

WESTERN DIGITAL CORP
Form 10-Q
January 27, 2012

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 30, 2011

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)

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

33-0956711
(I.R.S. Employer
Identification No.)

3355 Michelson Drive, Suite 100

Irvine, California
(Address of principal executive offices)

92612
(Zip Code)

Registrant's telephone number, including area code: (949) 672-7000

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, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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 19, 2012, 234,930,822 shares of common stock, par value \$.01 per share, were outstanding.

WESTERN DIGITAL CORPORATION

INDEX

	PAGE NO.
<u>PART I. FINANCIAL INFORMATION</u>	3
<u>Item 1. Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets December 30, 2011 and July 1, 2011</u>	3
<u>Condensed Consolidated Statements of Income Three and Six Months Ended December 30, 2011 and December 31, 2010</u>	4
<u>Condensed Consolidated Statements of Cash Flows Six Months Ended December 30, 2011 and December 31, 2010</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	16
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	29
<u>Item 4. Controls and Procedures</u>	29
<u>PART II. OTHER INFORMATION</u>	30
<u>Item 1. Legal Proceedings</u>	30
<u>Item 1A. Risk Factors</u>	30
<u>Item 6. Exhibits</u>	49

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every five years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Our fiscal second quarters ended December 30, 2011 and December 31, 2010 both consisted of 13 weeks. Fiscal year 2011 was comprised of 52 weeks and ended on July 1, 2011. Fiscal year 2012 will be comprised of 52 weeks and will end on June 29, 2012. 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 and WD to Western Digital Corporation and its subsidiaries.

We are a Delaware corporation that operates as the parent company of our hard drive business, Western Digital Technologies, Inc., which was formed in 1970.

Our principal executive offices are located at 3355 Michelson Drive, Suite 100, Irvine, California 92612. Our telephone number is (949) 672-7000 and our Web site is www.westerndigital.com. The information on our Web site is not incorporated in this Quarterly Report on Form 10-Q.

Western Digital, WD and the WD logo are trademarks of Western Digital Technologies, Inc. and/or its affiliates. All other trademarks mentioned are the property of their respective owners.

PART I. FINANCIAL INFORMATION**Item 1. FINANCIAL STATEMENTS****WESTERN DIGITAL CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in millions, except par values; unaudited)

	September 30, Dec. 30, 2011	September 30, Jul. 1, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,924	\$ 3,490
Accounts receivable, net	747	1,206
Inventories	466	577
Other current assets	261	214
Total current assets	5,398	5,487
Property, plant and equipment, net	2,091	2,224
Goodwill	151	151
Other intangible assets, net	63	71
Other non-current assets	104	185
Total assets	\$ 7,807	\$ 8,118
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 883	\$ 1,545
Accrued expenses	364	349
Accrued warranty	124	132
Current portion of long-term debt	181	144
Total current liabilities	1,552	2,170
Long-term debt	50	150
Other liabilities	282	310
Total liabilities	1,884	2,630
Commitments and contingencies (Notes 4, 5 and 11)		
Shareholders' equity:		
Preferred stock, \$.01 par value; authorized 5 shares; issued and outstanding none		
Common stock, \$.01 par value; authorized 450 shares; issued and outstanding 235 and 233 shares, respectively	2	2
Additional paid-in capital	1,151	1,091
Accumulated other comprehensive loss	(14)	(5)
Retained earnings	4,784	4,400
Total shareholders' equity	5,923	5,488
Total liabilities and shareholders' equity	\$ 7,807	\$ 8,118

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

The accompanying notes are an integral part of these condensed consolidated financial statements.

WESTERN DIGITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in millions, except per share amounts; unaudited)

	September 30, Three Months Ended		September 30, Six Months Ended	
	Dec. 30, 2011	Dec. 31, 2010	Dec. 30, 2011	Dec. 31, 2010
Revenue, net	\$ 1,995	\$ 2,475	\$ 4,689	\$ 4,871
Cost of revenue	1,347	2,000	3,500	3,959
Gross margin	648	475	1,189	912
Operating expenses:				
Research and development	191	169	384	336
Selling, general and administrative	96	66	185	125
Charges related to flooding (Note 11)	199		199	
Total operating expenses	486	235	768	461
Operating income	162	240	421	451
Other income (expense):				
Interest income	3	2	6	4
Interest and other expense	(5)	(3)	(9)	(5)
Total other expense, net	(2)	(1)	(3)	(1)
Income before income taxes	160	239	418	450
Income tax provision	15	14	34	28
Net income	\$ 145	\$ 225	\$ 384	\$ 422
Income per common share:				
Basic	\$ 0.62	\$ 0.98	\$ 1.64	\$ 1.83
Diluted	\$ 0.61	\$ 0.96	\$ 1.62	\$ 1.80
Weighted average shares outstanding:				
Basic	234	230	234	230
Diluted	237	235	237	235

The accompanying notes are an integral part of these condensed consolidated financial statements.

WESTERN DIGITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions; unaudited)

	September 30, Six Months Ended	
	Dec. 30, 2011	Dec. 31, 2010
Cash flows from operating activities		
Net income	\$ 384	\$ 422
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	298	301
Stock-based compensation	41	37
Deferred income taxes	18	1
Non-cash portion of charges related to flooding (Note 11)	109	
Changes in:		
Accounts receivable, net	459	7
Inventories	111	(8)
Accounts payable	(675)	157
Accrued expenses	(2)	(13)
Other assets and liabilities	(13)	(9)
Net cash provided by operating activities	730	895
Cash flows from investing activities		
Purchases of property, plant and equipment	(253)	(450)
Cash used in investing activities	(253)	(450)
Cash flows from financing activities		
Issuance of stock under employee stock plans	23	24
Taxes paid on vested stock awards under employee stock plans	(5)	(4)
Excess tax benefits from employee stock plans	2	11
Repurchases of common stock		(50)
Repayment of debt	(63)	(50)
Net cash used in financing activities	(43)	(69)
Net increase in cash and cash equivalents	434	376
Cash and cash equivalents, beginning of period	3,490	2,734
Cash and cash equivalents, end of period	\$ 3,924	\$ 3,110
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 8	\$ 6
Cash paid for interest	\$ 1	\$ 3

The accompanying notes are an integral part of these condensed consolidated financial statements.

WESTERN DIGITAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

The accounting policies followed by Western Digital Corporation (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 year ended July 1, 2011. In the opinion of management, all adjustments necessary to fairly state the unaudited 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 unaudited 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 year ended July 1, 2011. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year (see Note 11).

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.

2. Supplemental Financial Statement Data*Inventories*

	September 30, Dec. 30, 2011	September 30, Jul. 1, 2011
	(in millions)	
Raw materials and component parts	\$ 191	\$ 172
Work-in-process	185	263
Finished goods	90	142
Total inventories	\$ 466	\$ 577

Warranty

The Company records an accrual for estimated warranty costs when revenue is recognized. The Company generally warrants its products for a period of one to five years. The warranty provision considers estimated product failure rates and trends, estimated repair or replacement costs and estimated costs for customer compensatory claims related to product quality issues, if any. A statistical warranty tracking model is used to help prepare estimates and assists the Company in exercising judgment in determining the underlying estimates. The statistical tracking model captures specific detail on hard drive reliability, such as factory test data, historical field return rates, and costs to repair by product type. Management's judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base warranty estimates. Management reviews the warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross margin and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. If actual product return trends, costs to repair returned products or costs of customer compensatory claims differ significantly from estimates, future results of operations could be materially affected. Changes in the warranty accrual were as follows (in millions):

	September 30, Three Months Ended		September 30, Six Months Ended	
	Dec. 30, 2011	Dec. 31, 2010	Dec. 30, 2011	Dec. 31, 2010
Warranty accrual, beginning of period	\$ 173	\$ 173	\$ 170	\$ 170
Charges to operations	24	46	69	90
Utilization	(42)	(40)	(84)	(79)

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

Changes in estimate related to pre-existing warranties		1		(3)		1		(5)
Warranty accrual, end of period		\$ 156		\$ 176		\$ 156		\$ 176

Accrued warranty also includes amounts classified in other liabilities of \$32 million at December 30, 2011 and \$38 million at July 1, 2011.

3. Income per Common Share

The Company computes basic income per common share using net income and the weighted average number of common shares outstanding during the period. Diluted income per common share is computed using net income and the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include certain dilutive outstanding employee stock options, rights to purchase shares of common stock under the Company's Employee Stock Purchase Plan (ESPP) and restricted stock unit awards.

The following table illustrates the computation of basic and diluted income per common share (in millions, except per share data):

	September 30, Three Months Ended		September 30, Six Months Ended	
	Dec. 30, 2011	Dec. 31, 2010	Dec. 30, 2011	Dec. 31, 2010
Net income	\$ 145	\$ 225	\$ 384	\$ 422
Weighted average shares outstanding:				
Basic	234	230	234	230
Employee stock options and other	3	5	3	5
Diluted	237	235	237	235
Income per common share:				
Basic	\$ 0.62	\$ 0.98	\$ 1.64	\$ 1.83
Diluted	\$ 0.61	\$ 0.96	\$ 1.62	\$ 1.80
Anti-dilutive potential common shares excluded*	7	4	5	4

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

4. Debt

In February 2008, Western Digital Technologies, Inc. (WDTI), a wholly-owned subsidiary of the Company, entered into a five-year credit agreement that provided for a \$500 million term loan facility. As of December 30, 2011, the term loan facility had a variable interest rate of 1.56% and a remaining balance of \$231 million, which requires principal payments totaling \$81 million through the remainder of fiscal 2012 and \$150 million in fiscal 2013. The term loan facility has a maturity date of February 11, 2013. As of December 30, 2011, WDTI was in compliance with all covenants.

See Note 10 for additional disclosures related to the Company's new credit facility to be entered into in connection with the closing of the planned acquisition of Viviti Technologies Ltd., until recently known as Hitachi Global Storage Technologies Holdings Pte. Ltd (HGST).

5. Legal Proceedings

When the Company becomes aware of a claim or potential claim, the Company assesses the likelihood of any loss or exposure. The Company discloses information regarding each material claim where the likelihood of a loss contingency is probable or reasonably possible. If a loss contingency is probable and the amount of the loss can be reasonably estimated, the Company records an accrual for the loss. In such cases, there may be an exposure to potential loss in excess of the amount accrued. Where a loss is not probable but is reasonably possible or where a loss in excess of the amount accrued is reasonably possible, the Company discloses an estimate of the amount of the loss or range of possible losses for the claim if a reasonable estimate can be made, unless the amount of such reasonably possible losses is not material to the Company's financial position, results of operations or cash flows. 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

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

Intellectual Property Litigation

On June 20, 2008, plaintiff Convolve, Inc. (Convolve) filed a complaint in the Eastern District of Texas against the Company 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. On October 10, 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. A trial in the matter began on July 18, 2011 and concluded on July 26, 2011 with a verdict against the Company in an amount that is not material to the Company's financial position, results of operations or cash flows. The Company has filed post-trial motions challenging the verdict and will evaluate its options for appeal after the court rules on the post-trial motions.

On July 15, 2009, plaintiffs Carl B. Collins and Farzin Davanloo filed a complaint in the Eastern District of Texas against the Company and ten other companies alleging infringement of U.S. Patent Nos. 5,411,797 and 5,478,650. Plaintiffs are seeking injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to nanophase diamond films. On October 11, 2011, plaintiffs and the Company filed a joint motion to stay all deadlines applicable to claims involving the Company, indicating that the parties had reached an agreement in principle that would resolve the case for an immaterial amount that was accrued by the Company in the first quarter of fiscal 2012. The Court approved the motion on October 13, 2011. The parties entered into a formal written settlement agreement on November 18, 2011, and the Court granted an order dismissing the case with prejudice on December 7, 2011.

On December 7, 2009, plaintiff Nazomi Communications filed a complaint in the Eastern District of Texas against the Company and seven other companies alleging infringement of U.S. Patent Nos. 7,080,362 and 7,225,436. Plaintiffs dismissed the Eastern District of Texas suit after filing a similar complaint in the Central District of California on February 8, 2010. The case was subsequently transferred to the Northern District of California on October 14, 2010. Plaintiffs are seeking injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to processor cores capable of Java hardware acceleration. The Company intends to defend itself vigorously in this matter.

