or manufacturing in new geographies where we have no or limited direct prior experience;
- successfully managing relationships with our strategic partners and our combined supplier and customer base;
- coordinating and integrating independent R&D and engineering teams across technologies and product platforms to enhance product development while reducing costs;
- increased levels of investment in R&D, manufacturing capability and technology enhancement relating to SanDisk's business;
- successfully transitioning to 3D NAND and future technologies;
- coordinating sales and marketing efforts to effectively position the combined company's capabilities and the direction of product development;
- difficulties in integrating the systems and processes of two companies with complex operations and multiple manufacturing sites;
- the increased scale and complexity of our operations resulting from the Merger;
- retaining key employees;
- obligations that we have to counterparties of SanDisk that arose as a result of the change in control of SanDisk; and
- the diversion of management attention from other important business objectives.

If we do not successfully manage these issues and the other challenges inherent in integrating an acquired business of the size and complexity of SanDisk, then we may not achieve the anticipated benefits of the Merger and our revenue, expenses, operating results and financial condition could be materially adversely affected.

Our high level of debt may have an adverse impact on our liquidity, restrict our current and future operations, particularly our ability to respond to business opportunities, and increase our vulnerability to adverse economic and industry conditions.

As of December 29, 2017, our total indebtedness was \$12.24 billion in aggregate principal, and we had \$1.5 billion of additional borrowing availability under our revolving credit facility. On January 29, 2018, we announced the Refinancing Transactions, which remain subject to market and other conditions. After giving effect to the Refinancing Transactions, as of December 29, 2017 our total indebtedness would have been \$11.3 billion in aggregate principal and we would have had \$1.5 billion of additional borrowing availability under our revolving credit facility.

Table of Contents

Our high level of debt could have significant consequences, which include, but are not limited to, the following:

• limiting our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or other general corporate purposes;

• requiring a substantial portion of our cash flows to be dedicated to debt service payments instead of other purposes, thereby reducing the amount of cash flows available for working capital, capital expenditures, acquisitions, R&D and other general corporate purposes;

• imposing financial and other restrictive covenants on our operations, including limiting our ability to (i) declare or pay dividends or purchase our common stock; (ii) purchase assets, make investments, complete acquisitions, consolidate or merge with or into, or sell all or substantially all of our assets to, another person; (iii) dispose of assets; (iv) incur liens; and (v) enter into transactions with affiliates;

• placing us at a competitive disadvantage to competitors carrying less debt; and

• making us more vulnerable to economic downturns and limiting our ability to withstand competitive pressures or take advantage of new opportunities to grow our business.

Our ability to meet the debt service obligations contained in our debt agreements will depend on our available cash and our future performance, which will be affected by financial, business, economic and other factors, including potential changes in laws or regulations, industry conditions, industry supply and demand balance, customer preferences, the success of our products and pressure from competitors. If we are unable to meet our debt service obligations or should we fail to comply with our financial and other restrictive covenants contained in the agreements governing our indebtedness, causing an event of default under the applicable indebtedness, the debt holders could accelerate the related debt and that may result in the acceleration of any other debt, leases or other obligations to which a cross acceleration or cross-default provision applies. If we are required to repay our indebtedness before the due dates, we may not have sufficient funds available to repay such indebtedness and we may be required to refinance all or part of our debt, sell important strategic assets at unfavorable prices, incur additional indebtedness or issue common stock or other equity securities. We may not be able to, at any given time, refinance our debt, sell assets, incur additional indebtedness or issue equity securities on terms acceptable to us, in amounts sufficient to meet our needs or at all. Our inability to service our debt obligations or refinance our debt could have a material adverse effect on our business, operating results and financial condition. Further, if we are unable to repay, refinance or restructure our secured indebtedness, the holder of such debt could proceed against the collateral securing that indebtedness. Refinancing our indebtedness, including through the Refinancing Transactions, may also require us to expense previous debt issuance costs or to incur new debt issuance costs.

In addition, our credit ratings impact the cost and availability of future borrowings and, accordingly, our cost of capital. Our ratings reflect the opinions of the ratings agencies of our financial strength, operating performance and ability to meet our debt obligations. There can be no assurance that we will achieve a particular rating or maintain a particular rating in the future.

We may from time to time seek to further refinance our substantial indebtedness by issuing additional shares of our common stock in one or more securities offerings. These securities offerings may dilute our existing shareholders, reduce the value of our common stock, or both. Because our decision to issue securities will depend on, among other things, market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of any future securities offerings. Thus, holders of our common stock bear the risk of our future offerings diluting and potentially reducing the value of our common stock.

Table of Contents

We participate in a highly competitive industry that is subject to declining average selling prices (“ASPs”), volatile gross margins and significant shifts in market share, all of which could adversely affect our operating results and financial condition.

Demand for our devices, software and solutions that we offer to our customers, which we refer to in this Item 1A as our “products”, depends in large part on the demand for systems (including personal computers (“PCs”) and mobile devices) manufactured by our customers and on storage upgrades to existing systems. The demand for systems has been volatile in the past and often has had an exaggerated effect on the demand for our products in any given period. The price of NAND-flash memory is influenced by, among other factors, the balance between supply and demand, including the effects of new fab capacity in the industry, macroeconomic factors, business conditions, technology transitions, conversion of industry DRAM capacity to NAND, conversion of 2D NAND capacity to 3D NAND or other actions taken by us or our competitors. The price of HDDs is influenced by, among other factors, the balance between supply and demand, including the effects of new fab capacity in the industry, macroeconomic factors, business conditions, technology transitions, and other actions taken by us or our competitors. The storage market has experienced periods of excess capacity, which can lead to liquidation of excess inventories and significant reductions in price. If these price changes occur unnecessarily or in an unexpected manner, there will likely be an adverse impact on our revenue and gross margins. In addition, we compete based on our ability to offer our customers competitive solutions that provide the most current and desired product and service features. We expect that competition will continue to be intense, and there is a risk that our competitors’ products may be less costly, provide better performance or include additional features when compared to our products. Additionally, some of our competitors may be able to use their broader portfolio of products to win sales from us. Our ASPs and gross margins also tend to decline when there is a shift in the mix of product sales, and sales of lower priced products increase relative to those of higher priced products. Further, we face potential gross margin pressures resulting from our ASPs declining more rapidly than our cost of goods sold. Rapid technological changes often reduce the volume and profitability of sales of existing products and increase the risk of inventory obsolescence. These factors, along with others, may also result in significant shifts in market share among the industry’s major participants, including a substantial decrease in our market share, all of which could adversely impact our operating results and financial condition.

Our failure to accurately forecast market and customer demand for our products, or to quickly adjust to forecast changes, could adversely affect our business and financial results or operating efficiencies.

The data storage industry faces difficulties in accurately forecasting market and customer demand for its products. The variety and volume of products we manufacture are based in part on these forecasts. Accurately forecasting demand has become increasingly difficult for us, our customers and our suppliers in light of the volatility in global economic conditions and industry consolidation, resulting in less availability of historical market data for certain product segments. Further, for many of our OEMs utilizing just-in-time inventory, we do not generally require firm order commitments and instead receive a periodic forecast of requirements, which may prove to be inaccurate. In addition, because our products are designed to be largely interchangeable with competitors’ products, our demand forecasts may be impacted significantly by the strategic actions of our competitors. As forecasting demand becomes more difficult, the risk that our forecasts are not in line with demand increases. If our forecasts exceed actual market demand, then we could experience periods of product oversupply, excess inventory, and price decreases, which could impact our financial performance. If market demand increases significantly beyond our forecasts or beyond our ability to add manufacturing capacity, then we may not be able to satisfy customer product needs, possibly resulting in a loss of market share if our competitors are able to meet customer demands. In addition, some of our components have long lead-times, requiring us to place orders several months in advance of anticipated demand. Such long lead-times increase the risk of excess inventory or loss of sales in the event our forecasts vary substantially from actual demand.

We experience significant sales seasonality and cyclicalities, which could cause our operating results to fluctuate.

Sales of computer systems, mobile devices, storage subsystems, gaming consoles and consumer electronics (“CE”) tend to be seasonal and cyclical, and therefore we expect to continue to experience seasonality and cyclicity in our business as we respond to variations in our customers’ demand for our products. However, changes in seasonal and cyclical patterns have made it, and could continue to make it, more difficult for us to forecast demand, especially as a result of the current macroeconomic environment. Changes in the product or channel mix of our business can also impact seasonal and cyclical patterns, adding complexity in forecasting demand. Seasonality and cyclicity also may lead to higher volatility in our stock price. It is difficult for us to evaluate the degree to which seasonality and cyclicity may affect our stock price or business in future periods because of the rate and unpredictability of product transitions and new product introductions and macroeconomic conditions.

Table of Contents

Our sales to the CE, cloud computing, network attached storage (“NAS”), surveillance systems and enterprise markets, which have accounted for and may continue accounting for an increasing percentage of our overall revenue, may grow at a slower rate than current estimates or not at all, which could materially adversely impact our operating results and financial condition.

The secular growth of digital data has resulted in a more diversified mix of revenue from the CE, cloud computing, NAS, surveillance systems and enterprise markets. As sales into these markets have become a more significant portion of our revenue, events or circumstances that adversely impact demand in these markets, or our inability to address that demand successfully, could materially adversely impact our operating results. For example, demand in, or our sales to, these markets may be adversely affected by the following:

Mobile Devices. There has been and continues to be a rapid growth in devices that do not contain a hard drive such as tablet computers and smart phones. As tablet computers and smart phones provide many of the same capabilities as PCs, they have displaced or materially affected, and we expect will continue to displace or materially affect, the demand for PCs. If we are not successful in adapting our product offerings to include disk drives or alternative storage solutions that address these devices, even after our acquisition of SanDisk, demand for our products in these markets may decrease and our financial results could be materially adversely affected. In addition, global slowdown in the growth rate of mobile devices will also negatively impact our financial results.

Enterprise. The enterprise storage space is comprised of customers with long design, qualification and test cycles prior to sales. We spend substantial time and resources in our sales process without any assurance that our efforts will produce any customer orders on the timelines or in the quantities we expect. These lengthy and uncertain processes also make it difficult for us to forecast demand and timing of customer orders. Due to longer customer product cycles, we may not be able to transition customers to our leading edge products, which would prevent us from benefitting from the technology transitions that enable cost reductions, which may harm our gross margin. Demand for our enterprise solutions from our hyperscale customers is correlated to large projects and expansions which can be sporadic, resulting in demand that is lumpy and less consistent than the consumer-driven demand for many of our solutions. Hyperscale customers may place orders for significant volumes with short lead times that may be difficult for us to fulfill, and sales to hyperscale customers may negatively impact gross margins due to product mix and pricing, each of which could adversely affect our business. In addition, hyperscale companies may internally develop enterprise storage solutions that reduce the demand for our solutions.