On January 5, 2010, plaintiff Enova Technology Corporation filed a complaint in the District of Delaware against the Company and Initio Corporation alleging infringement of U.S. Patent Nos. 7,136,995 and 7,386,734. Plaintiff is seeking injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to real time full disk encryption application specific integrated circuits, or ASICs. The Company intends to defend itself vigorously in this matter.

On November 10, 2010, plaintiff Rembrandt Data Storage filed a complaint in the Western District of Wisconsin against the Company alleging infringement of U.S. Patent Nos. 5,995,342 and 6,195,232. Plaintiff is seeking injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to specific thin film heads having solenoid coils. After a favorable claim construction ruling by the Court, the Company secured a stipulation from plaintiff to dismiss the case. Plaintiff has indicated it will appeal the Court's claim construction ruling. The Company intends to continue to defend itself vigorously in this matter.

On August 1, 2011, plaintiff Guzik Technical Enterprises filed a complaint in the Northern District of California against the Company and various of its subsidiaries alleging infringement of U.S. Patent Nos. 6,023,145 and 6,785,085, breach of contract and misappropriation of trade secrets. Plaintiff is seeking injunctive relief and unspecified monetary damages, fees and costs. The patents asserted by plaintiff allegedly relate to devices used to test hard disk drive heads and media. The Company has filed counterclaims against plaintiff for patent infringement of U.S. Patent Nos. 5,844,420; 5,640,089; 6,891,696; and 7,480,116. The patents asserted by the Company relate to devices and methods used in the testing of hard disk drive heads and media. The Company intends to defend itself vigorously in this matter.

On September 6, 2011, plaintiff Powerline Innovations filed a complaint in the Eastern District of Texas against the Company alleging infringement of U.S. Patent No. 5,471,190. Plaintiff is seeking unspecified monetary damages, fees and costs. The asserted patent allegedly relates to power line Ethernet communications. The Company is being indemnified by a third party. All three parties have reached an agreement in principle to settle the matter, and the parties are in the process of finalizing a formal written settlement agreement. In the event a formal written settlement agreement is not reached and approved by the Court, the Company intends to defend itself vigorously in this matter.

Seagate Matter

On October 4, 2006, plaintiff Seagate Technology LLC (Seagate) filed an action in the District Court of Hennepin County, Minnesota, naming as defendants the Company and one of its now former employees previously employed by Seagate. The complaint in the action alleged claims based on supposed misappropriation of trade secrets and sought injunctive relief and unspecified monetary damages, fees and costs. On June 19, 2007, the Company s former employee filed a demand for arbitration with the American Arbitration Association. A motion to stay the litigation as against all defendants and to compel arbitration of all Seagate s claims was granted on September 19, 2007. On September 23, 2010, Seagate filed a motion to amend its claims and add allegations based on the supposed misappropriation of additional confidential information, and the arbitrator granted Seagate s motion. The arbitration hearing commenced on May 23, 2011 and concluded on July 11, 2011.

On November 18, 2011, the sole arbitrator ruled in favor of the Company in connection with five of the eight alleged trade secrets at issue, based on evidence that such trade secrets were known publicly at the time the former employee joined the Company. Based on a determination that the employee had fabricated evidence, the arbitrator then concluded that the Company had to know of the fabrications. As a sanction, the arbitrator precluded any evidence or defense by the Company disputing the validity, misappropriation, or use of the three remaining alleged trade secrets by the Company, and entered judgment in favor of Seagate with respect to such trade secrets. Using an unjust enrichment theory of damages, the arbitrator issued an interim award against the Company in the amount of \$525 million plus pre-award interest at the Minnesota statutory rate of 10% per year. In his decision with respect to these three trade secrets, the arbitrator did not question the relevance, veracity or credibility of any of the Company s ten expert and fact witnesses (other than the Company s former employee), nor the authenticity of any other evidence the Company presented. A hearing to consider the amount of pre-award interest was held on January 10, 2012. On January 23, 2012, the arbitrator issued a final award adding pre-award interest in the amount of \$105.4 million for a total final award of \$630.4 million. On January 23, 2012, the Company filed a petition in the District Court of Hennepin County, Minnesota to have the final arbitration award vacated. A hearing on the petition to vacate is set for March 1, 2012.

The Company believes the arbitrator exceeded his authority and refused to consider material evidence and that confirmation of the award would violate public policy. The Company strongly disputes the arbitrator s conclusion that the Company had to know of the alleged fabrication and believes that if all of its evidence had been properly considered it would have prevailed on all remaining claims. The Company intends to pursue vigorously its motion to vacate the award and, if necessary, to appeal the award if it is confirmed by the District Court of Hennepin County, Minnesota. The Company does not believe it is probable that the arbitrator s award will be sustained and accordingly has not recorded any cost or liability for the arbitrator s award in excess of the amount previously accrued by the Company (\$25 million). There is no assurance that the Company s efforts to vacate the award or to overturn the award on appeal if it is confirmed by the District Court of Hennepin County, Minnesota will be successful. It is reasonably possible that losses with respect to this matter could range from \$0 to \$605.4 million in excess of the amount previously accrued (\$25 million). This estimate does not include additional interest (as simple interest, not compounding) at the Minnesota statutory rate of 10% per year which will continue to accrue on the amount of the final award (\$630.4 million) while the Company pursues its motion to vacate the award, and if necessary, an appeal if the motion to vacate the award is unsuccessful.

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 and is therefore not predictable with assurance, 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, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these other matters could differ materially from those projected.

6. Income Taxes

The Company s income tax provision for the three months ended December 30, 2011 was \$15 million as compared to \$14 million in the prior-year period. The Company s income tax provision for the six months ended December 30, 2011 was \$34 million as compared to \$28 million in the prior-year period. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, Singapore and Thailand that expire at various dates through 2023 and the current year generation of income tax credits.

In the three months ended December 30, 2011, the Company recorded a net increase of \$1 million in its liability for unrecognized tax benefits. As of December 30, 2011, the Company had a recorded liability for unrecognized tax benefits of approximately \$232 million. Interest and penalties recognized on such amounts were not material.

The IRS has completed its field examination of the federal income tax returns for fiscal years 2006 and 2007 for the Company and calendar years 2005 and 2006 for Komag, Incorporated (Komag), which was acquired by the Company on September 5, 2007. In September 2011, the Company received a final Revenue Agent Report (RAR) and Closing Agreement with respect to the years under examination for Komag. This agreement resulted in an immaterial benefit to the Company s income tax provision. The Company has also received RARs from the IRS that seek adjustments to income before income taxes of approximately \$970 million in connection with unresolved issues related primarily to transfer pricing and certain other intercompany transactions. The Company disagrees with the proposed adjustments. In May 2011, the Company filed a protest with the IRS Appeals Office regarding the proposed adjustments. Meetings with the Appeals Office are scheduled to begin in February 2012. In January 2012, the IRS is also scheduled to commence an examination of the Company s fiscal years 2008 and 2009 and Komag s fiscal year ended September 5, 2007.

The Company believes that adequate provision has been made for any adjustments that may result from tax audits. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company s tax audits 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 30, 2011, 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 unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company s tax returns.

7. Fair Value Measurements

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.

The following table presents information about the Company s financial assets and liabilities that are measured at fair value on a recurring basis as of December 30, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

	September 30, Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, Fair Value Measurements at Reporting Date Using Significant Other Observable Inputs (Level 2)	September 30, Significant Unobservable Inputs (Level 3)	September 30, Total
Assets:				
Cash equivalents				
Money market funds	\$ 737	\$	\$	\$ 737
Auction-rate securities			15	15
Total assets at fair value	\$ 737	\$	\$ 15	\$ 752
Liabilities:				
Foreign exchange contracts		(18)		(18)
Total liabilities at fair value	\$	\$ (18)	\$	\$ (18)

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

The following table presents information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of July 1, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

	September 30, Quoted Prices in Active Markets for Identical Assets (Level 1)	September 30, Fair Value Measurements at Reporting Date Using Significant Other Observable Inputs (Level 2)	September 30, Fair Value Measurements at Reporting Date Using Significant Unobservable Inputs (Level 3)	September 30, Total
Assets:				
Cash equivalents				
Money market funds	\$ 721	\$	\$	\$ 721
U.S. Treasury securities		60		60
U.S. Government agency securities		78		78
Total cash equivalents	721	138		859
Auction-rate securities			15	15
Total assets at fair value	\$ 721	\$ 138	\$ 15	\$ 874
Liabilities:				
Foreign exchange contracts	\$	\$ (5)	\$	\$ (5)
Total liabilities at fair value	\$	\$ (5)	\$	\$ (5)

Money Market Funds. The Company's money market funds are funds that invest in U.S. Treasury securities and are recorded within cash and cash equivalents in the condensed consolidated balance sheets. Money market funds are valued based on quoted market prices.

U.S. Treasury Securities. The Company's U.S. Treasury securities are investments in Treasury bills with original maturities of three months or less, are held in custody by a third party and are recorded within cash and cash equivalents in the condensed consolidated balance sheets. U.S. Treasury securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

U.S. Government Agency Securities. The Company's U.S. Government agency securities are investments in fixed income securities sponsored by the U.S. Government with original maturities of three months or less, are held in custody by a third party and are recorded within cash and cash equivalents in the condensed consolidated balance sheets. U.S. Government agency securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

Auction-Rate Securities. The Company's auction-rate securities have maturity dates through 2050, are primarily backed by insurance products and are accounted for as available-for-sale securities. These investments are classified as long-term investments and recorded within other non-current assets in the condensed consolidated balance sheets. Auction-rate securities are valued using an income approach that is based on a discounted cash flow model or a credit default model. The inputs to the discounted cash flow model include market interest rates and a discount factor to reflect the illiquidity of the investments. The inputs to the credit default model include market interest rates, yields of similar securities, and probability-weighted assumptions related to the creditworthiness of the underlying assets.

Foreign Exchange Contracts. The Company's foreign exchange contracts are short-term contracts to hedge the Company's foreign currency risk related to the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling. Foreign exchange contracts are classified within other current liabilities in the condensed consolidated balance sheets. Foreign exchange contracts are valued using an income approach that is based on a present value of future cash flows model. The market-based observable inputs for the model include forward rates and credit default swap rates.

In the six months ended December 30, 2011, there were no changes in Level 3 financial assets measured on a recurring basis.

The carrying amounts of cash, accounts receivable, accounts payable and accrued expenses approximate fair value for all periods presented because of the short-term maturity of these assets and liabilities. The carrying amount of debt approximates fair value because of its variable interest rate.

8. Foreign Exchange Contracts

Although the majority of the Company's transactions are in U.S. dollars, some transactions are based in various foreign currencies. The Company purchases short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, revenue, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedging transactions is to minimize the impact of foreign currency fluctuations on the Company's results of operations. These contract maturity dates do not exceed 12 months. All foreign exchange contracts are for risk management purposes only. The Company does not purchase foreign exchange contracts for trading or speculative purposes. As of December 30, 2011, the Company had outstanding foreign exchange contracts with commercial banks for Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling. Thai Baht contracts are designated as either cash flow or fair value hedges. Malaysian Ringgit contracts are designated as cash flow hedges. Euro and British Pound Sterling contracts are designated as fair value hedges.

If the derivative is designated as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially deferred in other comprehensive income (loss), net of tax. These amounts are subsequently recognized into earnings when the underlying cash flow being hedged is recognized into earnings. Recognized gains and losses on foreign exchange contracts entered into for manufacturing-related activities are reported in cost of revenue. Hedge effectiveness is measured by comparing the hedging instrument's cumulative change in fair value from inception to maturity to the underlying exposure's terminal value. As of December 30, 2011, the net amount of unrealized losses expected to be reclassified into earnings within the next 12 months was \$14 million. As a result of the flooding in Thailand, the Company de-designated certain Thai Baht cash flow hedge contracts and the ineffective portion resulted in an immaterial net impact to earnings for the three months ended December 30, 2011.

A change in the fair value of fair value hedges is recognized in earnings in the period incurred and is reported as a component of operating expenses. All fair value hedges were determined to be effective. The fair value and the changes in fair value on these contracts were not material to the condensed consolidated financial statements during the three and six months ended December 30, 2011 and December 31, 2010.

As of December 30, 2011, the Company did not have any foreign exchange contracts with credit-risk-related contingent features. The Company opened \$391 million and \$1.3 billion, and closed \$815 million and \$1.7 billion in foreign exchange contracts in the three and six months ended December 30, 2011, respectively. The fair value and balance sheet location of such contracts were as follows (in millions):

Derivatives Designated as	Asset Derivatives				Liability Derivatives			
	September 30, Dec. 30, 2011		September 30, Jul. 1, 2011		September 30, Dec. 30, 2011		September 30, Jul. 1, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign exchange contracts					Accrued Expenses	\$ 18	Accrued Expenses	\$

The impact on the condensed consolidated financial statements was as follows (in millions):

Cash Relationships	September 30, Three Months Ended Dec. 30, 2011		September 30, Three Months Ended Dec. 31, 2010		September 30, Location of Gain (Loss) Reclassified from Accumulated OCI into Income	September 30, Three Months Ended Dec. 30, 2011		September 30, Three Months Ended Dec. 31, 2010
	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives		Amount of Gain (Loss) Reclassified From Accumulated OCI into Income	Amount of Gain (Loss) Reclassified From Accumulated OCI into Income	
Foreign exchange contracts	\$ 2	\$ (6)	\$ 19	\$ 74	Cost of revenue	\$ (8)	\$ 3	\$ 37

The total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements during the three and six months ended December 30, 2011 and December 31, 2010.

9. Stock-Based Compensation

During the three and six months ended December 30, 2011, the Company recognized in expense \$15 million and \$24 million, respectively, for stock-based compensation related to the vesting of options issued under stock option plans and the ESPP, compared to \$9 million and \$20 million in the comparative prior-year periods. As of December 30, 2011, total compensation cost related to unvested stock options and ESPP rights issued to employees but not yet recognized was \$77 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.4 years.

During the three and six months ended December 30, 2011, the Company recognized in expense \$9 million and \$17 million, respectively, related to the vesting of awards of restricted stock units (RSUs) compared to \$9 million and \$17 million in the comparative prior-year periods. As of December 30, 2011, the aggregate unamortized fair value of all unvested RSUs was \$53 million, which will be recognized on a straight-line basis over a weighted average vesting period of approximately 1.8 years.

Stock Option Activity

The following table summarizes activity under the Company's stock option plans (in millions, except per share amounts and remaining contractual lives):

	September 30, Number of Shares	September 30, Weighted Average Exercise Price Per Share	September 30, Weighted Average Remaining Contractual Life (in years)	September 30, Aggregate Intrinsic Value
Options outstanding at July 1, 2011	10.2	\$ 22.49		
Granted	2.5	29.64		
Exercised	(0.2)	7.99		
Canceled or expired				
Options outstanding at September 30, 2011	12.5	\$ 24.20		
Granted	0.2	26.20		
Exercised	(0.2)	15.38		
Canceled or expired				
Options outstanding at December 30, 2011	12.5	\$ 24.34	4.7	\$ 90
Exercisable at December 30, 2011	6.6	\$ 21.28	3.7	\$ 67
Vested and expected to vest after December 30, 2011	12.3	\$ 24.29	4.7	\$ 89

If an option has an exercise price that is less than the quoted price of the Company's common stock at the particular time, the aggregate intrinsic value of that option at that time is calculated based on the difference between the exercise price of the underlying options and the quoted price of the Company's common stock at that time. As of December 30, 2011, the Company had options outstanding to purchase an aggregate of 11.1 million shares with an exercise price below the quoted price of the Company's stock on that date resulting in an aggregate intrinsic value of \$90 million at that date. During the three and six months ended December 30, 2011, the aggregate intrinsic value of options exercised under the Company's stock option plans was \$3 million and \$8 million, respectively, determined as of the date of exercise, compared to \$8 million and \$10 million in the comparative prior-year periods.

Fair Value Disclosure - Binomial Model

The fair value of stock options granted is estimated using a binomial option-pricing model. The binomial model requires the input of highly subjective assumptions including the expected stock price volatility, the expected price multiple at which employees are likely to exercise stock options and the expected employee termination rate. The Company uses historical data to estimate option exercise, employee termination, and expected stock price volatility within the binomial model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The fair value of stock options granted was estimated using the following weighted average assumptions:

	September 30, Three Months Ended		September 30, Six Months Ended	
	Dec. 30, 2011	Dec. 31, 2010	Dec. 30, 2011	Dec. 31, 2010
Suboptimal exercise factor	1.80	1.81	1.81	1.81
Range of risk-free interest rates	0.12% to 1.35%	0.29% to 2.71%	0.12% to 1.43%	0.26% to 2.71%
Range of expected stock price volatility	0.45 to 0.55	0.42 to 0.57	0.41 to 0.55	0.42 to 0.59
Weighted average expected volatility	0.49	0.50	0.48	0.52
Post-vesting termination rate	2.48%	2.80%	2.62%	2.44%
Dividend yield				
Fair value	\$10.79	\$13.92	\$11.90	\$11.38

The weighted average expected term of the Company's stock options granted during the three and six months ended December 30, 2011 was 4.9 years, compared to 4.9 years and 4.7 years, respectively, in the comparative prior-year periods.

Fair Value Disclosure Black-Scholes-Merton Model

The fair value of ESPP purchase rights issued is estimated at the date of grant of the purchase rights using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes-Merton option-pricing model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until options are exercised. Purchase rights under the current ESPP provisions are granted on either June 1 or December 1. ESPP activity was immaterial to the condensed consolidated financial statements for the three and six months ended December 30, 2011 and December 31, 2010.

RSU Activity

The following table summarizes RSU activity (in millions, except weighted average grant date fair value):

	September 30, Number of Shares	September 30, Weighted Average Grant-Date Fair Value
RSUs outstanding at July 1, 2011	3.1	\$ 28.85
Granted	0.9	29.64
Vested	(0.6)	23.94
Canceled or expired		
RSUs outstanding at September 30, 2011	3.4	\$ 29.83
Granted	0.1	26.30
Vested	(0.1)	19.54
Canceled or expired		
RSUs outstanding at December 30, 2011	3.4	\$ 30.00
Expected to vest after December 30, 2011	3.1	\$ 28.85

The fair value of each RSU is the market price of our common stock at the date of grant. RSUs are generally payable in an equal number of shares of the Company's common stock at the time of vesting of the units. The grant-date fair value of the shares underlying the restricted stock awards at the date of grant was \$2 million and \$30 million for the three and six months ended December 30, 2011, respectively. These amounts are being recognized to expense over the corresponding vesting periods. For purposes of valuing these awards, the Company has assumed a forfeiture rate of 2.4%, based on a historical analysis indicating forfeitures for these types of awards.

10. Planned Acquisition

On March 7, 2011, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Hitachi, Ltd. ("Hitachi"), Viviti Technologies Ltd., until recently known as Hitachi Global Storage Technologies Holdings Pte. Ltd., a wholly owned subsidiary of Hitachi ("HGST"), and Western Digital Ireland, Ltd., an indirect wholly owned subsidiary of the Company ("WDI"). Pursuant to the Purchase Agreement, WDI agreed to acquire all of the issued and outstanding paid-up share capital of HGST from Hitachi. The planned acquisition is intended over

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

time to result in a more efficient and innovative customer-focused storage company, with significant operating scale, strong global talent and the industry's broadest product lineup backed by a rich technology portfolio. The aggregate purchase price of the planned acquisition is estimated to be approximately \$4.3 billion, due at closing, and is expected to be funded with existing cash, new debt, and 25 million newly issued shares of the Company's common

stock. The Purchase Agreement contains certain termination rights for both the Company and Hitachi, including the right to terminate the Purchase Agreement if the planned acquisition has not closed by March 7, 2012. The Purchase Agreement does not contain a termination right for the benefit of the Company in the event it cannot obtain financing for the transaction. If the planned acquisition has not closed by March 7, 2012 due to the failure to receive any required antitrust or competition authority's consent, approval or clearance or any action by certain governmental entities to prevent the planned acquisition for antitrust or competition reasons, the Company will, concurrently with the termination of the transaction, be required to pay Hitachi a fee of \$250 million in cash. During the three and six months ended December 30, 2011, the Company incurred \$11 million and \$22 million, respectively, of expenses related to the planned acquisition of HGST, which are included within selling, general and administrative expense in the condensed consolidated statements of income.

On March 7, 2011, in connection with the planned acquisition of HGST, the Company, WDTI and WDI entered into a commitment letter with Bank of America, N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated regarding a new credit facility for an amount of \$2.5 billion, consisting of a \$500 million revolving credit facility and \$2.0 billion in term loans, to be entered into in connection with the closing of the planned acquisition (the Senior Facility). Since entering into the commitment letter, Bank of America N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated led the effort to syndicate the Senior Facility for an amount of up to \$3.0 billion, consisting of a \$500 million revolving credit facility and up to \$2.5 billion in term loans. As a result of such effort, the Company, WDTI and WDI have fully negotiated definitive loan documents for the Senior Facility with the syndicate members. The Company, WDTI and WDI expect the final credit facility to be funded by these syndicate members, subject to customary closing conditions, including completion of the acquisition in accordance with its terms, the receipt of antitrust approvals or the expiration of applicable waiting periods without any action being taken by an authority that would impose any material adverse condition on the Company, HGST or their respective subsidiaries taken as a whole, and there not having occurred for HGST, the Company or WDI a material adverse effect on their respective business, financial condition or operations. The Company is required to pay a commitment fee at the rate of 0.35%, per annum, of the aggregate unfunded amount committed to be borrowed under the Senior Facility. During the three and six months ended December 30, 2011, the Company incurred debt commitment fees of \$3 million and \$5 million, respectively, related to the planned acquisition of HGST, which are included within interest and other expense in the condensed consolidated statements of income.

The planned acquisition of HGST is subject to several closing conditions, including the receipt of antitrust approvals or the expiration of applicable waiting periods. As of January 27, 2012, the Company had obtained certain governmental approvals, including approvals from the European Union, Japan and South Korea which are conditioned upon the divestiture of certain assets (and the license of related technology). The Company intends to comply with the proposed conditions and may, in some instances, be required to obtain consent from the applicable regulatory authority that its proposed implementation of the divestiture satisfies the conditions imposed. In addition, the transaction remains conditioned upon the receipt of approval from the United States and the People's Republic of China, and the Company is working closely with agencies in those countries to obtain their approval. Subject to obtaining the required regulatory approvals or expiration of applicable waiting periods, the Company is targeting the transaction to close in its third quarter of fiscal 2012.

11. Thailand Flooding

In October 2011, severe flooding in Thailand inundated all of the Company's Thailand manufacturing facilities and submerged certain equipment located there. These facilities included the Company's magnetic head slider fabrication facilities, as well as its hard drive, head gimbal assembly and head stack assembly facilities. As a result, the Company recorded \$199 million of flood-related charges in the three months ended December 30, 2011, including fixed asset impairments, recovery charges, a write-down of damaged inventory and wage continuation during the shutdown period of the Company's facilities. These charges are separately stated as a line item, "Charges related to flooding," within operating expenses on the accompanying condensed consolidated statements of income.

The following table summarizes the flood-related charges for the three months ended December 30, 2011 (in millions):

	September 30, Impairment of Property, Plant and Equipment	September 30, Recovery Charges	September 30, Inventory Write- Downs	September 30, Wage Continuation	September 30, Total
Accrual for flood-related charges at September 30, 2011	\$	\$	\$	\$	\$
Flood-related charges	109	39	28	23	199
Cash payments		(20)		(23)	(43)
Inventory write-off			(28)		(28)
Non-cash charges	(109)				(109)
Accrual for flood-related charges at December 30, 2011	\$	\$	19	\$	\$
					19

The accrued balance of \$19 million is expected to be paid in the Company's third quarter of fiscal 2012 and is included within accrued expenses in the accompanying condensed consolidated balance sheets. The Company maintains insurance coverage that provides property and business interruption coverage in the event of losses arising from flooding. The process of submitting claims to the Company's insurers is in its early stages and the Company is unable to determine how much of its losses will be covered by insurance. For an additional discussion of the Thailand flooding see Part I, Item 2 of this Quarterly Report on Form 10-Q.