Cloud Computing. Consumers traditionally have stored their data on their PC, often supplemented with personal external storage devices. Most businesses also include similar local storage as a primary or secondary storage location. This storage is typically provided by HDDs and increasingly SSDs. With cloud computing, applications and data are hosted, accessed and processed through a third-party provider over a broadband Internet connection, potentially reducing or eliminating the need for, among other things, significant storage inside the accessing electronic device. Even if we are successful at increasing revenues from sales to cloud computing customers, if we are not successful in manufacturing compelling products to address the cloud computing opportunity, demand for our products in these other markets may decrease and our financial results could be materially adversely affected. Demand for cloud computing solutions themselves may be volatile due to differing patterns of technology adoption and innovation, improved data storage efficiency by cloud computing service providers, and concerns about data protection by end users.

Obsolete Inventory. In some cases, products we manufacture for these markets are uniquely configured for a single customer’s application, creating a risk of obsolete inventory if anticipated demand is not actually realized. In addition, rapid technological change in our industry increases the risk of inventory obsolescence.

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Macroeconomic Conditions. Consumer spending has been, and may continue to be, adversely affected in many regions due to negative macroeconomic conditions and high unemployment levels. Please see the risk factor entitled “Adverse global economic conditions and credit market uncertainty could harm our business, results of operations and financial condition” for additional risks and uncertainties relating to macroeconomic conditions.

Table of Contents

In addition, demand in these areas also could be negatively impacted by developments in the regulation and enforcement of digital rights management and the emergence of new technologies, such as data duplication, compression and storage virtualization. If we are not able to respond appropriately, these factors could lead to our customers' storage needs being satisfied at lower prices with lower capacity hard drives or solid-state storage products, thereby decreasing our revenue or putting us at a disadvantage to competing storage technologies. As a result, even with increasing aggregate demand for digital storage, if we fail to anticipate or timely respond to these developments in the demand for storage, our ASPs could decline, which could adversely affect our operating results and financial condition. Furthermore, our ability to accurately read and respond to market trends, such as trends relating to the Internet of Things (commonly referred to as "IoT") or big data, could harm our results.

Deterioration in the PC market may continue or accelerate, which could cause our operating results to suffer.

While sales to non-PC markets are becoming a more significant source of revenue, sales to the PC market remain an important part of our business. We believe that sales of PCs have declined due to fundamental changes in the PC market, including the growth of alternative mobile devices and the lengthening of product life cycles, and that further deterioration of the PC market may continue or accelerate, which could cause our operating results and financial condition to suffer. Additionally, if demand in the PC market is worse than expected as a result of these or other conditions, or demand for our products in the PC market decreases at a faster rate than expected, our operating results and financial condition may be adversely affected.

Selling to the retail market is an important part of our business, and if we fail to maintain and grow our market share or gain market acceptance of our branded products, our operating results could suffer.

Selling branded products is an important part of our business, and as our branded products revenue increases as a portion of our overall revenue, our success in the retail market becomes increasingly important to our operating results. Our success in the retail market depends in large part on our ability to maintain our brand image and corporate reputation and to expand into and gain market acceptance of our products in multiple channels. We must successfully respond to the rapid change away from traditional advertising media, marketing and sales methods to the use of Internet media and advertising, particularly social media, and online sales, or our brand and retail sales could be negatively affected. Adverse publicity, whether or not justified, or allegations of product or service quality issues, even if false or unfounded, could tarnish our reputation and cause our customers to choose products offered by our competitors. In addition, the proliferation of new methods of mass communication facilitated by the Internet makes it easier for false or unfounded allegations to adversely affect our brand image and reputation. If customers no longer maintain a preference for our product brands, our operating results may be adversely affected. A significant portion of our sales is made through retailers, and if our retailers are not successful in selling our products, not only would our revenue decrease, but we could also experience lower gross margin due to the return of unsold inventory or the protection we provide to retailers against price declines.

Sales in the distribution channel are important to our business, and if we fail to respond to demand changes in distribution markets or if distribution markets for our products weaken, our operating results could suffer.

Our distribution customers typically sell to small computer manufacturers, dealers, systems integrators and other resellers. We face significant competition in this channel as a result of limited product qualification programs and a significant focus on price and availability of product. In addition, the PC market is experiencing a shift to notebook and other mobile devices and, as a result, more computing devices are being delivered to the market as complete systems, which could weaken the distribution market. If we fail to respond to changes in demand in the distribution market, our operating results could suffer. Additionally, if the distribution market weakens as a result of a slowing PC growth rate, technology transitions or a significant change in consumer buying preference, or if we experience significant price declines due to demand changes in the distribution channel, then our operating results would be

adversely affected. Negative changes in the credit-worthiness or the ability to access credit, or the bankruptcy or shutdown of any of our significant retail or distribution partners would harm our revenue and our ability to collect outstanding receivable balances.

Table of Contents

Loss of market share with or by a key customer, or consolidation among our customer base, could harm our operating results.

During the three months ended December 29, 2017, 41.2% of our revenue came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, often resulting in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results and financial condition would likely be harmed.

Additionally, if there is consolidation among our customer base, our customers may be able to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. In addition, if, as a result of increased leverage, customer pressures require us to reduce our pricing such that our gross margins are diminished, it might not be feasible to sell our products to a particular customer, which could result in a decrease in our revenue. Consolidation among our customer base may also lead to reduced demand for our products, replacement of our products by the combined entity with those of our competitors and cancellations of orders, each of which could harm our operating results.

Also, the storage ecosystem is constantly evolving, and our traditional customer base is changing. Fewer companies now hold greater market share for certain applications and services, such as mobile, social media, shopping and streaming media. As a result, the competitive landscape is changing, giving these companies increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. In addition, the changes in our evolving customer base create new selling and distribution patterns to which we must adapt. To remain competitive, we must respond to these changes by ensuring we have proper scale in this evolving market, as well as offer products that meet the technological requirements of this customer base at competitive pricing points. To the extent we are not successful in adequately responding to these changes, our operating results and financial condition could be harmed.

Expansion into new markets may increase the complexity of our business and cause us to increase our R&D expenses and investments in manufacturing capability, technology enhancements and go-to-market capability, and if we are unable to successfully adapt our business processes and product offerings as required by these new markets, our ability to grow will be adversely affected.

To remain a significant supplier in the storage industry and to expand into new markets, we will need to offer a broader range of storage products to our customers. We currently offer a variety of 3.5-inch and 2.5-inch HDDs, SSDs and systems, flash storage solutions, and other products for the PC, mobile, enterprise, data center and other storage markets. As we expand our product lines to sell into new markets, such as our recent entry into active archive systems and new flash memory business through the Merger, including the vertically integrated business model through Flash Ventures, the overall complexity of our business may increase at an accelerated rate and we may become subject to different market dynamics. These dynamics may include, among other things, different demand volume, cyclicalities, seasonality, product requirements, sales channels, and warranty and return policies. In addition, expansion into other markets may result in increases in R&D expenses and substantial investments in manufacturing capability, technology enhancements and go-to-market capability. Flash Ventures requires significant investments by both TMC and us for technology transitions, including the transition to 3D NAND, and capacity expansions. If we fail to successfully expand into new markets with products that we do not currently offer, we may lose business to our competitors or new entrants who offer these products.

Our vertical integration of some of our products makes us dependent on our ability to timely and cost-effectively develop products with leading technology and overall quality, increasing capital expenditure costs and asset utilization risks for our business.

We develop NAND-flash memory as well as other non-volatile memory technology through our partnership with TMC; we are also vertically integrated in a substantial portion of the recording heads and magnetic media used in the hard drive products we produce. Consequently, for some of our products, we are more dependent upon our own development and execution efforts and less able to take advantage of technologies developed by other manufacturers. Since we may not have access to alternative technologies that we do not develop internally, we may have to pay royalties in order to access those technologies.

Table of Contents

In addition, we may be unsuccessful in timely and cost-effectively developing and manufacturing products using future technologies. We also may not effectively transition our design and technology to achieve acceptable manufacturing yields using the technologies necessary to satisfy our customers' product needs, or we may encounter quality problems with the products we manufacture. If we are unable to timely and cost-effectively develop products with leading technology and overall quality, continuing the cost reductions necessary to maintain adequate gross margin and our ability to sell our products may be significantly diminished, which could materially and adversely affect our business and financial results.

Further, as a result of our vertical integration of some of our products, we make more capital investments and carry a higher percentage of fixed costs than we would if we were not vertically integrated. If our overall level of production decreases for any reason, and we are unable to reduce our fixed costs to match sales, some of our assets may face underutilization that may impact our operating results. We are therefore subject to additional risks related to overall asset utilization, including the need to operate at high levels of utilization to drive competitive costs and the need for assured supply of components that we do not manufacture ourselves. In addition, as a result of adverse labor rates or availability, we may be required to increase investments in automation, which may cause our capital expenditures to increase. If we do not adequately address these challenges, our ongoing operations could be disrupted, resulting in a decrease in our revenue or profit margins and negatively impacting our operating results.

We make significant investments in R&D to improve our technology and develop new technologies, and unsuccessful investments or investments that are not cost effective could materially adversely affect our business, financial condition and results of operations.

As a leading supplier of hard drives and flash storage solutions, we make significant investments to maintain our existing products and to lead innovation and development of new technologies. This strategy requires us to make significant investments in R&D. In addition, we may increase our capital expenditures and expenses above our historical run-rate model in order to remain competitive or as a result of the Merger with SanDisk, which has historically maintained higher levels of investment in R&D than our company. The current inherent physical limitations associated with storage technologies are resulting in more costly capital expenditures that reduce the cost benefits of technology transitions and could limit our ability to keep pace with reductions in ASPs. These investments may not result in viable technologies or products, and even if they do result in viable technologies or products, they may not be profitable or accepted by the market. Significant investments in unsuccessful or cost-ineffective R&D efforts could materially adversely affect our business, financial condition and results of operations. In addition, increased investments in technology could cause our cost structure to fall out of alignment with demand for our products, which would have a negative impact on our financial results.

Current or future competitors may gain a technology advantage or develop an advantageous cost structure that we cannot match.

It may be possible for our current or future competitors to gain an advantage in product technology, manufacturing technology, or process technology, which may allow them to offer products or services that have a significant advantage over the products and services that we offer. Advantages could be in price, capacity, performance, reliability, serviceability, industry standards or formats, brand and marketing, or other attributes. A competitive cost structure for our products, including critical components, labor and overhead, is also critical to the success of our business. We may be at a competitive disadvantage to any companies that are able to gain a technological or cost structure advantage. The Chinese government and various agencies, state-owned or affiliated enterprises and investment funds are making significant investments to promote China's domestic semiconductor industry consistent with the government's stated national policy objectives. If we are unable to effectively compete with any manufacturers located in China or non-Chinese competitors benefitting from alliances with Chinese companies in the markets where we compete, our operating results and financial condition will suffer.

Consolidation within the data storage industry could provide competitive advantages to our competitors.

The data storage industry as a whole has experienced consolidation over the past several years through acquisitions, mergers and decisions by industry players to exit the industry. Further consolidation across the industry, including by our competitors who are vertically integrated with NAND-flash memory, may enhance their capacity, abilities and resources and lower their cost structure, causing us to be at a competitive disadvantage.

Table of Contents

Some of our competitors with diversified business units outside of storage products, may, over extended periods of time, sell storage products at prices that we cannot profitably match.