12. Recent Accounting Pronouncements

In June 2011, the FASB issued Accounting Standards Update (ASU) 2011-05 Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires that all non-owner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but continuous statements. If presented in two separate statements, the first statement should present total net income and its components followed immediately by a second statement of total other comprehensive income, its components and the total comprehensive income. In December 2011, the FASB issued ASU 2011-12 Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). ASU 2011-12 defers those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. The FASB has deferred those changes in order to reconsider whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. ASU 2011-12 does not impact the requirement of ASU 2011-05 to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. ASU 2011-05 is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2011, which for the Company is the first quarter of fiscal 2013. The Company is currently evaluating how it will report comprehensive income, but either method permitted will constitute a change in the Company's financial statement presentation.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This information should be read 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 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K for the year ended July 1, 2011.

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, the Company and WD refer to Western Digital Corporation and its subsidiaries.

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:

the impact of the flooding in Thailand on the industry and our business in the March quarter and beyond, including our hard drive production capacity, the availability of components from our suppliers, our planned operations recovery efforts and the expected costs and expenses that we will incur in connection with these efforts, and our ability to complete recovery efforts and return operations to pre-flood capacity levels;

expectations regarding industry demand and the impact of the flooding in Thailand on industry supply in the March quarter;

expectations regarding the impact of the Thailand flooding on our net revenue, gross margin and unit shipments in the March quarter;

expectations regarding the production of sliders in our Bang Pa-In, Thailand facility in the March quarter and our Penang, Malaysia facility in the June quarter;

the planned acquisition of Viviti Technologies Ltd., until recently known as Hitachi Global Storage Technologies Holdings Pte. Ltd., a wholly owned subsidiary of Hitachi Ltd. (HGST), including the expected timing and anticipated benefits of the acquisition;

the terms of and our ability to syndicate the new credit facility to be entered into in connection with the planned acquisition of HGST;

demand for hard drives and solid-state drives in the various markets and factors contributing to such demand;

our plans to continue to develop new products and expand into new storage markets and into emerging economic markets;

our entry into and position in the traditional enterprise market;

emergence of new storage markets for hard drives;

emergence of competing storage technologies;

our share repurchase plans;

our stock price volatility;

expectations regarding the outcome of legal proceedings in which we are involved, including the outcome of our motion to vacate the award entered against us in our arbitration with Seagate Technology LLC and, if necessary, our appeal of the award;

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

our beliefs regarding the adequacy of our tax provisions and the timing of future payments, if any, relating to the unrecognized tax benefits;

expectations regarding our capital expenditure plans in fiscal 2012 and calendar 2012, and depreciation and amortization for fiscal 2012; and

our beliefs regarding the sufficiency of our cash and cash equivalents to meet our working capital, capital expenditure and other cash needs, and the expected impact of the flooding in Thailand and suspension of our Thailand operations on our liquidity.

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 (the SEC). 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.

Our Company

We are a global provider of solutions for the collection, storage, management, protection and use of digital content, including audio and video. Our principal products are hard drives, which are devices that use one or more rotating magnetic disks (magnetic media) to store and allow fast access to data. Hard drives are currently the primary storage medium for digital content. Our hard drives are used in desktop and notebook computers, corporate and cloud computing data centers, home entertainment equipment and stand-alone consumer storage devices. In addition to hard drives, we offer solid-state drives and home entertainment and networking products.

Planned Acquisition of Hitachi Global Storage Technologies

On March 7, 2011, we entered into a stock purchase agreement (the Purchase Agreement) with Hitachi, Ltd. (Hitachi), Viviti Technologies Ltd., until recently known as Hitachi Global Storage Technologies Holdings Pte. Ltd., a wholly owned subsidiary of Hitachi (HGST), and Western Digital Ireland, Ltd., our indirect wholly owned subsidiary (WDI). Pursuant to the Purchase Agreement, WDI agreed to acquire all of the issued and outstanding paid-up share capital of HGST from Hitachi. The planned acquisition is intended over time to result in a more efficient and innovative customer-focused storage company, with significant operating scale, strong global talent and the industry s broadest product lineup backed by a rich technology portfolio. The aggregate purchase price of the planned acquisition is estimated to be approximately \$4.3 billion, due at closing, and is expected to be funded with existing cash, new debt, and 25 million newly issued shares of our common stock. The Purchase Agreement contains certain termination rights for both us and Hitachi, including the right to terminate the Purchase Agreement if the planned acquisition has not closed by March 7, 2012. The Purchase Agreement does not contain a termination right for the benefit of WD in the event we cannot obtain financing for the transaction. If the planned acquisition has not closed by March 7, 2012 due to the failure to receive any required antitrust or competition authority s consent, approval or clearance or any action by certain governmental entities to prevent the planned acquisition for antitrust or competition reasons, we will, concurrently with such termination, be required to pay Hitachi a fee of \$250 million in cash.

On March 7, 2011, in connection with the planned acquisition of HGST, WD, Western Digital Technologies, Inc. (WDTI), our wholly-owned subsidiary, and WDI entered into a commitment letter with Bank of America, N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated regarding a new credit facility for an amount of \$2.5 billion, consisting of a \$500 million revolving credit facility and \$2.0 billion in term loans, to be entered into in connection with the closing of the planned acquisition (the Senior Facility). Since entering into the commitment letter, Bank of America N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated led the effort to syndicate the Senior Facility for an amount of up to \$3.0 billion, consisting of a \$500 million revolving credit facility and up to \$2.5 billion in term loans. As a result of such effort, WD, WDTI and WDI have fully negotiated definitive loan documents for the Senior Facility with the syndicate members. WD, WDTI and WDI expect the final credit facility to be funded by these syndicate members, subject to customary closing conditions, including completion of the acquisition in accordance with its terms, the receipt of antitrust approvals or the expiration of applicable waiting periods without any action being taken by an authority that would impose any material adverse condition on WD, HGST or their respective subsidiaries taken as a whole, and there not having occurred for HGST, WD or WDI a material adverse effect on their respective business, financial condition or operations. We are required to pay a commitment fee at the rate of 0.35%, per annum, of the aggregate unfunded amount committed to be borrowed under the Senior Facility.

The planned acquisition of HGST is subject to several closing conditions, including the receipt of antitrust approvals or the expiration of applicable waiting periods. As of January 27, 2012, we have obtained certain governmental approvals, including approvals from the European Union, Japan and South Korea which are conditioned upon our divestiture of certain assets (and the license of related technology). We intend to comply with the proposed conditions and may, in some instances, be required to obtain consent from the applicable regulatory

authority that our proposed implementation of the divestiture satisfies the conditions imposed. In addition, the transaction remains conditioned upon the receipt of approval from the United States and the People's Republic of China, and we are working closely with agencies in those countries to obtain their approval. Subject to obtaining the required regulatory approvals or expiration of applicable waiting periods, we are targeting the transaction to close in our third quarter of fiscal 2012.

Second Quarter Overview

As described in more detail below, in October 2011, Thailand experienced historic flooding which severely impacted the hard drive supply chain. The overall hard drive industry is experiencing significant supply constraints as a result of the Thailand flooding. For the December quarter, we believe that overall hard drive industry shipments were well below demand and totaled approximately 119 million units, down 29% from the prior-year period and down 32% sequentially from the September quarter.

The following table sets forth, for the periods presented, selected summary information from our condensed consolidated statements of income by dollars and percentage of net revenue (in millions, except percentages):

	September 30, Dec. 30, 2011	September 30, Three Months Ended Dec. 31, 2010	September 30, Dec. 31, 2010	September 30, Dec. 30, 2011	September 30, Six Months Ended Dec. 31, 2010	September 30, Dec. 31, 2010	September 30, Dec. 31, 2010	
Net revenue	\$ 1,995	100.0%	\$ 2,475	100.0%	\$ 4,689	100.0%	\$ 4,871	100.0%
Gross margin	648	32.5	475	19.2	1,189	25.4	912	18.7
Total operating expenses	486	24.4	235	9.5	768	16.4	461	9.5
Operating income	162	8.1	240	9.7	421	9.0	451	9.3
Net income	145	7.3	225	9.1	384	8.2	422	8.7

The following is a summary of our financial performance for the second quarter of 2012:

Consolidated net revenue totaled \$2.0 billion.

33% of our hard drive revenue was derived from non-compute and enterprise markets, which include CE products, enterprise applications, and WD®-branded products, as compared to 37% in the prior-year period.

Hard drive unit shipments decreased by 45% from the prior-year period to 28.5 million units.

Gross margin increased to 32.5%, compared to 19.2% for the prior-year period.

Operating income, including \$199 million of charges related to the Thailand flooding and \$11 million of acquisition-related expenses, was \$162 million, a decrease of \$78 million from the prior-year period.

We generated \$378 million in cash flow from operations in the second quarter of fiscal 2012, and we finished the quarter with \$3.9 billion in cash and cash equivalents.

Thailand Flooding

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

We suspended production in all of our Thailand manufacturing facilities during the week of October 10, 2011 due to severe flooding in Thailand, where flood waters inundated our facilities and submerged certain equipment located there. The flooded facilities in Thailand included our magnetic head slider fabrication facilities, which supplied a substantial majority of our magnetic head requirements prior to the flooding. The flooded facilities in Thailand also included our hard drive, head gimbal assembly (HGA) and head stack assembly (HSA) facilities. In addition to the temporary suspension of our Thailand operations and the internal slider shortages, we experienced other shortages of component parts in the December quarter from vendors located in several Thailand industrial parks that were flooded or affected by protective plant shutdowns.

Since the flooding, we have restarted and continue to increase hard drive production capacity and have recommenced slider production in Thailand. We are also extending slider production capacity into Malaysia and expect to begin shipping hard drives with sliders produced in Malaysia in the June quarter. We are targeting to return to our pre-flood world-wide hard drive capacity levels in the quarter ending September 2012. However, we expect the overall hard drive industry will continue to be supply constrained through calendar 2012 with gradual improvement throughout the year.

In the December quarter, we recorded \$199 million of charges related to the flooding, including \$109 million of fixed asset impairments, \$39 million of recovery charges, \$28 million of write-downs of damaged inventory and \$23 million in wage continuation during the shutdown period of our facilities. We maintain insurance coverage that provides property and business interruption coverage in the event of losses arising from flooding. The process of submitting claims to our insurers is in its early stages and we are unable to determine how much of our losses will be covered by insurance.

We believe that overall hard drive industry unit shipments will continue to be significantly supply constrained in the March quarter. We expect that pricing will continue to be significantly above pre-flood levels due to the supply-constrained environment, under-absorption of our manufacturing assets and higher component costs. We expect our hard drive shipments during the March quarter will be between 31 and 33 million units. Therefore, we expect our net revenue in the March quarter to remain flat or increase slightly from the December quarter. We expect to incur about \$50 million of additional charges related to the Thailand flooding in the March quarter, consisting primarily of ongoing reclaim and recovery work, and wage continuation for idled workers. In addition, for calendar 2012, the total amount of capital spending we expect to restore our capacity to pre-flood levels and enhance our supply chain infrastructure is approximately \$650 million.

Arbitration Award

As disclosed above in Part I, Item 1, Note 5 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, on November 18, 2011, a sole arbitrator ruled against us in an arbitration in Minnesota. The arbitration involves claims brought by Seagate Technology LLC against us and a now former employee, alleging misappropriation of confidential information and trade secrets. The arbitrator issued an interim award against us in the amount of \$525 million plus pre-award interest. On January 23, 2012, the arbitrator issued a final award adding pre-award interest in the amount of \$105.4 million, for a total award of \$630.4 million. On January 23, 2012, we filed a petition in the District Court of Hennepin County, Minnesota to have the final arbitration award vacated. A hearing on the petition to vacate is set for March 1, 2012. Interest (as simple interest, not compounding) on the final award (\$630.4 million) also accrues at the Minnesota statutory rate of 10% per year while we pursue our motion to vacate the award, and if necessary, an appeal if the motion to vacate the award is unsuccessful. We intend to pursue vigorously our motion to vacate the award and, if necessary, to appeal the award if it is confirmed by the District Court of Hennepin County Minnesota. The Company does not believe it is probable that the arbitrator's award will be sustained and accordingly has not recorded any cost or liability for the arbitrator's award in excess of the amount previously accrued by the Company (\$25 million). We cannot make any assurances that we will be successful in our efforts to vacate the award or to overturn the award on appeal. If we are unsuccessful in these efforts, payment of the award, including interest, would adversely affect our financial condition, results of operations and cash flows. We will also be required to record a liability for the award if we should determine it is probable we will be required to pay the award.