Some of our competitors earn a significant portion of their revenue from business units outside of storage products. Because they do not depend solely on sales of storage products to achieve profitability, they may sell storage products at lower prices and operate their storage business unit at a loss over an extended period of time while still remaining profitable overall. In addition, if these competitors can increase sales of non-storage products to the same customers, they may benefit from selling their storage products at lower prices. Our operating results may be adversely affected if we cannot successfully compete with the pricing by these companies.

If we fail to qualify our products and achieve design wins with our customers, it may have a significant adverse impact on our sales and margins.

We regularly engage in new product qualification with our customers, and the product qualification process may be lengthy for some customers, including those in enterprise storage. Once a product is accepted for qualification testing, failures or delays in the qualification process can result in delayed or reduced product sales, reduced product margins caused by having to continue to offer a more costly current generation product, or lost sales to that customer until the next generation of products is introduced. The effect of missing a product qualification opportunity is magnified by the limited number of high volume OEMs and hyperscale customers, which continue to consolidate their share of the storage markets. Likewise, if product life cycles lengthen, we may have a significantly longer period to wait before we have an opportunity to qualify a new product with a customer, which could reduce our profits because we expect declining gross margins on our current generation products as a result of competitive pressures. Even if our products meet customer specifications, our sales to these customers are dependent upon the customers choosing our products over those of our competitors and purchasing our products in sufficient volume, our ability to supply our products in sufficient quantity and in a timely manner and, with respect to OEM partners, the OEMs' ability to create, market and successfully sell products containing our solutions. Moreover, in transitioning to new technologies, such as 3D NAND, and products, we may not achieve design wins, our customers may delay transition to these new technologies, our competitors may transition more quickly than we do, or we may experience product delays, cost overruns or performance issues that could harm our operating results and financial condition.

We are subject to risks related to product defects or the unintended use or security breaches of our products, which could result in product recalls or epidemic failures and could subject us to warranty claims in excess of our warranty provisions or which are greater than anticipated, litigation or indemnification claims.

We warrant the majority of our products for periods of one to five years. We test our products in our manufacturing facilities through a variety of means. However, our testing may fail to reveal defects in our products that may not become apparent until after the products have been sold into the market. In addition, our products may be used in a manner that is not intended or anticipated by us, resulting in potential liability. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement. As part of a product recall, we may be required or choose to replace the defective product. Moreover, there is a risk that product defects may trigger an epidemic failure clause in a customer agreement. If an epidemic failure occurs, we may be required to replace or refund the value of the defective product and to cover certain other costs associated with the consequences of the epidemic failure. In addition, product defects, product recalls or epidemic failures may cause damage to our reputation or customer relationships, lost revenue, indemnification for a recall of our customers' products, warranty claims, litigation or loss of market share with our customers, including our OEM and original design manufacturers ("ODM") customers. Our business liability insurance may be inadequate or future coverage may be unavailable on acceptable terms, which could adversely impact our operating results and financial condition.

Our standard warranties contain limits on damages and exclusions of liability for consequential damages and for misuse, improper installation, alteration, accident or mishandling while in the possession of someone other than us. We record an accrual for estimated warranty costs at the time revenue is recognized. We may incur additional expenses if our warranty provision do not reflect the actual cost of resolving issues related to defects in our products, whether as a result of a product recall, epidemic failure or otherwise. If these additional expenses are significant, it could adversely affect our business, financial condition and operating results.

Certain of our products contain encryption or security algorithms to protect third party content and user-generated data stored on our products. To the extent our products are hacked or the encryption schemes are compromised or breached, this could harm our business by hurting our reputation, requiring us to employ additional resources to fix the errors or defects and expose us to litigation and indemnification claims.

Table of Contents

In addition, third-party components or applications that we incorporate or use in our products may contain defects in design or manufacturing that could unexpectedly result in epidemic failures, security vulnerabilities or performance issues and subject us to liability.

Our strategic relationships subject us to risks that could adversely affect our business, financial condition and results of operations.

We have entered into strategic relationships with various partners for future product development, sales growth and the supply of technologies, components, equipment and materials for use in our product design and manufacturing, including our partnership with TMC for NAND-flash memory development and manufacturing. Please see the risk factor entitled “Because we are dependent on a limited number of qualified suppliers for components, sub-assemblies, testing, equipment, consumables, raw materials, and logistics, a supplier’s inability, unwillingness, or failure to support us in a timely manner with goods or services at a quality level and cost acceptable to us can adversely affect our margins, revenues and operating results” for a further description of the risks associated with our reliance on external suppliers. These strategic relationships are subject to various risks that could adversely affect the value of our investments and our results of operations and financial condition. These risks include, but are not limited to, the following:

• our interests could diverge from our partners’ interests or we may not agree with co-venturers on ongoing activities, technology transitions or on the amount, timing or nature of further investments in the relationship;

• we may experience difficulties and delays in product and technology development at, ramping production at, and transferring technology to, our business ventures;

• our control over the operations of our business ventures is limited;

• due to financial constraints, our co-venturers may be unable to meet their commitments to us or may pose credit risks for our transactions with them;

• due to differing business models, financial constraints or long-term business goals, our partners may decide not to join us in funding capital investment by our business ventures, which may result in higher levels of cash expenditures by us or prevent us from proceeding in the investment;

• we may lose the rights to technology or products being developed by the strategic relationship, including if any of our co-venturers is acquired by another company or otherwise transfers its interest in the business venture, files for bankruptcy or experiences financial or other losses;

• a bankruptcy event involving a co-venturer could result in the early termination or adverse modification of the business venture or agreements governing the business venture;

• we may experience difficulties or delays in collecting amounts due to us from our co-venturers;

• the terms of our arrangements may turn out to be unfavorable; and

• changes in tax, legal or regulatory requirements may necessitate changes in the agreements with our co-venturers.

If our strategic relationships are unsuccessful or there are unanticipated changes in, or termination of, our strategic relationships, our business, results of operations and financial condition may be adversely affected.

Table of Contents

Because we are dependent on a limited number of qualified suppliers for components, sub-assemblies, testing, equipment, consumables, raw materials, and logistics, a supplier's inability, unwillingness, or failure to support us in a timely manner with goods or services at a quality level and cost acceptable to us can adversely affect our margins, revenues and operating results.

We depend on an external supply base for technologies, software (including firmware), preamps, controller, components, equipment and materials for use in our product design and manufacturing. We also depend on suppliers for a portion of our wafer testing, chip assembly, product assembly and product testing, and on service suppliers for providing technical support for our products. In addition, we use logistics partners to manage our just-in-time hubs, distribution centers and freight from suppliers to our factories and from our factories to our customers throughout the world. Many of the components and much of the equipment we acquire must be specifically designed to be compatible for use in our products or for developing and manufacturing our future products, and are only available from a limited number of suppliers, some of whom are our sole-source suppliers. We are therefore dependent on these suppliers to be able and willing to dedicate adequate engineering resources to develop components that can be successfully integrated into our products, technology and equipment that can be used to develop and manufacture our next-generation products efficiently. Our supply base has experienced industry consolidation. Where we rely on a limited number of suppliers or a single supplier, the risk of supplier loss due to industry consolidation is enhanced. Some of our suppliers may be competitors in other areas of our business, which could lead to difficulties in price negotiations or meeting our supply requirements. Any disruption in our supply chain could reduce our revenue and adversely impact our financial results.

From time to time, our suppliers have experienced difficulty meeting our requirements. If we are unable to purchase sufficient quantities from our current suppliers or qualify and engage additional suppliers, we may not be able to meet demand for our products. We do not have long-term contracts with some of our existing suppliers, nor do we always have guaranteed manufacturing capacity with our suppliers and, therefore, we cannot guarantee that they will devote sufficient resources or capacity to manufacturing our products. We are not able to directly control product delivery schedules or quality assurance. Furthermore, we manufacture on a turnkey basis with some of our suppliers. In these arrangements, we do not have visibility and control of our suppliers' inventories of purchased parts necessary to build our products or of the progress of our products through their assembly line. Any significant problems that occur at our suppliers, or their failure to perform at the level we expect, could lead to product shortages or quality assurance problems, either of which would harm our operating results and financial condition. In addition, if we are unable to purchase sufficient quantities from our current suppliers, we may not be able to engage alternative suppliers who are able or willing to provide goods or services in sufficient quantities or at a cost acceptable to us.

Many of our products require preamps, controllers and firmware. We rely on a limited number of third-party vendors to develop or supply preamps and controllers for many of our products. Any delays or cost increases in developing or sourcing preamps, controllers or firmware, or incompatibility or quality issues relating to the controllers or firmware in our products, could harm our financial results as well as business relationships with our customers.

A majority of our flash memory is currently supplied by Flash Ventures and, to a much lesser extent, by third-party silicon suppliers. Any disruption or shortage in supply of flash memory from our captive or non-captive sources would harm our operating results and financial condition. Many of the risks that affect us also affect our supply base and Flash Ventures, including, but not limited to, having single site manufacturing locations and other facilities based in high risk regions of the world (for example, Flash Ventures is located in Yokkaichi, Japan), natural disasters, power shortages, macro and local economic conditions, shortages of commodity materials, proper management of technology transitions, geo-political risks, employee strikes and other labor actions, compliance with legal requirements, financial instability and exposure to IP and other litigation, including an injunction or other action that could delay shipping. If any of these risks were to affect our suppliers or Flash Ventures, we could also be adversely affected, especially in the case of products, components or services that are single-sourced. For example, if suppliers

are facing increased costs due to the above risks, they may require us to enter into long-term volume agreements to shift the burden of fixed costs to us. Further, we work closely with many of our suppliers and strategic partners to develop new technologies and, as a result, we may become subject to litigation from our suppliers, strategic partners or third parties.

Table of Contents

Without a capable and financially stable supply base that has established appropriate relationships within the supply chain and has implemented business processes, strategies and risk management safeguards, we would be unable to develop our products, manufacture them in high volumes, and distribute them to our customers to execute our business plans effectively. Some of our suppliers have also experienced a decline in financial performance. Our suppliers may be acquired by our competitors, consolidate, or decide to exit the industry, redirect their investments and increase costs to us, each of which may have an adverse effect on our business and operations. In addition, moving to new technologies may require us to align to, and build, a new supply base. Our success in new product areas may be dependent on our ability to develop close relationships with new suppliers, with preferential agreements. Where this cannot be done, our business and operations may be adversely affected.

In addition to an external supply base, we also rely on an internal supply chain of heads, media and media substrate, and we rely on our business ventures with TMC for the supply of NAND-flash memory. Please see the risk factors entitled, “The substitution or replacement of our technologies and products by new technologies could make our products obsolete and harm our operating results,” “If we do not properly manage technology transitions, our competitiveness and operating results may be negatively affected,” “We rely substantially on our business ventures with Toshiba’s wholly owned subsidiary, Toshiba Memory Corporation (“TMC”), for the supply of NAND-flash memory and the development of NAND-flash technology, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results” and “Our strategic relationships subject us to risks that could adversely affect our business, financial condition and results of operations” for a review of some of the risks related to these supplies.

Price volatility, shortages of critical materials or components, or use by other industries of materials and components used in the storage industry, may negatively impact our operating results.

Increases in the cost for certain critical materials and components and oil may increase our costs of manufacturing and transporting our products and key components and may result in lower operating margins if we are unable to pass these increased costs on to our customers. Shortages of critical components such as DRAM and NAND-flash memory, or materials such as glass substrates, stainless steel, aluminum, nickel, neodymium, ruthenium, platinum or cerium, may increase our costs and may result in lower operating margins if we are unable to find ways to mitigate these increased costs. We or our suppliers acquire certain precious metals and rare earth metals like ruthenium, platinum, neodymium and cerium, which are critical to the manufacture of components in our products from a number of countries, including the People’s Republic of China. The government of China or any other nation may impose regulations, quotas or embargoes upon these metals that would restrict the worldwide supply of such metals or increase their cost, both of which could negatively impact our operating results until alternative suppliers are sourced. Furthermore, if other high volume industries increase their demand for materials or components used in our products, our costs may further increase, which could have an adverse effect on our operating margins. In addition, shortages in other components and materials used in our customers’ products could result in a decrease in demand for our products, which would negatively impact our operating results.

Contractual commitments with component suppliers may result in us paying increased charges and cash advances for such components or may cause us to have inadequate or excess component inventory.

To reduce the risk of component shortages, we attempt to provide significant lead times when buying components, which may subject us to cancellation charges if we cancel orders as a result of technology transitions or changes in our component needs. In addition, we may from time to time enter into contractual commitments with component suppliers in an effort to increase and stabilize the supply of those components and enable us to purchase such components at favorable prices. Some of these commitments may require us to buy a substantial number of components from the supplier or make significant cash advances to the supplier; however, these commitments may not result in a satisfactory increase or stabilization of the supply of such components. Furthermore, as a result of

uncertain global economic conditions, our ability to forecast our requirements for these components has become increasingly difficult, therefore increasing the risk that our contractual commitments may not meet our actual supply requirements, which could cause us to have inadequate or excess component inventory and adversely affect our operating results and increase our operating costs.

Table of Contents

If we do not properly manage technology transitions, our competitiveness and operating results may be negatively affected.

The storage markets in which we offer our products continuously undergo technology transitions that we must anticipate and adapt our products to address in a timely manner. If we fail to implement new technologies successfully, or if we are slower than our competitors at implementing new technologies, we may not be able to competitively offer products that our customers desire or keep pace with ASP reduction, which could harm our operating results. For example, in transitioning our 2D NAND manufacturing capacity to 3D NAND technology, we could experience delays or other challenges in the production ramp, qualification of wafers, shipment of samples to customers or customer approval process. 3D NAND and any new manufacturing node may be more susceptible to manufacturing yield issues. Manufacturing yield issues may not be identified during the development or production process or solved until an actual product is manufactured and tested, further increasing our costs. If our technology transitions, including the production ramp of 3D NAND technology, take longer, are more costly to complete than anticipated, or do not improve manufacturing yield or other manufacturing efficiencies, our flash memory costs may not remain competitive with other NAND-flash memory producers or may not fall commensurate with declines in the price of NAND-flash memory, which would harm revenues, our gross margin and operating results.

Many companies, including some of our competitors, have developed or are attempting to develop alternative non-volatile technologies. Successful broad-based commercialization of one or more competing technologies, as well as differing strategies and timing with respect to the transition from 2D NAND to 3D NAND, could reduce the competitiveness and future revenue and profitability of our 2D NAND and 3D NAND-flash technologies. For additional technology transition risks related to 3D NAND, see “We rely substantially on our business ventures with Toshiba’s wholly owned subsidiary, Toshiba Memory Corporation (“TMC”), for the supply of NAND-flash memory and the development of NAND-flash technology, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results” and “Our strategic relationships subject us to risks that could adversely affect our business, financial condition and results of operations.”

With respect to HDDs, we announced that we will use microwave-assisted magnetic recording (MAMR) technology to increase HDD capacities. If our HDD technology transitions, including the production ramp of MAMR HDDs, take longer or are more costly to complete than anticipated or if we otherwise fail to implement new HDD technologies successfully, we may not remain competitive with other HDD producers, which could adversely affect our revenues, our gross margin and operating results.

In addition, if our customers choose to delay transition to new technologies, if demand for the products that we develop is lower than expected or if the supporting technologies to implement these new technologies are not available, we may be unable to achieve the cost structure required to support our profit objectives or may be unable to grow or maintain our market position.

Changes in product life cycles could adversely affect our financial results.

If product life cycles lengthen, we may need to develop new technologies or programs to reduce our costs on any particular product to maintain competitive pricing for that product. Longer product life cycles could also restrict our ability to transition customers to our newer products in a timely manner, or at all, negatively impacting our ability to recoup our significant R&D investments to improve our existing technology and develop new technologies. If product life cycles shorten, it may result in an increase in our overall expenses and a decrease in our gross margins, both of which could adversely affect our operating results. In addition, shortening of product life cycles also makes it more difficult to recover the cost of product development before the product becomes obsolete. Our failure to recover the cost of product development in the future could adversely affect our operating results.

Table of Contents

The substitution or replacement of our technologies and products by new technologies could make our products obsolete and harm our operating results.

Given the pace of technological development, there is a possibility that new technologies could substitute for or replace our current technologies and products and make them obsolete. Historically, when the industry experiences a fundamental change in storage technologies or standards, any manufacturer that fails to successfully and timely adjust its designs and processes to accommodate or manufacture the new technology or standard fails to remain competitive. There are some revolutionary technologies, such as current-perpendicular-to-plane giant magnetoresistance, shingle magnetic recording, heat-assisted magnetic recording, patterned magnetic media and advanced signal processing that, if implemented by a competitor on a commercially viable basis ahead of the industry, could put us at a competitive disadvantage. In addition, many companies, including some of our competitors, have developed or are attempting to develop alternative non-volatile technologies, including non-NAND technologies such as magnetoresistive random-access memory (“RAM”), resistive random-access memory (“ReRAM”) and phase change, as well as NAND based vertical or stacked 3D memories based on charge trap, floating gate and other cell architecture. In embedded solutions, certain competitors have recently introduced a mobile storage standard referred to as Universal Flash Storage (“UFS”). In the data center market, certain competitors have recently introduced a non-volatile memory express (“NVMe”) product that can be used as a substitute for our peripheral component interconnect express (“PCIe”) solutions. In addition, a provider of processors and non-volatile memory solutions may be developing a new standard to attach ultra-low latency non-volatile memory to its processor memory bus, which it may choose not to license to its competitors, resulting in it being a single source provider of such non-volatile memory solutions. As a result of these shifts in technology and standards, we could incur substantial costs in developing new technologies, such as recording heads, magnetic media and tools, in adopting new standards or in investing in different capital equipment or manufacturing processes to remain competitive. If we fail to successfully implement these new technologies or standards, or if we are significantly slower than our competitors at implementing new technologies or standards, we may not be able to offer products with capacities and capabilities that our customers desire, which could harm our operating results.

The difficulty of introducing hard drives with higher levels of areal density and the challenges of reducing other costs may impact our ability to achieve historical levels of cost reduction.

Storage capacity of the hard drive, as manufactured by us, is determined by the number of disks and each disk’s areal density. Areal density is a measure of the amount of magnetic bits that can be stored on the recording surface of the disk. Generally, the higher the areal density, the more information can be stored on a single platter. Higher areal densities require existing recording head and magnetic media technology to be improved or new technologies developed to accommodate more data on a single disk. Historically, we have been able to achieve a large percentage of cost reduction through increases in areal density. Increases in areal density mean that the average drive we sell has fewer heads and disks for the same capacity and, therefore, may result in a lower component cost. However, increasing areal density has become more difficult in the storage industry. If we are not able to increase areal density at the same rate as our competitors or at a rate that is expected by our customers, we may be required to include more components in our drives to meet demand without corresponding incremental revenue, which could negatively impact our operating margins and make achieving historical levels of cost reduction difficult or unlikely. Additionally, increases in areal density may require us to make further capital expenditures on items such as new test equipment needed as a result of an increased number of gigabytes per platter. Our inability to achieve cost reductions could adversely affect our operating results.

Table of Contents

Our license and royalty revenue may fluctuate or decline significantly in the future due to license agreement expirations or renewals, declines in sales of the products or use of technology underlying the license and royalty revenue by our licensees, or if licensees fail to perform on a portion or all of their contractual obligations.

If our existing licensees do not renew their licenses upon expiration, renew or sign new agreements on less favorable terms, exercise their option to terminate the license or fail to exercise their option to extend the licenses, or we are not successful in signing new licensees in the future, our license revenue, profitability and cash provided by operating activities would be harmed and we may incur significant patent litigation costs to enforce our patents against these licensees. As our older patents expire, and the coverage of our newer patents may be different, it may be more difficult to negotiate or renew favorable license agreement terms or a license agreement at all. Our agreements may require us in certain instances to recognize license revenue related to a particular licensee all in one period instead of over time, which could create additional volatility in our licensing revenue. A portion of our license and royalty revenue is based on sales of product categories as well as the underlying technology, and fluctuations in the sales of those products or technology adoption rates would also result in fluctuations in the license and royalty revenue due to us under our agreements. If our licensees or we fail to perform on contractual obligations, we may incur costs to enforce or defend the terms of our licenses and there can be no assurance that our enforcement, defense or collection efforts will be effective. If we license new IP from third parties or existing licensees, we may be required to pay license fees, royalty payments or offset existing license revenue. We may enter into agreements with customers, suppliers or partners that could limit our ability to monetize our IP or could result in us being required to provide IP indemnification to our customers, suppliers or partners. In addition, we may be subject to disputes, claims or other disagreements on the timing, amount or collection of royalties or license payments under our license agreements.

If we do not properly manage new product development, our competitiveness and operating results may be negatively affected.

Our success depends in part on our ability to develop and introduce new products in a timely manner in order to keep pace with technology advancements. Advances in semiconductor technology have resulted in other emerging technologies that can be competitive with traditional storage technologies. We may be unsuccessful in anticipating and developing new and improved products for the client, enterprise and other storage markets in response to competing technologies. If our hard drive, solid-state products and our storage solutions products fail to offer a superior value proposition to alternative storage products, we will be at a competitive disadvantage and our business will suffer. In some cases, our customers' demand for a more diversified portfolio results in investments in new products for a particular market that do not necessarily expand overall market opportunity, which may negatively affect our operating results. As we introduce new products, standards or technologies, it can take time for these new standards or technologies to be adopted, for consumers to accept and transition to these new standards or technologies and for significant sales to be generated, if at all. Failure of consumers or enterprises to adopt our new products, standards or technologies could harm our results of operations as we fail to reap the benefits of our investments.

In addition, the success of our new product introductions depends on a number of other factors, including:

- difficulties faced in manufacturing ramp;
- implementing at an acceptable cost product features expected by our customers;
- market acceptance/qualification;
- effective management of inventory levels in line with anticipated product demand;
-

quality problems or other defects in the early stages of new product introduction and problems with compatibility between our products and those of our customers that were not anticipated in the design of those products;

our ability to increase our software development capability; and

the effectiveness of our go-to-market capability in selling these new products.