Results of Operations

Net Revenue

(in millions, except percentages and average selling price)	September 30, Three Months Ended			September 30, Six Months Ended		
	Dec. 30, 2011	Dec. 31, 2010	Percentage Change	Dec. 30, 2011	Dec. 31, 2010	Percentage Change
Net revenue	\$ 1,995	\$ 2,475	(19)%	\$ 4,689	\$ 4,871	(4)%
Average selling price (per unit)*	\$ 69	\$ 47	47%	\$ 54	\$ 46	17%
Revenues by Geography (%)						
Americas	22%	22%		20%	23%	
Europe, Middle East and Africa	21	25		22	24	
Asia	57	53		58	53	
Revenues by Channel (%)						
OEM	59%	45%		56%	47%	
Distributors	25	33		27	33	
Retailers	16	22		17	20	

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

(in millions, except percentages and average selling price)	September 30,			September 30,		
	Three Months Ended			Six Months Ended		
	Dec. 30, 2011	Dec. 31, 2010	Percentage Change	Dec. 30, 2011	Dec. 31, 2010	Percentage Change
Unit Shipments*						
Compute	21.2	37.8		62.4	75.3	
Non-compute	5.6	12.1		19.8	23.0	
Enterprise	1.7	2.3		4.1	4.6	
Total units shipped	28.5	52.2	(45)%	86.3	102.9	(16)%

* Based on sales of hard drive units only.

For the quarter ended December 30, 2011, net revenue was \$2.0 billion, a decrease of 19% from the prior-year period. Total hard drive shipments decreased to 28.5 million units for the quarter ended December 30, 2011 as compared to 52.2 million units in the prior-year period. For the six months ended December 30, 2011, net revenue was \$4.7 billion, a decrease of 4% from the prior-year period. Total hard drive shipments decreased to 86.3 million units for the six months ended December 30, 2011, as compared to 102.9 million units for the prior-year period. These decreases in net revenue resulted primarily from a decrease in hard drive shipments due to the impact of the Thailand flooding, partially offset by increases in average selling price (ASP). For the quarter ended December 30, 2011, ASP increased by \$22, from \$47 to \$69. For the six months ended December 30, 2011, ASP increased by \$8, from \$46 to \$54. These increases in ASP for the three and six months ended December 30, 2011 were directly related to the severe supply constraints across the hard drive industry brought about by the Thailand floods.

Changes in revenue by geography and channel generally reflect normal fluctuations in market demand and competitive dynamics. However, during the three months ended December 30, 2011, changes in revenue by geography and channel reflected our efforts to allocate products to our customers by balancing their immediate needs with their prevailing inventory positions in order to maximize the availability of hard drive products to the end customer within the shortest time horizon. For the three months ended December 30, 2011, sales to Dell Inc. and Acer Inc. accounted for 12% and 10% of our net revenue, respectively. For the six months ended December 30, 2011, sales to Dell Inc. accounted for 10% of our net revenue.

In accordance 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 30, 2011, these programs represented 1% and 5% of gross revenues, respectively, compared to 10% and 11% in the comparative prior-year period. These amounts generally vary according to several factors, including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product. However, for the three months ended December 30, 2011, sales incentive and marketing programs were significantly reduced due to the severe supply constraints across the hard drive industry brought about by the Thailand floods.

Gross Margin

(in millions, except percentages)	September 30,			September 30,		
	Three Months Ended			Six Months Ended		
	Dec. 30, 2011	Dec. 31, 2010	Percentage Change	Dec. 30, 2011	Dec. 31, 2010	Percentage Change
Net revenue	\$ 1,995	\$ 2,475	(19)%	\$ 4,689	\$ 4,871	(4)%
Gross margin	648	475	36%	1,189	912	30%
Gross margin %	32.5%	19.2%		25.4%	18.7%	

For the three months ended December 30, 2011, gross margin as a percentage of revenue increased to 32.5% as compared to 19.2% for the prior-year period. For the six months ended December 30, 2011, gross margin as a percentage of revenue increased to 25.4% as compared to 18.7% for the prior-year period. These increases were primarily a result of higher ASPs, partially offset by increased costs per unit due to lower production volume, the use of air freight as opposed to less expensive sea freight, a higher mix of externally procured heads and higher costs for other components, in each case as a result of the impact of the Thailand flooding on our production and supply chain partners.

Operating Expenses

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

(in millions, except percentages)	September 30,			September 30,		
	Three Months Ended		Percentage Change	Six Months Ended		Percentage Change
	Dec. 30, 2011	Dec. 31, 2010		Dec. 30, 2011	Dec. 31, 2010	
R&D expense	\$ 191	\$ 169	13%	\$ 384	\$ 336	14%
SG&A expense	96	66	45%	185	125	48%
Charges related to flooding	199		100%	199		100%
Total operating expenses	\$ 486	\$ 235		\$ 768	\$ 461	

Research and development (R&D) expense was \$191 million for the three months ended December 30, 2011, an increase of \$22 million from the prior-year period. For the six months ended December 30, 2011, R&D expense was \$384 million, an increase of \$48 million from the prior-year period. These increases were primarily due to the continued investment in product development to support new programs and increases in variable incentive compensation. As a percentage of net revenue, R&D expense increased to 9.6% and 8.2% in the three and six months ended December 30, 2011, respectively, compared to 6.8% and 6.9% in the prior-year periods.

Selling, general and administrative (SG&A) expense was \$96 million for the three months ended December 30, 2011, an increase of \$30 million over the prior-year period. This increase was primarily due to the expansion of sales and marketing to support new products and growing markets, increases in variable incentive compensation and expenses related to the planned acquisition of HGST. For the six months ended December 30, 2011, SG&A expense was \$185 million, an increase of \$60 million over the prior-year period. This increase was primarily due to the expansion of sales and marketing to support new products and growing markets, increases in variable incentive compensation, expenses related to the planned acquisition of HGST and unrelated litigation accruals. SG&A expense as a percentage of net revenue increased to 4.8% and 3.9% in the three and six months ended December 30, 2011, respectively, compared to 2.7% and 2.6% in the comparative prior-year periods.

During the three months ended December 30, 2011, we recorded \$199 million of charges related to the flooding, including \$109 million of fixed asset impairments, \$39 million of recovery charges, \$28 million of write-downs of damaged inventory and \$23 million in wage continuation during the shutdown period of our facilities.

Other Income (Expense)

Interest income for the three and six months ended December 30, 2011 increased \$1 million and \$2 million, respectively, as compared to the prior-year periods primarily due to higher average daily invested cash balances for the periods. Interest and other expense for the three and six months ended December 30, 2011 increased \$2 million and \$4 million, respectively, as compared to the prior-year periods. These increases were primarily due to \$3 million and \$5 million of debt commitment fees related to the planned acquisition of HGST in the three and six months ended December 30, 2011, respectively, offset by decreases in our term loan interest expense due to a lower principal balance.

Income Tax Provision

Our income tax provision for the three months ended December 30, 2011 was \$15 million as compared to \$14 million in the prior-year period. Our income tax provision for the six months ended December 30, 2011 was \$34 million as compared to \$28 million in the prior-year period. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, Singapore and Thailand that expire at various dates through 2023 and the current year generation of income tax credits.

In the three months ended December 30, 2011, we recorded a net increase of \$1 million in our liability for unrecognized tax benefits. As of December 30, 2011, we had a recorded liability for unrecognized tax benefits of approximately \$232 million. Interest and penalties recognized on such amounts were not material.

The IRS has completed its field examination of the federal income tax returns for fiscal years 2006 and 2007 for us and calendar years 2005 and 2006 for Komag, Incorporated (Komag), which was acquired by us on September 5, 2007. In September 2011, we received a final Revenue Agent Report (RAR) and Closing Agreement with respect to the years under examination for Komag. This agreement resulted in an immaterial benefit to our income tax provision. We have also received RARs from the IRS that seek adjustments to income before income taxes of approximately \$970 million in connection with unresolved issues related primarily to transfer pricing and certain other intercompany transactions. We disagree with the proposed adjustments. In May 2011, we filed a protest with the IRS Appeals Office regarding the proposed adjustments. Meetings with the Appeals Office are scheduled to begin in February 2012. In January 2012, the IRS is also scheduled to commence an examination of our fiscal years 2008 and 2009 and Komag 's fiscal year ended September 5, 2007.

We believe that adequate provision has been made for any adjustments that may result from tax audits. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in our tax audits are resolved in a manner not consistent with management 's expectations, we could be required to adjust our provision for income taxes in the period such resolution occurs. As of December 30, 2011, 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 our unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of our tax returns.

Liquidity and Capital Resources

We ended the second quarter of fiscal 2012 with total cash and cash equivalents of \$3.9 billion. The following table summarizes our statements of cash flows (in millions):

	September 30, Six Months Ended	
	Dec. 30, 2011	Dec. 31, 2010
Net cash flow provided by (used in):		
Operating activities	\$ 730	\$ 895
Investing activities	(253)	(450)
Financing activities	(43)	(69)
Net increase in cash and cash equivalents	\$ 434	\$ 376

Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing return through the full investment of available funds. We believe our current cash, cash equivalents and cash generated from operations will be sufficient to meet our working capital and capital expenditure needs for the next 12 months as well as to pay the portion of the purchase price for our planned acquisition of HGST that will be funded with existing cash. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

We had cash and cash equivalents of \$3.9 billion at December 30, 2011 and \$3.5 billion at July 1, 2011, of which \$3.2 billion and \$3.0 billion was held outside of the United States at December 30, 2011 and July 1, 2011, respectively. Substantially all of the amounts held outside of the United States are intended to be indefinitely reinvested in foreign operations. The Thailand floods did not have a material impact on our United States cash flows and our current plans do not anticipate that we will need funds from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed in the United States, any repatriation could result in the accrual and payment of additional U.S. income tax.

Operating Activities

Net cash provided by operating activities during the six months ended December 30, 2011 was \$730 million as compared to \$895 million during the six months ended December 31, 2010. Cash flow from operating activities consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash used to fund working capital changes was \$120 million for the six months ended December 30, 2011 as compared to \$134 million provided by working capital changes for the prior-year period.

Our working capital requirements primarily depend on the effective management of our cash conversion cycle, which measures how quickly we can convert our products into cash through sales. The cash conversion cycles were as follows:

	September 30, Three Months Ended	
	Dec. 30, 2011	Dec. 31, 2010
Days sales outstanding	34	46
Days in inventory	31	26
Days payables outstanding	(60)	(74)
Cash conversion cycle	5	(2)

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

For the three months ended December 30, 2011, our days sales outstanding (DSOs) decreased by 12 days, days in inventory (DIOs) increased by 5 days, and days payable outstanding (DPOs) decreased by 14 days as compared to the prior-year period. The decreases in DSOs and DPOs were primarily due to the acceleration of cash payments from our customers and to our vendors in order to increase liquidity in the supply chain during the Thailand flood recovery period. The increase in DIOs was primarily due to a decrease in production as a result of the Thailand flooding.

Investing Activities

Cash used in investing activities for the six months ended December 30, 2011 was \$253 million as compared to \$450 million for the prior-year period and consisted of capital expenditures.

For fiscal 2012, we expect capital expenditures to be between \$750 million and \$800 million, which includes capital expenditures we expect to restore our capacity to pre-flood levels and enhance our supply chain infrastructure. In addition, for fiscal 2012, we expect depreciation and amortization to be approximately \$600 million.

Our cash equivalents at December 30, 2011 were invested in highly liquid money market funds that are invested in U.S. Treasury securities. We also have \$15 million of auction-rate securities, which are classified as available-for-sale securities.

Financing Activities

Net cash used in financing activities for the six months ended December 30, 2011 was \$43 million as compared to \$69 million in the prior-year period. Net cash used in financing activities for the six months ended December 30, 2011 consisted of \$63 million used to repay long-term debt, offset by a net \$20 million related to employee stock plans. Net cash used in financing activities for the six months ended December 31, 2010 consisted of \$50 million used to repurchase shares of our common stock and \$50 million used to repay long-term debt, offset by a net \$31 million related to employee stock plans.