In particular, as part of our growth strategy, we have made significant investments in active archive systems, which are designed to enable organizations to rapidly access massive long-term data stores. We expect to continue to make significant investments in active archive systems. Our active archive systems may fail to gain market acceptance, or the market for active archive systems may not grow as we anticipate.

Table of Contents

We have also seen, and anticipate continuing to see, an increase in customers requesting that we develop products, including software associated with our products, that incorporate open source software elements and operate in an open source environment. Adapting to this demand may cause product delays, placing us at a competitive disadvantage. Open source products could also reduce our capability for product differentiation or innovation and our affected products could be diminished to commodity status, which we expect would place increased downward pressure on our margins. If we fail to successfully anticipate and manage issues associated with our product development generally, our business may suffer.

Additionally, we have announced our intention to transition future core, processor and controller development to the RISC-V architecture, which is an open source, data-centric compute architecture. There is no guarantee that this transition will be successful or that the expected benefits of such transition will be realized.

Our operations, and those of certain of our suppliers and customers, are concentrated in large, purpose-built facilities, subjecting us to substantial risk of damage or loss if operations at any of these facilities are disrupted.

As a result of our cost structure and strategy of vertical integration, we conduct our operations at large, high volume, purpose-built facilities in California and throughout Asia. The concentration of Flash Ventures in Yokkaichi, Japan, magnifies the risks of supply disruption. The facilities of many of our customers, our suppliers and our customers' suppliers are also concentrated in certain geographic locations throughout Asia and elsewhere. A localized health risk affecting our employees at these facilities or the staff of our or our customers' other suppliers, such as the spread of a pandemic influenza, could impair the total volume of our products that we are able to manufacture or sell, which would result in substantial harm to our operating results. Similarly, a fire, flood, earthquake, tsunami or other natural disaster, condition or event such as political instability, civil unrest or a power outage that adversely affects any of these facilities, including access to or from these facilities by employees or logistics operators, would significantly affect our ability to manufacture or sell our products, which would result in a substantial loss of sales and revenue and a substantial harm to our operating results. For example, prior to the 2011 flooding in Thailand, all of our internal slider capacity and 60% of our hard drive manufacturing capacity was in Thailand. As a result of the flooding in Thailand, our facilities were inundated and temporarily shut down. During that period, our ability to manufacture hard drives was significantly constrained, adversely affecting our business, financial condition and results of operations. In addition, the concentration of our manufacturing sites could exacerbate the negative impacts resulting from localized labor unrest or other employment issues. A significant event that impacts any of our manufacturing sites, or the sites of our customers or suppliers, could adversely affect our ability to manufacture or sell our products, and our business, financial condition and results of operations could suffer.

We may incur losses beyond the limits of, or outside the scope of, the coverage of our insurance policies. There can be no assurance that in the future we will be able to maintain existing insurance coverage or that premiums will not increase substantially. Due to market availability, pricing or other reasons, we may elect not to purchase insurance coverage or to purchase only limited coverage. We maintain limited insurance coverage and, in some cases, no coverage at all, for natural disasters and environmental damages, as these types of insurance are sometimes not available or available only at a prohibitive cost. We depend upon TMC to obtain and maintain sufficient property, business interruption and other insurance for Flash Ventures. If TMC fails to do so, we could suffer significant unreimbursable losses, and such failure could also cause Flash Ventures to breach various financing covenants.

Table of Contents

If our technology infrastructure, systems or products are compromised, damaged or interrupted by cyber attacks, data security breaches, other security problems, security vulnerabilities or design defects, or sustain system failures, our operating results and financial condition could be adversely affected.

We experience cyber attacks of varying degrees on our technology infrastructure and systems and, as a result, unauthorized parties have obtained in the past, and may in the future obtain, access to our computer systems and networks. The technology infrastructure and systems of our suppliers, vendors and partners may also experience such attacks. Cyber attacks can include computer viruses, computer denial-of-service attacks, worms, and other malicious software programs or other attacks, covert introduction of malware to computers and networks, impersonation of authorized users, and efforts to discover and exploit any design flaws, bugs, security vulnerabilities or security weaknesses, as well as intentional or unintentional acts by employees or other insiders with access privileges, intentional acts of vandalism by third parties and sabotage. In some instances, efforts to correct vulnerabilities or prevent attacks may reduce the performance of our computer systems and networks, which could negatively impact our business. We believe cyber attack attempts are increasing in number and that cyber attackers are developing increasingly sophisticated systems and means to not only attack systems, but also to evade detection or to obscure their activities. Our products are also targets for cyber attacks. While some of our products contain encryption or security algorithms to protect third-party content or user-generated data stored on our products, these products could still be hacked or the encryption schemes could be compromised, breached, or circumvented by motivated and sophisticated attackers. We have agreed with certain customers and strategic partners, including TMC, to undertake certain commitments to promote information security, and we may be liable to TMC or such other parties if we fail to meet our cyber security commitments.

In addition, our technology infrastructure and systems are vulnerable to damage or interruption from natural disasters, power loss and telecommunications failures. Further, our products contain sophisticated hardware and operating system software and applications that may contain security problems, security vulnerabilities, or defects in design or manufacture, including “bugs” and other problems that could interfere with the intended operation of our products.

If efforts to breach our infrastructure, systems or products are successful or we are unable to protect against these risks, we could suffer interruptions, delays, or cessation of operations of our systems, and loss or misuse of proprietary or confidential information, IP, or sensitive or personal information. Breaches of our infrastructure, systems or products could also cause our customers and other affected third parties to suffer loss or misuse of proprietary or confidential information, IP, or sensitive or personal information, and could harm our relationships with customers and other third parties. As a result, we could experience additional costs, indemnification claims, litigation, and damage to our brand and reputation. All of these consequences could harm our reputation and our business and materially and adversely affect our operating results and financial condition.

Manufacturing, marketing and selling our products globally subjects us to numerous risks.

Currently, a large portion of our revenue is derived from our international operations, and many of our products and components are produced overseas. Our revenue and future growth is significantly dependent on the growth of international markets, and we may face difficulties in entering or maintaining international sales markets. We are subject to risks associated with our global manufacturing operations and global marketing and sales efforts, as well as risks associated with our utilization of and reliance on contract manufacturers, including:

- obtaining requisite governmental permits and approvals, compliance with foreign laws and regulations, changes in foreign laws and regulations;

- the need to comply with regulations on international business, including the Foreign Corrupt Practices Act, the United Kingdom Bribery Act 2010, the anti-bribery laws of other countries and rules regarding conflict minerals;

•urrency exchange rate fluctuations or restrictions;

•olitical and economic instability, civil unrest and natural disasters;

•imited transportation availability, delays, and extended time required for shipping, which risks may be compounded in periods of price declines;

•igher freight rates;

•abor challenges, including difficulties finding and retaining talent or responding to labor disputes or disruptions;

•rade restrictions or higher tariffs and fees;

83

Table of Contents

• import and export restrictions and license and certification requirements, including on encryption technology, and complex customs regulations;

• copyright levies or similar fees or taxes imposed in European and other countries;

• exchange, currency and tax controls and reallocations;

• increasing labor and overhead costs;

• weaker protection of IP rights;

• difficulties in managing international operations, including appropriate internal controls; and

• loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

As a result of these risks, our business, results of operations or financial condition could be adversely affected. Some of these risks, such as trade restrictions, higher tariffs and fees, import and export restrictions or loss of favorable tax treatment under agreements or treaties with foreign tax authorities, could increase as a result of changes to policies, rules and regulations which may be proposed or implemented by the U.S. President and his administration.

Terrorist attacks may adversely affect our business and operating results.

Recent terrorist incidents around the world and the continued threat of terrorist activity and other acts of war or hostility have created uncertainty in the financial and insurance markets and have significantly increased the political, economic and social instability in some of the geographic areas in which we, our suppliers or our customers operate. Additionally, it is uncertain what impact the reactions to such acts by various governmental agencies and security regulators worldwide will have on shipping costs. Acts of terrorism, either domestically or abroad, could create further uncertainties and instability. To the extent this results in disruption or delays of our manufacturing capabilities, R&D activities (including our operations in Israel) or shipments of our products, our business, operating results and financial condition could be adversely affected. Any of these events could also increase volatility in the U.S. and world financial markets, which could have a negative effect on our stock price and may limit the capital resources available to us and our customers or suppliers, or adversely affect consumer confidence.

Sudden disruptions to the availability of air transportation, or ocean or land freight lanes, could have an impact on our operations.

We generally ship our products to our customers, and receive shipments from our suppliers, via air, ocean or land freight. The sudden unavailability or disruption of air transportation, cargo operations or ocean, rail or truck freight lanes caused by, among other things, labor difficulties or disputes, severe weather patterns or other natural disasters, or political instability or civil unrest, could impact our operating results by impairing our ability to timely and efficiently receive shipments from our suppliers or deliver our products.

Table of Contents

If we fail to identify, manage, complete and integrate acquisitions, investment opportunities or other significant transactions, which are a key part of our growth strategy, it may adversely affect our future results.

We seek to be an industry-leading developer, manufacturer and provider of innovative storage solutions, balancing our core hard drive and flash memory business with growing investments in newer areas that we believe will provide us with higher growth opportunities. Acquisitions of, investment opportunities in, or other significant transactions with companies that are complementary to our business are a key part of our overall business strategy. In order to pursue this part of our growth strategy successfully, we must continue to identify attractive acquisition or investment opportunities, successfully complete the transactions, some of which may be large and complex, and manage post-closing issues such as integration of the acquired company or employees. We may not be able to continue to identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. We are also subject to certain covenants in our debt agreements which place limits on our ability to complete acquisitions and investments. Even if we identify and complete suitable corporate transactions, we may not be able to successfully address any integration challenges in a timely manner, or at all. Failing to successfully integrate or realign our business to take advantage of efficiencies or reduce redundancies of an acquisition may result in not realizing all or any of the anticipated benefits of the acquisition. In addition, failing to achieve the financial model projections for an acquisition or changes in technology development and related roadmaps following an acquisition may result in the incurrence of impairment charges and other expenses, both of which could adversely impact our results of operations or financial condition. Acquisitions and investments may also result in the issuance of equity securities that may be dilutive to our shareholders and the issuance of additional indebtedness which would put additional pressure on liquidity. Furthermore, we may agree to provide continuing service obligations or enter into other agreements in order to obtain certain regulatory approvals of our corporate transactions, and failure to satisfy these additional obligations could result in our failing to obtain regulatory approvals or the imposition of additional obligations on us, any of which could adversely affect our business, financial condition and results of operations.

If we are unable to successfully integrate the systems and operations of HGST, our business and financial condition may be adversely affected.

In connection with obtaining the regulatory approvals required to complete the acquisition of HGST, we agreed to certain conditions required by the Ministry of Commerce of the People's Republic of China ("MOFCOM"), including adopting measures to keep HGST as an independent competitor until MOFCOM agreed otherwise. In October 2015, MOFCOM announced that it had made a decision allowing us to integrate substantial portions of our HGST and WD subsidiaries, provided that we were obligated to continue offering both HGST and WD product brands and maintaining separate sales teams to separately offer products under the WD and HGST brands for two years from the date of the decision. As of December 29, 2017, the integration of the substantial portions of our HGST and WD subsidiaries that we were permitted to integrate as a result of MOFCOM's 2015 decision (including corporate functions, R&D, recording heads and magnetic media operations, engineering and manufacturing), were largely completed. However, certain financial and operational systems have not yet been integrated. The MOFCOM restrictions related to our HGST and WD product brands and sales teams expired in October 2017, which enabled us to begin integrating our sales teams and brands. While we combine our HGST and WD product brands and sales teams and integrate certain financial and operating systems, we will continue to incur additional costs. These additional costs, along with any delay in the integration process or higher than expected integration costs or other integration issues, could adversely affect our business and financial condition.

The loss of our key executive management, staff and skilled employees, the inability to hire and integrate new employees or decisions to realign our business could negatively impact our business prospects.

Our success depends upon the continued contributions of our key management, staff and skilled employees, many of whom would be extremely difficult to replace. Global competition for skilled employees in the data storage industry is

intense and, as we attempt to move to a position of technology leadership in the storage industry, our business success becomes increasingly dependent on our ability to retain our key staff and skilled employees, to attract, integrate and retain new skilled employees, including employees from acquisitions, and to make decisions to realign our business to take advantage of efficiencies or reduce redundancies. Volatility or lack of positive performance in our stock price and the overall markets may adversely affect our ability to retain key staff or skilled employees who have received equity compensation. Additionally, because a substantial portion of our key employees' compensation is placed "at risk" and linked to the performance of our business, when our operating results are negatively impacted, we are at a competitive disadvantage for retaining and hiring key management, staff and skilled employees versus other companies that pay a relatively higher fixed salary. If we lose our existing key management, staff or skilled employees, or are unable to hire and integrate new key management, staff or skilled employees, or if we fail to implement succession plans for our key management or staff, our operating results would likely be harmed. Furthermore, if we do not realize the anticipated benefits of our intended realignment after we make decisions regarding our personnel and implement our realignment plans, our operating results could be adversely affected.

Table of Contents

From time to time we may become subject to income tax examinations or similar proceedings, and as a result we may incur additional costs and expenses or owe additional taxes, interest and penalties that may negatively impact our operating results.

We are subject to income taxes in the U.S. and certain foreign jurisdictions, and our determination of our tax liability is subject to review by applicable domestic and foreign tax authorities. For example, as we have previously disclosed, we are under examination by the Internal Revenue Service for certain fiscal years and in connection with that examination, we received a Revenue Agent's Report seeking certain adjustments to income as disclosed in Part I, Item 1, Note 10, Income Tax Expense (Benefit), of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q. Although we believe our tax positions are properly supported, the final timing and resolution of any tax examinations are subject to significant uncertainty and could result in our having to pay amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations or cash flows.

We are subject to risks associated with loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

Portions of our operations are subject to a reduced tax rate or are free of tax under various tax holidays that expire in whole or in part from time to time, or may be terminated if certain conditions are not met. Although many of these holidays may be extended when certain conditions are met, we may not be able to meet such conditions. If the tax holidays are not extended, or if we fail to satisfy the conditions of the reduced tax rate, then our effective tax rate could increase in the future. In addition, any actions by us to repatriate non-U.S. earnings for which we have not previously provided for U.S. taxes may impact our effective tax rate.

Changes in tax laws could increase our worldwide tax rate and materially affect our financial position and results of operations.

On December 22, 2017, the President of the United States of America signed the Tax Cuts and Jobs Act (the "2017 Act"), which includes a broad range of tax reform proposals affecting businesses, including a reduction in the U.S. federal corporate tax rate from 35% to 21%, a one-time mandatory deemed repatriation tax on earnings of certain foreign subsidiaries that were previously tax deferred, and a new minimum tax on certain foreign earnings. The 2017 Act significantly impacts our effective tax rate for fiscal year 2018 as a result of the deemed repatriation tax, and may impact several other elements of our operating model. In future years, certain additional provisions of the 2017 Act, such as a minimum tax on foreign earnings, will also apply to the Company and, as a result, the Company generally expects its effective tax rate to increase from the rate expected for fiscal year 2018 (excluding the mandatory deemed repatriation tax and the re-measurement of deferred taxes). Taxes due over a period of time as a result of the new tax law could be accelerated upon certain triggering events, including failure to pay such taxes when due. The new law makes broad and complex changes to the U.S. tax code and we expect to see future regulatory, administrative or legislative guidance. We are analyzing the 2017 Act to determine the full impact of the new tax law, and to the extent any future guidance differs from our preliminary interpretation of the law, it could have a material effect on our financial position and results of operations.

In addition, many countries in the European Union and around the globe have adopted and/or proposed changes to current tax laws. Further, organizations such as the Organization for Economic Cooperation and Development, have published action plans that, if adopted by countries where we do business, could increase our tax obligations in these countries. Due to the large scale of our U.S. and international business activities, many of these enacted and proposed changes to the taxation of our activities could increase our worldwide effective tax rate and harm our financial

position and results of operations.

We and certain of our officers are at times involved in litigation, investigations and governmental proceedings, which may be costly, may divert the efforts of our key personnel and could result in adverse court rulings, fines or penalties, which could materially harm our business.

We are involved in litigation, including cases involving our IP rights and those of others, antitrust and commercial matters, putative securities class action suits and other actions. We are the plaintiff in some of these actions and the defendant in others. Some of the actions seek injunctive relief, including injunctions against the sale of our products, and substantial monetary damages, which if granted or awarded, could materially harm our business, financial condition and operating results. From time to time, we may also be the subject of inquiries, requests for information, investigations and actions by government and regulatory agencies regarding our businesses. Any such matters could result in material adverse consequences to our results of operations, financial condition or ability to conduct our business, including fines, penalties or restrictions on our business activities.

86

Table of Contents

Litigation is subject to inherent risks and uncertainties that may cause actual results to differ materially from our expectations. In the event of an adverse outcome in any litigation, investigation or governmental proceeding, we could be required to pay substantial damages, fines or penalties and cease certain practices or activities, including the manufacture, use and sale of products. With or without merit, such matters can be complex, can extend for a protracted period of time, can be very expensive and the expense can be unpredictable. Litigation initiated by us could also result in counter-claims against us, which could increase the costs associated with the litigation and result in our payment of damages or other judgments against us. In addition, litigation, investigations or governmental proceedings and any related publicity, may divert the efforts and attention of some of our key personnel and may also harm the market prices of our securities.

We may be obligated to indemnify our current or former directors or employees, or former directors or employees of companies that we have acquired, in connection with litigation, investigations or governmental proceedings. These liabilities could be substantial and may include, among other things: the costs of defending lawsuits against these individuals; the cost of defending shareholder derivative suits; the cost of governmental, law enforcement or regulatory investigations or proceedings; civil or criminal fines and penalties; legal and other expenses; and expenses associated with the remedial measures, if any, which may be imposed.

We are subject to laws, rules, and regulations in the U.S. and other countries relating to the collection, use, sharing, and security of third-party data including personal data, and our failure to comply with these laws, rules and regulations could subject us to proceedings by governmental entities or others and cause us to incur penalties, significant legal liability, or loss of customers, loss of revenue, and reputational harm.

We are subject to laws, rules, and regulations in the U.S. and other countries relating to the collection, use, and security of third-party data including data that relates to or identifies an individual person. In many cases, these laws apply not only to third-party transactions, but also to transfers of information between us and our subsidiaries, and among us, our subsidiaries and other parties with which we have commercial relations. Our possession and use of third-party data, including personal data and employee data in conducting our business subjects us to legal and regulatory burdens that may require us to notify vendors, customers or employees or other parties with which we have commercial relations of a data security breach and to respond to regulatory inquiries and to enforcement proceedings. Global privacy and data protection legislation, enforcement, and policy activity in this area are rapidly expanding and evolving, and may be inconsistent from jurisdiction to jurisdiction. Compliance requirements and even our inadvertent failure to comply with applicable laws may cause us to incur substantial costs, subject us to proceedings by governmental entities or others, and cause us to incur penalties or other significant legal liability, or lead us to change our business practices.

The nature of our industry and its reliance on IP and other proprietary information subjects us and our suppliers, customers and partners to the risk of significant litigation.

The data storage industry has been characterized by significant litigation. This includes litigation relating to patent and other IP rights, product liability claims and other types of litigation. We have historically been involved in frequent disputes regarding patent and other IP rights, and we have in the past received, and we may in the future receive, communications from third parties asserting that certain of our products, processes or technologies infringe upon their patent rights, copyrights, trademark rights or other IP rights. We may also receive claims of potential infringement if we attempt to license IP to others. IP risks increase when we enter into new markets where we have little or no IP protection as a defense against litigation. The complexity of the technology involved and the uncertainty of IP litigation increase the IP risks we face. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may result in adverse rulings or decisions. We may be subject to injunctions, enter into settlements or be subject to judgments that may, individually or in the

aggregate, have a material adverse effect on our business, financial condition or operating results.

If we incorporate third-party technology into our products or if claims or actions are asserted against us for alleged infringement of the IP of others, we may be required to obtain a license or cross-license, modify our existing technology or design a new non-infringing technology. Such licenses or design modifications can be extremely costly. We evaluate notices of alleged patent infringement and notices of patents from patent holders that we receive from time to time. We may decide to settle a claim or action against us, which settlement could be costly. We may also be liable for any past infringement. If there is an adverse ruling against us in an infringement lawsuit, an injunction could be issued barring production or sale of any infringing product. It could also result in a damage award equal to a reasonable royalty or lost profits or, if there is a finding of willful infringement, treble damages. Any of these results would increase our costs and harm our operating results. In addition, our suppliers, customers and partners are subject to similar risks of litigation, and a material, adverse ruling against a supplier, customer or partner could negatively impact our business.

Table of Contents

Moreover, from time to time, we agree to indemnify certain of our suppliers and customers for alleged IP infringement. The scope of such indemnity varies but may include indemnification for direct and consequential damages and expenses, including attorneys' fees. We may be engaged in litigation as a result of these indemnification obligations. Third party claims for patent infringement are excluded from coverage under our insurance policies. A future obligation to indemnify our customers or suppliers may harm our business, financial condition and operating results.

Our reliance on IP and other proprietary information subjects us to the risk that these key ingredients of our business could be copied by competitors.