Off-Balance Sheet Arrangements

Other than 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 off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any 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 our unaudited condensed consolidated financial statements. Additionally, we do not have an interest in, or relationships with, any special-purpose entities.

Contractual Obligations and Commitments

Long-Term Debt In February 2008, WDTI, entered into a five-year credit agreement that provided for a \$500 million term loan facility. As of December 30, 2011, the remaining balance of the term loan facility was \$231 million, which requires principal payments totaling \$81 million through the remainder of 2012 and \$150 million in 2013. See Part I, Item 1, Note 4 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

On March 7, 2011, in connection with the planned acquisition of HGST, WD, WDTI and WDI entered into a commitment letter for the Senior Facility. Since entering into the commitment letter, Bank of America N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated led the effort to syndicate the Senior Facility for an amount of up to \$3.0 billion, consisting of a \$500 million revolving credit facility and up to \$2.5 billion in term loans. As a result of such effort, WD, WDTI and WDI have fully negotiated definitive loan documents for the Senior Facility with the syndicate members. WD, WDTI and WDI expect the final credit facility to be funded by these syndicate members, subject to customary closing conditions, including completion of the acquisition in accordance with its terms, the receipt of antitrust approvals or the expiration of applicable waiting periods without any action being taken by an authority that would impose any material adverse condition on WD, HGST, or their respective subsidiaries taken as a whole, and there not having occurred for HGST, WD or WDI a material adverse effect on their respective business, financial condition or operations. We are required to pay a commitment fee at the rate of 0.35%, per annum, of the aggregate unfunded amount committed to be borrowed under the Senior Facility.

Purchase Orders In the normal course of business, we enter into purchase orders with suppliers for the purchase of hard drive components used to manufacture our products. These purchase orders generally cover forecasted component supplies needed for production during the next quarter, are recorded as a liability upon receipt of the components, and generally may be changed or canceled at any time prior to shipment of the components. We also enter into purchase orders with suppliers for capital equipment that are recorded as a liability upon receipt of the equipment. Our ability to change or cancel a capital equipment purchase order without penalty depends on the nature of the equipment being ordered. In some cases, we may be obligated to pay for certain costs related to changes to, or cancellation of, a purchase order, such as costs incurred for raw materials or work in process of components or capital equipment.

We have entered into long-term purchase agreements with various component suppliers, which contain minimum quantity requirements. However, the dollar amount of the purchases may depend on the specific products ordered, achievement of pre-defined quantity or quality specifications or future price negotiations. We have also entered into long-term purchase agreements with various component suppliers that carry fixed volumes and pricing which obligate us to make certain future purchases, contingent on certain conditions of performance, quality and technology of the vendor's components.

We enter into, from time to time, other long-term purchase agreements for components with certain vendors. Generally, future purchases under these agreements are not fixed and determinable as they depend on our overall unit volume requirements and are contingent upon the prices, technology and quality of the supplier's products remaining competitive.

On November 15, 2011, we entered into an agreement with SAE Magnetics (H.K.) Ltd., a subsidiary of TDK (SAE), for the supply of heads, which includes quarterly minimum volumes for multiple quarters. The term of the agreement will commence in the third quarter of fiscal 2012. We have had an ongoing supply relationship for heads with SAE over periods spanning several years prior to this agreement.

See Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Contractual Obligations and Commitments in our Annual Report on Form 10-K for the year ended July 1, 2011, for further discussion of our purchase orders and purchase agreements and the associated dollar amounts. See Part II, Item 1A of this Quarterly Report on Form 10-Q for a discussion of the risks associated with these commitments.

Foreign Exchange Contracts We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, revenue, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. See Part I, Item 3, of this Quarterly Report on Form 10-Q under the heading Disclosure About Foreign Currency Risk, for a description of our current foreign exchange contract commitments and Part I, Item 1, Note 8 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

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, or from intellectual property 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.

Unrecognized Tax Benefits As of December 30, 2011, the cash portion of our total recorded liability for unrecognized tax benefits was \$150 million. We estimate the timing of the future payments of these liabilities to be within the next one to five years. See Part I, Item 1, Note 6 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for information regarding our total tax liability for unrecognized tax benefits.

Stock Repurchase Program Our Board of Directors previously authorized us to repurchase \$750 million of our common stock in open market transactions under a stock repurchase program through March 31, 2013. Since the inception of this program in 2005 through December 30, 2011, we have repurchased 20 million shares of our common stock for a total cost of \$334 million. We did not repurchase any shares under this program during the six months ended December 30, 2011. We may continue to repurchase our stock as we deem appropriate and market conditions allow. We expect stock repurchases to be funded principally by operating cash flows.

Planned Acquisition Termination Fee If the planned acquisition of HGST has not closed by March 7, 2012 due to the failure to receive any required antitrust or competition authority's consent, approval or clearance or any action by any certain governmental entities to prevent the planned acquisition for antitrust or competition reasons, we will, concurrently with the termination of the transaction, be required to pay Hitachi a fee of \$250 million in cash.

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. We believe the following are our most critical accounting policies that affect significant areas and involve judgment and estimates made by us. If these estimates differ significantly from actual results, the impact to the consolidated financial statements may be material.

Revenue and Accounts Receivable

In accordance with standard industry practice, we provide distributors and retailers (collectively referred to as resellers) with limited price protection for inventories held by resellers at the time of published list price reductions, and we provide resellers and OEMs with other sales incentive programs. At the time we recognize revenue to resellers and OEMs, we record a reduction of revenue for estimated price protection until the resellers sell such inventory to their customers and we also record a reduction of revenue for the other programs in effect. We base these adjustments on several factors including anticipated price decreases during the reseller holding period, resellers' sell-through and inventory levels, estimated amounts to be reimbursed to qualifying customers, historical pricing information and customer claim processing. If customer demand for hard drives or market conditions differs from our expectations, our operating results could be materially affected, as exemplified by the impact of the Thailand flooding on our operating results. We also have programs under which we reimburse qualified distributors and retailers for certain marketing expenditures, which are recorded as a reduction of revenue. These amounts generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product. Generally, total sales incentive and marketing programs range from 9% to 12% of gross revenues per quarter. However, for the three months ended December 30, 2011, sales incentive and marketing programs were 1% of gross revenues due to the severe supply constraints across the hard drive industry brought about by the Thailand floods. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue from the current range. Adjustments to revenues due to changes in accruals for these programs related to revenues reported in prior periods have averaged 0.3% of quarterly gross revenue since the first quarter of fiscal 2011. Customer sales incentive and marketing programs are recorded as a reduction of revenue.

We record an allowance for doubtful accounts by analyzing specific customer accounts and assessing the risk of loss based on insolvency, disputes or other collection issues. In addition, we routinely analyze the different receivable aging categories and establish reserves based on a combination of past due receivables and expected future losses based primarily on our historical levels of bad debt losses. If the financial condition of a significant customer deteriorates resulting in its inability to pay its accounts when due, or if our overall loss history changes significantly, an adjustment in our allowance for doubtful accounts would be required, which could materially affect operating results.

We establish provisions against revenue and cost of revenue for sales returns in the same period that the related revenue is recognized. We base these provisions on existing product return notifications. If actual sales returns exceed expectations, an increase in the sales return accrual would be required, which could materially affect operating results.

Warranty

We record an accrual for estimated warranty costs when revenue is recognized. We generally warrant our products for a period of one to five years. Our warranty provision considers estimated product failure rates and trends, estimated repair or replacement costs and estimated costs for customer compensatory claims related to product quality issues, if any. We use a statistical warranty tracking model to help prepare our estimates and assist us in exercising judgment in determining the underlying estimates. Our statistical tracking model captures specific detail on hard drive reliability, such as factory test data, historical field return rates, and costs to repair by product type. Our judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base our warranty estimates. We review our warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross margin and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. If actual product return trends, costs to repair returned products or costs of customer compensatory claims differ significantly from our estimates, our future results of operations could be materially affected. For a summary of historical changes in estimates related to pre-existing warranty provisions, refer to Part I, Item 1, Note 2 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Inventory

We value inventories at the lower of cost (first-in, first-out and weighted-average methods) or net realizable value. We use the first-in, first-out (FIFO) method to value the cost of the majority of our inventories, while we use the weighted-average method to value precious metal inventories. Weighted-average cost is calculated based upon the cost of precious metals at the time they are received by us. We have determined that it is not practicable to assign specific costs to individual units of precious metals and, as such, we relieve our precious metals inventory based on the weighted-average cost of the inventory at the time the inventory is used in production. The weighted-average method of valuing precious metals does not materially differ from a FIFO method. We record inventory write-downs for the valuation of inventory at the lower of cost or net realizable value by analyzing market conditions and estimates of future sales prices as compared to inventory costs and inventory balances.

We evaluate inventory balances for excess quantities and obsolescence on a regular basis by analyzing estimated demand, inventory on hand, sales levels and other information, and reduce inventory balances to net realizable value for excess and obsolete inventory based on this analysis. Unanticipated changes in technology or customer demand could result in a decrease in demand for one or more of our products, which may require a write down of inventory that could materially affect operating results.

Litigation and Other Contingencies

When we become aware of a claim or potential claim, we assess the likelihood of any loss or exposure. We disclose information regarding each material claim where the likelihood of a loss contingency is probable or reasonably possible. If a loss contingency is probable and the amount of the loss can be reasonably estimated, we record an accrual for the loss. In such cases, there may be an exposure to potential loss in excess of the amount accrued. Where a loss is not probable but is reasonably possible or where a loss in excess of the amount accrued is reasonably possible, we disclose an estimate of the amount of the loss or range of possible losses for the claim if a reasonable estimate can be made, unless the amount of such reasonably possible losses is not material to our financial position, results of operations or cash flows. 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. Refer to Part I, Item 1, Note 5 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Income Taxes

We account for income taxes under the asset and liability method, which provides that deferred tax assets and liabilities be recognized for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities and expected benefits of utilizing net operating loss and tax credit carryforwards. We record a valuation allowance when it is more likely than not that the deferred tax assets will not be realized. Each quarter, we evaluate the need for a valuation allowance for our deferred tax assets and we adjust the valuation allowance so that we record net deferred tax assets only to the extent that we conclude it is more likely than not that these deferred tax assets will be realized.

We recognize liabilities for uncertain tax positions based on a two-step process. To the extent a tax position does not meet a more-likely-than-not level of certainty, no benefit is recognized in the financial statements. If a position meets the more-likely-than-not level of certainty, it is recognized in the financial statements at the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. Interest and penalties related to unrecognized tax benefits are recognized on liabilities recorded for uncertain tax positions and are recorded in our provision for income taxes. The actual liability for unrealized tax benefits in any such contingency may be materially different from our estimates, which could result in the need to record additional liabilities for unrecognized tax benefits or potentially adjust previously-recorded liabilities for unrealized tax benefits and materially affect our operating results.

Stock-based Compensation

We account for all stock-based compensation at fair value. Stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. The fair values of all stock options granted are estimated using a binomial model, and the fair values of all Employee Stock Purchase Plan (ESPP) purchase rights are estimated using the Black-Scholes-Merton option-pricing model. Both the binomial and the Black-Scholes-Merton models require the input of highly subjective assumptions. We are required to use judgment in estimating the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ significantly from the original estimate, stock-based compensation expense and our results of operations could be materially affected.

Recent Accounting Pronouncements

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operations and financial condition, refer to Part I, Item I, Note 12 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 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, revenue, liabilities and commitments for operating expenses and product costs 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 trading or speculative purposes. Currently, we focus on hedging our foreign currency risk related to the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling. Thai Baht contracts are designated as either cash flow or fair value hedges. Malaysian Ringgit contracts are designated as cash flow hedges. Euro and British Pound Sterling contracts are designated as fair value hedges. See Part I, Item 1, Note 8 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

As of December 30, 2011, we had outstanding the following purchased foreign exchange contracts (in millions, except weighted average contract rate):

	September 30, Contract Amount	September 30, Weighted Average Contract Rate*	September 30, Unrealized Loss
Foreign exchange contracts:			
Thai Baht cash flow hedges	\$ 494	31.01	\$ 11
Thai Baht fair value hedges	\$ 150	31.86	
Malaysian Ringgit cash flow hedges	\$ 214	3.11	\$ 3
Euro fair value hedges	\$ 9	0.77	
British Pound Sterling fair value hedges	\$ 2	0.64	

* Expressed in units of foreign currency per U.S. dollar.

During the three and six months ended December 30, 2011, total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements. As a result of the flooding in Thailand, the Company de-designated certain Thai Baht cash flow hedge contracts and the ineffective portion resulted in an immaterial net impact to earnings for the three months ended December 30, 2011.

Disclosure About Other Market Risks

Variable Interest Rate Risk

Borrowings under the term loan facility bear interest at a rate equal to, at the option of WDTI, either (a) a LIBOR rate determined by reference to the cost of funds for Eurodollar deposits for the interest period relevant to such borrowing, adjusted for certain additional costs (the Eurocurrency Rate) or (b) a base rate determined by reference to the higher of (i) the federal funds rate plus 0.50% and (ii) the prime rate as announced by JPMorgan Chase Bank, N.A. (the Base Rate); in each case plus an applicable margin. The applicable margin for borrowings under the term loan facility ranges from 1.25% to 1.50% with respect to borrowings at the Eurocurrency Rate and 0.0% to 0.125% with respect to borrowings at the Base Rate. The applicable margins for borrowings under the term loan facility are determined based upon a leverage ratio of the Company and its subsidiaries calculated on a consolidated basis. If the federal funds rate, prime rate or LIBOR rate increase, our interest payments could also increase. A one percent increase in the variable rate of interest on the term loan facility would increase interest expense by approximately \$2 million annually.

Item 4. CONTROLS AND PROCEDURES

As required by SEC Rule 13a-15(b) of 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 has been no change in our internal control over financial reporting during the second fiscal quarter ended December 30, 2011, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

For a description of our legal proceedings, refer to Part I, Item 1, Note 5 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

We have updated a number of the risk factors affecting our business since those presented in our Annual Report on Form 10-K, Part I, Item 1A, for the fiscal year ended July 1, 2011. Except for revisions to the first three risk factors below, there have been no material changes in our assessment of our risk factors from those set forth in our Annual Report on Form 10-K for the fiscal year ended July 1, 2011. For convenience, all of our risk factors are included below.

Recent severe flooding in Thailand, which inundated our Thailand manufacturing facilities and resulted in the temporary suspension of all production in those facilities, has affected, and will continue to affect, adversely the near-term availability of components and our near-term business, results of operations and financial condition.

As previously disclosed, the recent severe flooding in Thailand resulted in the temporary suspension of production in all of our Thailand manufacturing facilities. Hard disk drive and slider production has resumed in our Bang Pa-In facilities, and production of head stack assemblies (HSAs) has resumed in our Navanakorn facilities. It will, however, take some months for these facilities to ramp up production to pre-flood levels. Many of the facilities of our suppliers and our customers – other suppliers also remain impacted by the effects of the flooding. The flooding has affected, and will continue to affect, adversely our near-term business, results of operations and financial condition. Material risks and uncertainties we face as a result of flooding in Thailand include the following:

Return of Operations to Pre-Flood Levels. We have resumed hard disk drive and slider production in our Bang Pa-In facilities, and HSA production in our Navanakorn facilities. We have also transferred a portion of our hard disk drive production capacity from Thailand to our Malaysian manufacturing facilities. Our ability and the time required to return operations to pre-flood levels will be affected by the time required to repair or replace damaged equipment and complete customer qualification of any replaced equipment, the extent of additional capacity we can achieve from our Malaysian manufacturing facilities and our ability to access freight lanes and transportation routes. At this time, we expect that hard disk drive production will not return to pre-flood levels until the first quarter of fiscal 2013. Until we are able to recommence production at pre-flood levels, our costs will be impacted negatively by significant under-absorption of our assets and infrastructure, our ability to assemble and supply hard drives will be constrained and our business and results of operations will be adversely affected.

Availability of Components. Our facilities in Thailand include our magnetic head slider fabrication facilities in Bang Pa-In, which prior to the flooding supplied a substantial majority of our magnetic head requirements, as well as our assembly facilities for hard drives, head gimbal assemblies (HGAs) and HSAs. Due to the flooding and the temporary suspension of our operations in Thailand, the availability of magnetic heads for our hard drives has been significantly constrained. We have entered into a volume purchase agreement with an existing external supplier for the purchase of sliders and HGAs. We also recently resumed slider

production in our Bang Pa-In facilities and HSA production in our Navanakorn facilities, and are also in the process of transferring slider production capacity to one of our Malaysian facilities. Despite these efforts, we expect slider and magnetic head availability to be constrained until the first quarter of fiscal 2013. In addition to slider and magnetic head constraints, we are also experiencing other shortages of components from vendors located in several Thailand industrial parks that were inundated by the floods or affected by protective plant shut downs. We have worked, and are continuing to work, with our suppliers to understand the extent and duration of their capacity constraints, if any, and to find alternative sources for our component materials, including sliders. Some of these suppliers may fail to remain in business as a result of liquidity issues caused by the flooding. We cannot make any assurances that we will be able to successfully, or on a timely basis, find or maintain alternative sources of quality component materials at acceptable prices or at all. In addition, due to supply constraints, the cost of certain component materials has increased and may continue to increase, which may further adversely affect our results of operations.

Recovery and Related Charges and Expenses. We have incurred, and expect to incur in the future, significant charges and expenses related to the recovery from the flooding of our Thailand facilities and its impact on our operations, including fixed asset impairments, inventory write-downs, wage continuation during the shutdown period of our facilities, and charges for restoration and recovery work. The total amount of these charges and expenses that we may incur in the future cannot currently be estimated and is dependent on a number of factors, including the time and effort required to restore or replace damaged equipment, our ability to extract existing equipment from our Thailand facilities and successfully transfer such equipment to alternative locations and bring it up to operation and the time required to recommence production at pre-flood levels.

Restoration or Replacement of Equipment. The equipment we use for the fabrication of our sliders and to assemble our hard drives, HGAs and HSAs is highly sophisticated and complex. Our ability to repair any damage to this equipment as a result of the flooding of our Thailand facilities will be dependent on our ability to source and install replacement parts for the equipment. If we are unable to successfully do so or if the extent of damage to any of our equipment is too extensive to repair, we may need to replace the equipment. We cannot assure that replacement equipment will be available on acceptable terms or at all. In addition, extended lead-time requirements for replacing some of the equipment used in our Thailand facilities, particularly equipment used for our wafer and slider fabrication, may adversely affect our ability to return operations to pre-flood levels on a timely basis.

Insurance. We maintain insurance coverage that provides property and business interruption coverage in the event of losses arising from flood. The claim process is in its early stages and we are unable to predict how much of our losses will be covered by insurance. It is reasonably possible that the final losses that we incur in connection with the flood damage and our business interruption will exceed the limits of our insurance policies. We also cannot estimate the timing of the proceeds we will ultimately receive under our insurance policies, and there may be a substantial delay between our incurrence of losses and our recovery under our insurance policies.

New Product Development. The flooding of our Thailand facilities and suspension of operations may delay or adversely impact our development and introduction of new products and technologies, and delays in implementing new technologies and introducing new products may reduce our sales and adversely affect our results of operations even after operations are restored.

Product Transitions. Due to the constraints on hard disk drive availability resulting from the flooding in Thailand, device-makers may accelerate product transitions to devices that contain less hard drive storage or do not contain a hard drive at all, which may reduce our sales and adversely affect our results of operations.

The successful completion of our planned acquisition of HGST is subject to risks and uncertainties, including obtaining the requisite regulatory approvals, and our business may suffer in the event we fail to successfully complete the acquisition.

In March 2011, we announced our planned acquisition of HGST. Completion of the planned acquisition of HGST is subject to risks and uncertainties, including, but not limited to:

Required Government Approvals. Completion of our planned acquisition of HGST is conditioned upon, among other things, obtaining required governmental approvals. As we have previously disclosed, we have obtained certain governmental approvals, including approvals from the European Union, Japan and South Korea which are conditioned upon our divestiture of certain assets (and the license of related technology). There is no assurance that we will implement successfully the asset divestiture upon which certain governmental approvals have been conditioned, or if implemented, the timing of such divestiture. In addition, the transaction remains conditioned upon the receipt of approval from the United States and the People's Republic of China. There is no assurance that we will obtain such approvals or, if obtained, the timing of the approvals. We agreed to take any and all actions to obtain the requisite governmental approvals in specified jurisdictions unless such action would reasonably be expected to materially impair the business operations of the combined company absent such imposed condition. There also can be no assurance that conditions or changes will not be imposed and any such conditions or changes could have the effect of jeopardizing or delaying completion of the planned acquisition or reducing the anticipated benefits of the planned acquisition. If we agree to any material conditions in order to obtain any approvals required to complete the planned acquisition, the business and results of operations of the combined company may be adversely affected.

Termination Fee. If the acquisition agreement is terminated by any party because the acquisition has not closed by March 7, 2012, and if, as of the time of such termination, certain regulatory and antitrust closing conditions have not been satisfied due to the failure to receive any required antitrust or competition consent, approval or clearance or any action by any certain governmental entities to prevent the acquisition for antitrust or competition reasons, then we will be required to pay a termination fee of \$250 million.

Transaction Costs. We have incurred and will continue to incur costs relating to the planned acquisition (including significant legal and financial advisory fees) and many of these costs are payable by us whether or not the planned acquisition is completed.

Time and Resources Commitment. Matters relating to the planned acquisition (including integration planning) have and will continue to require substantial commitments of time and resources by our management team, which could otherwise have been devoted to other opportunities that may have been beneficial to us.

Financing. We may fail to complete the planned financing for the transaction.

These risks and uncertainties regarding the acquisition may adversely affect our relationships with our vendors and customers, which could harm our operating results. In addition, in the event that the acquisition is not completed or is delayed, our business could suffer and the current market price of our common stock may decline.

The nature of our business and our reliance on intellectual property and other proprietary information subjects us to the risk of significant litigation.

The data storage industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. 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 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. As disclosed above in Part I, Item 1, Note 5 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, on November 18, 2011, a sole arbitrator ruled against us in an arbitration in Minnesota. The arbitration involves claims brought by Seagate Technology LLC against us and a now former employee, alleging misappropriation of confidential information and trade secrets. The arbitrator issued an interim award against us in the amount of \$525 million plus pre-award interest. On January 23, 2012, the arbitrator issued a final award adding pre-award interest in the amount of \$105.4 million, for a total award of \$630.4 million. On January 23, 2012, we filed a petition in the District Court of Hennepin County, Minnesota to have the final arbitration award vacated. Interest (as simple interest, not compounding) on the final award (\$630.4 million) also accrues at the Minnesota statutory rate of 10% per year while we pursue our motion to vacate the award, and if necessary, an appeal if the motion to vacate the award is unsuccessful. We intend to pursue vigorously our motion to vacate the award and, if necessary, to appeal the award if it is confirmed by the District Court of Hennepin County.

Minnesota. We do not believe it is probable that the arbitrator's award will be sustained and accordingly have not recorded any liability for the arbitrator's award in excess of the amount we have previously accrued (\$25 million). We cannot make any assurances that we will be successful in our efforts to vacate the award or to overturn the award on appeal. If we are unsuccessful in these efforts, payment of the award, including interest, would adversely affect our financial condition, results of operations and cash flows. We will also be required to record a liability for the award if we should determine it is probable we will be required to pay the award.

We evaluate notices of alleged patent infringement and notices of patents from patent holders that we receive from time to time. If claims or actions are asserted against us, 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. In addition, 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.

Even if we successfully complete our planned acquisition of HGST, we may fail to successfully integrate HGST's business into our operations and realize the anticipated benefits from such integration on a timely basis, or at all, which could negatively impact our business.