Our success depends, in significant part, on the proprietary nature of our technology, including non-patentable IP such as our process technology. We primarily rely on patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies and processes. There can be no assurance that our existing patents will continue to be held valid, if challenged, or that they will have sufficient scope or strength to protect us. It is also possible that competitors or other unauthorized third parties may obtain, copy, use or disclose, illegally or otherwise, our proprietary technologies and processes, despite our efforts to protect our proprietary technologies and processes. If a competitor is able to reproduce or otherwise capitalize on our technology despite the safeguards we have in place, it may be difficult, expensive or impossible for us to obtain necessary legal protection. There are entities whom we believe may infringe our IP. Enforcement of our rights often requires litigation. If we bring a patent infringement action and are not successful, our competitors would be able to use similar technology to compete with us. Moreover, the defendant in such an action may successfully countersue us for infringement of their patents or assert a counterclaim that our patents are invalid or unenforceable. Also, the laws of some foreign countries may not protect our IP to the same extent as do U.S. laws. In addition to patent protection of IP rights, we consider elements of our product designs and processes to be proprietary and confidential. We rely upon employee, consultant and vendor non-disclosure agreements and contractual provisions and a system of internal safeguards to protect our proprietary information. However, any of our registered or unregistered IP rights may be challenged or exploited by others in the industry, which could harm our operating results.

The success of our branded products depends in part on the positive image that consumers have of our brands. We believe the popularity of our brands makes them a target of counterfeiting or imitation, with third parties attempting to pass off counterfeit products as our products. Any occurrence of counterfeiting, imitation or confusion with our brands could adversely affect our reputation and impair the value of our brands, which in turn could negatively impact sales of our branded products, our share and our gross margin, as well as increase our administrative costs related to brand protection and counterfeit detection and prosecution.

The costs of compliance with state, federal and international legal and regulatory requirements, such as environmental, labor, trade, health, safety, anti-corruption and tax regulations, customers' standards of corporate citizenship, and industry and coalition standards, such as those established by the Electronics Industry Citizenship Coalition ("EICC"), could cause an increase in our operating costs.

We are subject to, and may become subject to additional, state, federal and international laws and regulations governing our environmental, labor, trade, health, safety, anti-corruption and tax practices. These laws and regulations, particularly those applicable to our international operations, are or may be complex, extensive and subject to change. We will need to ensure that we and our suppliers and partners timely comply with such laws and regulations, which may result in an increase in our operating costs. Legislation has been, and may in the future be, enacted in locations where we manufacture or sell our products. In addition, climate change and financial reform legislation is a significant topic of discussion and has generated and may continue to generate federal, international or other regulatory responses in the near future. If we or our suppliers or partners fail to timely comply with applicable

legislation, our customers may refuse to purchase our products or we may face increased operating costs as a result of taxes, fines or penalties, or legal liability and reputational damage, which would have a materially adverse effect on our business, operating results and financial condition.

In connection with our compliance with environmental laws and regulations, as well as our compliance with industry and coalition environmental initiatives, such as those established by the EICC, the standards of business conduct required by some of our customers, and our commitment to sound corporate citizenship in all aspects of our business, we could incur substantial compliance and operating costs and be subject to disruptions to our operations and logistics. In addition, if we were found to be in violation of these laws or noncompliant with these initiatives or standards of conduct, we could be subject to governmental fines, liability to our customers and damage to our reputation and corporate brand which could cause our financial condition and operating results to suffer.

Table of Contents

Conflict minerals regulations may cause us to incur additional expenses and could limit the supply and increase the cost of certain components and metals contained in our products.

We are subject to the SEC's diligence and disclosure requirements regarding the use and source of gold, tantalum, tin and tungsten, commonly referred to as 3TG or conflict minerals, which are necessary to the functionality or production of products manufactured or contracted to be manufactured by public companies. As a result of these rules, we report annually regarding whether such 3TG originated from the Democratic Republic of the Congo or an adjoining country. These rules could affect our ability to source components that contain 3TG, or 3TG generally, at acceptable prices and could impact the availability of such components or 3TG, since there may be only a limited number of suppliers of "conflict free" 3TG. Our customers, including our OEM customers, may require, and some of our customers have notified us that they require, that our products contain only conflict free 3TG, and our revenues and margins may be harmed if we are unable to meet this requirement at a reasonable price, or at all, or are unable to pass through any increased costs associated with meeting this requirement. Additionally, we may suffer reputational harm with our customers and other stakeholders and challenges from government regulators if our products are not conflict free or if we are unable to sufficiently verify the origins of the 3TG contained in our products through the due diligence procedures that we implement. We could incur significant costs to the extent that we are required to make changes to products, processes, or sources of supply due to the foregoing requirements or pressures. Conflict minerals legislation in Europe, Canada or any other jurisdiction, could increase these risks.

Violation of applicable laws, including labor or environmental laws, and certain other practices by our suppliers, customers or partners could harm our business.

We expect our suppliers, customers and partners to operate in compliance with applicable laws and regulations, including labor and environmental laws, and to otherwise meet our required standards of conduct. While our internal operating guidelines promote ethical business practices, we do not control our suppliers, customers, partners or their labor or environmental practices. The violation of labor, environmental or other laws by any of them, or divergence of their business practices from those generally accepted as ethical, could harm our business by:

- interrupting or otherwise disrupting the shipment of our product components;
- damaging our reputation;
- forcing us to find alternate component sources;
- reducing demand for our products (for example, through a consumer boycott); or
- exposing us to potential liability for our suppliers', customers' or partners' wrongdoings.

Flash Ventures' equipment lease agreements contain covenants and other cancellation events, and cancellation of the leases would harm our business, operating results and financial condition.

Flash Ventures sells and leases back from a consortium of financial institutions ("lessors") a portion of its equipment and Flash Ventures has entered into equipment lease agreements, most of which we and Toshiba each guarantee half of the total outstanding obligations and some of which we guarantee in full for our share of the Flash Ventures investment. As of December 29, 2017, the portion of outstanding Flash Ventures' lease obligations covered by our guarantees totaled approximately \$941 million, based upon the Japanese yen to U.S. dollar exchange rate at December 29, 2017. The equipment lease agreements contain covenants and cancellation events that are customary for Japanese lease facilities and that relate to Flash Ventures and each of the guarantors. Cancellation events relating to the guarantors include, among other things, an assignment of all or a substantial part of a guarantor's business, a

bankruptcy event involving a guarantor and acceleration of other monetary debts of a guarantor above a specified threshold.

The breach of a covenant or the occurrence of another cancellation event could result in an acceleration of the Flash Ventures' lease obligations. If a cancellation event were to occur, Flash Ventures would be required to negotiate a resolution with the lessors, as well as other parties to the lease transactions, to avoid cancellation and acceleration of the lease obligations. Such resolution could include, among other things, supplementary security to be supplied by us, as guarantor, increased interest rates or waiver fees. If a cancellation event occurs and we fail to reach a resolution, we may be required to pay all or a portion of the outstanding lease obligations covered by our guarantees, which would significantly reduce our cash position and may force us to seek additional financing, which may not be available on terms acceptable to us, if at all.

Table of Contents

Any decisions to reduce or discontinue paying cash dividends to our shareholders could cause the market price for our common stock to decline.

We may modify, suspend or cancel our cash dividend policy in any manner and at any time. Any reduction or discontinuance by us of the payment of quarterly cash dividends could cause the market price of our common stock to decline. Moreover, in the event our payment of quarterly cash dividends are reduced or discontinued, our failure or inability to resume paying cash dividends at historical levels could cause the market price of our common stock to decline.

Fluctuations in currency exchange rates as a result of our international operations may negatively affect our operating results.

Because we manufacture and sell our products abroad, our revenue, cost of goods sold, margins, operating costs and cash flows are impacted by fluctuations in foreign currency exchange rates. If the U.S. dollar exhibits sustained weakness against most foreign currencies, the U.S. dollar equivalents of unhedged manufacturing costs could increase because a significant portion of our production costs are foreign-currency denominated. Conversely, there would not be an offsetting impact to revenues since revenues are substantially U.S. dollar denominated. Additionally, we negotiate and procure some of our component requirements in U.S. dollars from non-U.S. based vendors. If the U.S. dollar weakens against other foreign currencies, some of our component suppliers may increase the price they charge for their components in order to maintain an equivalent profit margin. In addition, our purchases of NAND-flash memory from Flash Ventures and our investment in Flash Ventures are denominated in Japanese yen. If the Japanese yen appreciates against the U.S. dollar, our cost of purchasing NAND-flash memory wafers and the cost to us of future capital funding of Flash Ventures would increase, which could negatively impact our operating results. If any of these events occur, they would have a negative impact on our operating results.

Prices for our products are substantially U.S. dollar denominated, even when sold to customers that are located outside the U.S. Therefore, as a substantial portion of our sales are from countries outside the U.S., fluctuations in currency exchanges rates, most notably the strengthening of the U.S. dollar against other foreign currencies, contribute to variations in sales of products in impacted jurisdictions and could adversely impact demand and revenue growth. In addition, currency variations can adversely affect margins on sales of our products in countries outside the U.S.

We attempt to manage the impact of foreign currency exchange rate changes by, among other things, entering into short-term, foreign exchange contracts. However, these contracts do not cover our full exposure, and can be canceled by the counterparty if currency controls are put in place. Thus, our decisions and hedging strategy with respect to currency risks may not be successful and harm our operating results. Further, the ability to enter into foreign exchange contracts with financial institutions is based upon our available credit from such institutions and compliance with covenants and other restrictions. Operating losses, third party downgrades of our credit rating or instability in the worldwide financial markets could impact our ability to effectively manage our foreign currency exchange rate risk. Hedging also exposes us to the credit risk of our counterparty financial institutions.

Increases in our customers' credit risk could result in credit losses and term extensions under existing contracts with customers with credit losses could result in an increase in our operating costs.

Some of our OEM customers have adopted a subcontractor model that requires us to contract directly with companies, such as ODMs, that provide manufacturing and fulfillment services to our OEM customers. Because these subcontractors are generally not as well capitalized as our direct OEM customers, this subcontractor model exposes us to increased credit risks. Our agreements with our OEM customers may not permit us to increase our product prices to alleviate this increased credit risk. Additionally, as we attempt to expand our OEM and distribution channel sales into emerging economies such as Brazil, Russia, India and China, the customers with the most success in these regions

may have relatively short operating histories, making it more difficult for us to accurately assess the associated credit risks. Any credit losses we may suffer as a result of these increased risks, or as a result of credit losses from any significant customer, especially in situations where there are term extensions under existing contracts with such customers, would increase our operating costs, which may negatively impact our operating results.

Our operating results fluctuate, sometimes significantly, from period to period due to many factors, which may result in a significant decline in our stock price.

Our quarterly operating results may be subject to significant fluctuations as a result of a number of other factors including:

- weakness in demand for one or more product categories;

Table of Contents

the timing of orders from and shipment of products to major customers, loss of major customers;

our product mix;

reductions in the ASPs of our products and lower margins;

excess output, capacity or inventory, resulting in lower ASPs, financial charges or impairments, or insufficient output, capacity or inventory, resulting in lost revenue opportunities;

inability to successfully transition to 3D NAND or other technology developments, or other failure to reduce product costs to keep pace with reduction in ASPs;

manufacturing delays or interruptions;

delays in design wins or customer qualifications, acceptance by customers of competing products in lieu of our products;

success of our partnerships and joint ventures, in particular the volume, timing and cost of wafer production at Flash Ventures, and our success in managing the relationships with our strategic partners;

inability to realize the potential benefits of our acquisitions and the success of our integration efforts;

ability to penetrate new markets for our storage solutions;

variations in the cost of and lead times for components for our products, disruptions of our supply chain;

limited availability of components that we obtain from a single or a limited number of suppliers;

seasonal and other fluctuations in demand often due to technological advances;

increase in costs due to warranty claims;

higher costs as a result of currency exchange rate fluctuations; and

availability and rates of transportation.

We often ship a high percentage of our total quarterly sales in the third month of the quarter, which makes it difficult for us to forecast our financial results before the end of the quarter. As a result of the above or other factors, our forecast of operating results for the quarter may differ materially from our actual financial results. If our results of operations fail to meet the expectations of analysts or investors, it could cause an immediate and significant decline in our stock price.

We have made and continue to make a number of estimates and assumptions relating to our consolidated financial reporting, and actual results may differ significantly from our estimates and assumptions.

We have made and continue to make a number of estimates and assumptions relating to our consolidated financial reporting. The highly technical nature of our products and the rapidly changing market conditions with which we deal means that actual results may differ significantly from our estimates and assumptions. These changes have impacted

our financial results in the past and may continue to do so in the future. Key estimates and assumptions for us include:

price protection adjustments and other sales promotions and allowances on products sold to retailers, resellers and distributors;

inventory adjustments for write-down of inventories to lower of cost or market value (net realizable value);

testing of goodwill and other long-lived assets for impairment;

accruals for product returns;

Table of Contents

accruals for litigation and other contingencies

liabilities for unrecognized tax benefits; and

provisional estimates related to tax reform.

In addition, changes in existing accounting or taxation rules or practices, new accounting pronouncements or taxation rules, or varying interpretations of current accounting pronouncements or taxation practice could have an adverse effect on our results of operations and financial condition.

The market price of our common stock is volatile.

The market price of our common stock has been, and may continue to be, volatile. Factors that may significantly affect the market price of our common stock include the following:

actual or anticipated fluctuations in our operating results, including those resulting from the seasonality of our business;

perceptions about our strategic relationships and joint ventures, access to supply of NAND-flash memory, new technologies and technology transitions;

announcements of technological innovations by us or our competitors, which may decrease the volume and profitability of sales of our existing products and increase the risk of inventory obsolescence;

new products introduced by us or our competitors;

strategic actions by us or competitors, such as acquisitions and restructurings;

periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures or industry consolidation;

developments with respect to patents or proprietary rights, and any litigation;

proposed or adopted regulatory changes or developments or anticipated or pending investigations, proceedings or litigation that involve or affect us or our competitors;

conditions and trends in the hard drive, solid-state storage, flash memory, computer, mobile, data and content management, storage and communication industries;

contraction in our operating results or growth rates that are lower than our previous high growth-rate periods;

failure to meet analysts' revenue or earnings estimates or changes in financial estimates or publication of research reports and recommendations by financial analysts relating specifically to us or the storage industry in general;

announcements relating to dividends and share repurchases; and

macroeconomic conditions that affect the market generally and, in particular, developments related to market conditions for our industry.

In addition, the sale of substantial amounts of shares of our common stock, or the perception that these sales may occur, could adversely affect the market price of our common stock. Further, the stock market is subject to fluctuations in the stock prices and trading volumes that affect the market prices of the stock of public companies, including us. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of shares of our common stock. For example, expectations concerning general economic conditions may cause the stock market to experience extreme price and volume fluctuations from time to time that particularly affect the stock prices of many high technology companies. These fluctuations may be unrelated to the operating performance of the companies.

Table of Contents

Securities class action lawsuits are often brought against companies after periods of volatility in the market price of their securities. A number of such suits have been filed against us in the past, and should any new lawsuits be filed, such matters could result in substantial costs and a diversion of resources and management's attention.

Our cash balances and investment portfolio are subject to various risks, any of which could adversely impact our financial position.

Given the international footprint of our business, we have both domestic and international cash balances and investments. We maintain an investment portfolio of various holdings, security types, and maturities. These investments are subject to general credit, liquidity, market, political, sovereign and interest rate risks, which may be exacerbated by unusual events that affect global financial markets. A material part of our investment portfolio consists of investment grade corporate securities, bank deposits, asset backed securities and U.S. government and agency securities. If global credit and equity markets experience prolonged periods of decline, or if there is a downgrade of the U.S. government credit rating due to an actual or threatened default on government debt, our investment portfolio may be adversely impacted and we could determine that our investments may experience an other-than-temporary decline in fair value, requiring impairment charges that could adversely affect our financial results. A failure of any of these financial institutions in which deposits exceed Federal Deposit Insurance Corporation ("FDIC") limits could also have an adverse impact on our financial position.

In addition, if we are unable to generate sufficient cash flows from operations to repay our indebtedness, fund acquisitions, pay dividends, or repurchase shares of our common stock, we may choose or be required to increase our borrowings, if available, or to repatriate funds to the U.S. at an additional tax cost. We must comply with regulations regarding the conversion and distribution of funds earned in the local currencies of various countries. If we cannot comply with these or other applicable regulations, we may face increased difficulties in using cash generated in these countries.

If our internal controls are found to be ineffective, our stock price may be adversely affected.

Our most recent evaluation resulted in our conclusion that as of June 30, 2017, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal control over financial reporting was effective. If our internal control over financial reporting is found to be ineffective or if we identify a material weakness in our financial reporting in future periods, investors may lose confidence in the reliability of our financial statements, we may be required to restate our financial results, our access to capital markets may be limited, and we may be subject to sanctions from regulatory agencies and The NASDAQ Global Select Market, each of which may adversely affect our stock price.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits listed in the Exhibit Index below are filed with, or incorporated by reference in, this Quarterly Report on Form 10-Q, as specified in the Exhibit List, from exhibits previously filed with the Securities and Exchange Commission. Certain agreements listed in the Exhibit Index that we have filed or incorporated by reference may contain representations and warranties by us or our subsidiaries. These representations and warranties have been made solely for the benefit of the other party or parties to such agreements and (i) may have been qualified by disclosures made to such other party or parties, (ii) were made only as of the date of such agreements or such other date(s) as may be specified in such agreements and are subject to more recent developments, which may not be fully reflected in our public disclosures, (iii) may reflect the allocation of risk among the parties to such agreements and (iv) may apply materiality standards different from what may be viewed as material to investors. Accordingly, these representations and warranties may not describe the actual state of affairs at the date hereof and should not be relied upon.

93

Table of Contents

EXHIBIT INDEX

| Exhibit Number | Description |
|-------------------|---|
| <u>2.1</u> | Agreement and Plan of Merger, dated as of October 21, 2015, among Western Digital Corporation, Schrader Acquisition Corporation and SanDisk Corporation (Filed as Exhibit 2.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on October 26, 2015)± |
| <u>3.1</u> | Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on February 8, 2006) |
| <u>3.2</u> | Amended and Restated By-Laws of Western Digital Corporation, as amended effective as of February 2, 2017 (Filed as Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on February 7, 2017) |
| <u>10.1</u> | Western Digital Corporation 2017 Performance Incentive Plan (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on November 3, 2017)* |
| <u>10.1.1</u> | Form of Notice of Grant of Stock Option and Option Agreement – Executives, under the Western Digital Corporation 2017 Performance Incentive Plan†* |
| <u>10.1.2</u> | Form of Notice of Grant of Stock Option and Option Agreement – Non-Executives, under the Western Digital Corporation 2017 Performance Incentive Plan†* |
| <u>10.1.3</u> | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement – Executives, under the Western Digital Corporation 2017 Performance Incentive Plan†* |
| <u>10.1.4</u> | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement, under the Western Digital Corporation 2017 Performance Incentive Plan†* |
| <u>10.1.5</u> | Form of Notice of Grant of Performance Stock Units and Performance Stock Unit Award Agreement – Executives, under the Western Digital Corporation 2017 Performance Incentive Plan†* |
| <u>10.2</u> | Western Digital Corporation 2017 Performance Incentive Plan Non-Employee Director Restricted Stock Unit Grant Program, as amended November 1, 2017†* |
| <u>10.3</u> | Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors†* |
| <u>10.4</u> | Amendment No. 5, dated as of November 8, 2017, to the Loan Agreement dated as of April 29, 2016, by and among Western Digital Corporation, JPMorgan Chase Bank, N.A., as administrative agent and collateral agent, the lenders party thereto and the other loan parties thereto (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on November 8, 2017) |
| <u>10.5</u> | Amendment No. 6, dated as of November 29, 2017, to the Loan Agreement dated as of April 29, 2016, by and among Western Digital Corporation, JPMorgan Chase Bank, N.A., as administrative agent and collateral agent, the lenders party thereto and the other loan parties thereto (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on November 29, 2017) |
| <u>10.6</u> | FAL Commitment and Extension Agreement, dated as of December 12, 2017, by and among Western Digital Corporation, SanDisk LLC, SanDisk (Ireland) Limited and Toshiba Memory Corporation†# |
| <u>10.7</u> | Y6 Facility Agreement, dated as of December 12, 2017, by and among Western Digital Corporation, SanDisk LLC, SanDisk (Cayman) Limited, SanDisk (Ireland) Limited, SanDisk Flash B.V., Flash Partners, Ltd., Flash Alliance, Ltd., Flash Forward, Ltd. and Toshiba Memory Corporation†# |
| <u>10.8</u> | Confidential Settlement and Mutual Release Agreement, dated as of December 12, 2017, by and among Western Digital Corporation, SanDisk LLC, SanDisk (Cayman) Limited, SanDisk (Ireland) Limited, SanDisk Flash B.V., Toshiba Corporation and Toshiba Memory Corporation†# |
| <u>10.9</u> | Confidential Settlement and Mutual Release Agreement, dated as of December 12, 2017, by and among Western Digital Corporation, SanDisk LLC, SanDisk (Cayman) Limited, SanDisk (Ireland) Limited, |

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SanDisk Flash B.V., Bain Capital Private Equity, L.P., BCPE Pangea Cayman, L.P., BCPE Pangea Cayman2, Ltd., Bain Capital Fund XII, L.P., Bain Capital Asia Fund III, L.P. and K.K. Pangea†#

- 12.1 Statement of Computation of Ratio of Earnings to Fixed Charges†
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
- 32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
- 32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
- 101.INS XBRL Instance Document†

Table of Contents

- 101.SCH XBRL Taxonomy Extension Schema Document†
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document†
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document†
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document†
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document†

† Filed with this report.

**Furnished with this report.

* Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.

± Certain schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish supplemental copies of any of the omitted schedules upon request by the Securities and Exchange Commission.

Pursuant to a request for confidential treatment, certain portions of this exhibit have been redacted from the publicly filed document and have been furnished separately to the Securities and Exchange Commission as required by Rule 24b-2 under the Securities Exchange Act of 1934, as amended.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10 Q to be signed on its behalf by the undersigned, thereunto duly authorized.

WESTERN DIGITAL CORPORATION

By: /s/ MARK P. LONG

Mark P. Long

President WD Capital, Chief Strategy Officer and Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

Dated: February 5, 2018