The success of our planned acquisition of HGST will depend on our ability to realize the anticipated benefits from integrating HGST's business into our operations. Due to legal restrictions, we and HGST have conducted, and until the completion of the planned acquisition will conduct, only limited planning regarding the integration of the two companies following the acquisition. Our ongoing business could be disrupted and our management's attention diverted due to these integration planning activities and as a result of the actual integration of the two companies following the acquisition. Following the planned acquisition, we may fail to realize the anticipated benefits from this integration on a timely basis, or at all, for a variety of reasons, including the following:

agreements we may reach with regulatory authorities, as a requirement to obtain regulatory approval, regarding structural remedies in addition to those already the subject of conditional approval by the European Union, Japan and Korea;

difficulties entering new markets or manufacturing in new geographies where we have no or limited direct prior experience;

difficulties in coordinating geographically separate organizations, which may be subject to additional complications resulting from being geographically distant from our other operations;

failure to identify or assess the magnitude of certain liabilities we are assuming in the acquisition, which could result in unexpected litigation or regulatory exposure, unfavorable accounting treatment, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition;

failure to realize the anticipated increase in our revenues due to the acquisition if customers adjust their purchasing decisions and allocate more market share to our competitors;

difficulties or delays in incorporating acquired technologies or products with our existing product lines and maintaining uniform standards, controls, processes and policies;

failure to successfully manage relationships with our combined supplier and customer base;

the impact of the March 2011 earthquakes, tsunami and related events in Japan on HGST's business, component supply or Japan facilities;

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

the impact of the recent flooding in Thailand on HGST's business, component supply or Thailand facilities;

difficulties integrating and harmonizing business systems;

difficulties in modifying HGST's existing accounting and internal control systems to comply with Section 404 of the Sarbanes-Oxley Act of 2002, to which HGST is not currently subject, which could adversely impact the effectiveness of internal control over financial reporting for the combined company; and

the loss of key employees.

If we are not able to successfully integrate HGST's business and technology into our operations, the anticipated benefits and efficiencies of the planned acquisition may not be realized fully or at all, or may take longer to realize than expected, and our ability to compete, our revenue and gross margins and our results of operations may be adversely affected.

The integration of HGST may result in significant restructuring charges that could adversely affect the financial results of the combined company.

The financial results of the combined company may be adversely affected by cash expenses and non-cash accounting charges incurred in connection with the combination. The amount and timing of these possible charges are not yet known. The price of our common stock following the acquisition could decline to the extent the combined company's financial results are materially affected by these charges.

The financing of our planned HGST acquisition will dilute our stockholders' ownership interest in the company, and may have an adverse impact on our liquidity, limit our flexibility in responding to other business opportunities and increase our vulnerability to adverse economic and industry conditions.

Our planned acquisition of HGST will be financed by a combination of the issuance of additional shares of our common stock, the use of a significant amount of our cash on hand and the incurrence of a significant amount of indebtedness. The issuance of additional shares of our common stock will dilute our stockholders' ownership interest in the company. The use of cash on hand and indebtedness to finance the acquisition will reduce our liquidity and could cause us to place more reliance on cash flow from operations to pay principal and interest on our debt, thereby reducing the availability of our cash flow for operations and development activities. The credit agreement we expect to enter into with respect to the indebtedness we will incur to finance the planned acquisition contains restrictive covenants, including financial covenants requiring us to maintain specified financial ratios. Our ability to meet these restrictive covenants can be affected by events beyond our control. The indebtedness and these restrictive covenants will also have the effect, among other things, of impairing our ability to obtain additional financing, if needed, limiting our flexibility in the conduct of our business and making us more vulnerable to economic downturns and adverse competitive and industry conditions. In addition, a breach of the restrictive covenants could result in an event of default under the credit agreement we will enter into with respect to the indebtedness, which, if not cured or waived, could result in the indebtedness becoming immediately due and payable and could have a material adverse effect on our business, financial condition or operating results.

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. Some of the risks and uncertainties we face as a result of these global economic and credit market conditions include the following:

Volatile Demand. Negative or uncertain global economic conditions could cause many of our direct and indirect customers to 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) 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 slows significantly as a result of a deterioration in economic conditions or otherwise, we may need to execute 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 or financial condition.

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 traditionally seek to mitigate our credit risk 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 and is unable to pay us. Additionally, negative or uncertain global economic conditions increase the risk that if a customer whose accounts receivable we have insured fails, 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 an accounts receivable that we cannot recover through credit insurance would have a negative impact on our financial results.

Impairment Charges. 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 such that they are insufficient, 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 an impairment of our long-lived assets or goodwill is determined, our results of operations will be adversely affected.

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

Demand for our hard drives depends in large part on the demand for systems 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 hard drives in any given period. As a result, the hard drive market has experienced periods of excess capacity, which can lead to liquidation of excess inventories and more intense price competition. If more intense price competition occurs, we may be forced to lower prices sooner and more than expected, which could result in lower ASPs, revenue and gross margins. 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. In addition, 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 result in significant shifts in market share among the industry's major participants.

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 is 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 a recent shift from air to ocean freight in response to increased transportation costs, which requires additional lead times. In addition, because hard drives 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 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, which could result in a loss of market share if our competitors are able to meet customer demands.

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

Sales of computer systems, storage subsystems and consumer electronics tend to be seasonal and cyclical, and therefore we expect to continue to experience seasonality and cyclical in our business as we respond to variations in our customers' demand for hard drives. In the desktop, mobile, CE and retail markets, seasonality is partially attributable to the increase in sales of PCs and CE devices during the back-to-school and winter holiday seasons. As such, we anticipate that sales of our products will continue to be lower during the second half of our fiscal year. However, prior to the flooding in Thailand, we began to experience a muting of typical seasonal demand patterns partially driven by the increased adoption of sea freight in the PC supply chain, which requires additional lead times, and the increased importance of emerging markets, which may have different seasonal demand patterns. While this muting of typical season demand patterns has been impacted by the flooding in Thailand, we expect this pattern to continue once the effects of the flooding subside. In the enterprise market our sales are seasonal because of the capital budgeting and purchasing cycles of our end users. However, changes in seasonal and cyclical patterns have made it, and could continue to make it, more difficult for us to forecast demand, especially in 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 cyclical also may lead to higher volatility in our stock price. It is difficult for us to evaluate the degree to which seasonality and cyclical 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.

Our customers' demand for storage may not continue to grow at current industry estimates, which may lower the prices our customers are willing to pay for our products or put us at a disadvantage to competing technologies.

Our customers' demand for storage may not continue to grow at current industry estimates as a result of:

Mobile Devices. There has been a recent rapid growth in CE devices that do not contain a hard drive such as tablet computers and smartphones. While tablet computers and smartphones provide many of the same capabilities as PCs, the extent to which they will displace or materially affect the demand for PCs is uncertain. If device-makers are successful in achieving customer acceptance of these devices as a replacement for traditional computing applications that contain hard drives, or if we are not successful in adapting our product offerings to include alternative storage solutions that address these devices, then demand for our products may decrease.

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 hard disk drives. Recently, cloud computing has emerged whereby 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 computer. This trend could cause the market for disk drives in computers to decline over time, which could harm our business to the extent this decline is not offset by the sale of our products to customers who provide cloud computing services.

Demand for our products also could be negatively impacted by developments in the regulation and enforcement of digital rights management, the emergence of processes such as data deduplication and storage virtualization, economic conditions, and the rate of increase in areal density exceeding the increase in our customers' demand for storage. These factors could lead to our customers' storage needs being satisfied at lower prices with lower capacity hard drives or solid-state storage products that we do not offer, thereby decreasing our revenue or putting us at a disadvantage to competing storage technologies. As a result, even with increasing aggregate demand for 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.

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, including the e-tail channel. Adverse publicity, whether or not justified, or allegations of product 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 WD[®]-brand products, our operating results may be adversely affected.

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 hard drives 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.

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

During the quarter ended December 30, 2011, a large percentage of our revenue, 51%, 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, which often results 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 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, we could decide not 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.

Our entry into additional markets increases the complexity of our business, and if we are unable to successfully adapt our business processes as required by these new markets, we will be at a competitive disadvantage and our ability to grow will be adversely affected.

As we expand our product line to sell into additional markets, the overall complexity of our business increases at an accelerated rate and we become subject to different market dynamics. The new markets into which we are expanding, or may expand, may have different characteristics from the markets in which we currently exist. These different characteristics may include, among other things, demand volume requirements, demand seasonality, product generation development rates, customer concentrations, warranty and product return policies and performance and compatibility requirements. Our failure to make the necessary adaptations to our business model to address these different characteristics, complexities and new market dynamics could adversely affect our operating results. For example, as we have previously disclosed, we entered the traditional enterprise market in November 2009. In addition to requiring significant capital expenditures, our entry into the traditional enterprise market adds complexity to our business that requires us to effectively adapt our business and management processes to address the unique challenges and different requirements of the traditional enterprise market, while maintaining a competitive operating cost model. If we fail to gain market acceptance in the traditional enterprise storage market, we will remain at a competitive disadvantage to the companies that succeed in this market and our ability to continue our growth will be negatively affected.

Expansion into new hard drive markets may cause our capital expenditures to increase, and if we do not successfully expand into new markets, our business may suffer.

To remain a significant supplier of hard drives, we will need to offer a broad range of hard drive products to our customers. We currently offer a variety of 3.5-inch or 2.5-inch hard drives for the desktop, mobile, enterprise, CE and external storage markets. However, demand for hard drives may shift to products in form factors or with interfaces that our competitors offer but which we do not. Expansion into other hard drive markets and resulting increases in manufacturing capacity requirements may require us to make substantial additional investments in part because our operations are largely vertically integrated now that we manufacture heads and magnetic media for use in many of the hard drives we manufacture. If we fail to successfully expand into new hard drive markets with products that we do not currently offer, we may lose business to our competitors who offer these products.

Our vertical integration of head and magnetic media manufacturing makes us dependent on our ability to timely and cost-effectively develop heads and magnetic media with leading technology and overall quality, and creates additional capital expenditure costs and asset utilization risks to our business.

Under our business plan, we are developing and manufacturing a substantial portion of the heads and magnetic media used in the hard drive products we manufacture. Consequently, we are more dependent upon our own development and execution efforts and less able to take advantage of head and magnetic media technologies developed by other manufacturers. Technology transition for head and magnetic media designs is critical to increasing our volume production of heads and magnetic media. There can be no assurance, however, that we will be successful in timely and cost-effectively developing and manufacturing heads or magnetic media for products using future technologies. We also may not effectively transition our head or magnetic media 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 heads or magnetic media we manufacture. If we are unable to timely and cost-effectively develop heads and magnetic media with leading technology and overall quality, our ability to sell our products may be significantly diminished, which could materially and adversely affect our business and financial results.

In addition, as a result of our vertical integration of head and magnetic media manufacturing, 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, our head or magnetic media manufacturing assets may face under-utilization 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. If we do not adequately address the challenges related to our head or magnetic media manufacturing operations, 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 research and development to improve our technology and develop new technologies, and unsuccessful investments could materially adversely affect our business, financial condition and results of operations.

Over the past several years, our business strategy has been to derive a competitive advantage by moving from being a follower of new technologies to being a leader in the innovation and development of new technologies. This strategy requires us to make significant investments in research and development and, in attempting to remain competitive, we may increase our capital expenditures and expenses above our historical run-rate model. There can be no assurance that these investments will result in viable technologies or products, or if these investments do result in viable technologies or products, that they will be profitable or accepted by the market. Significant investments in unsuccessful research and development 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 capacity, performance, reliability, serviceability, 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.

Further industry consolidation could provide competitive advantages to our competitors.

The hard drive industry has experienced consolidation over the past several years, including the acquisition of the hard disk drive business of Samsung Electronics Co., Ltd. by Seagate Technology plc in December 2011. Consolidation by our competitors may enhance their capacity, abilities and resources and lower their cost structure, causing us to be at a competitive disadvantage.

Some of our competitors with diversified business units outside the hard drive industry may over extended periods of time sell hard drives at prices that we cannot profitably match.

Some of our competitors earn a significant portion of their revenue from business units outside the hard drive industry. Because they do not depend solely on sales of hard drives to achieve profitability, they may sell hard drives at lower prices and operate their hard drive 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-hard drive products to the same customers, they may benefit from selling their hard drives 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 with our customers or if product life cycles lengthen, it may have a significant adverse impact on our sales and margins.

We regularly engage in new product qualification with our customers. 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, 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.

We are subject to risks related to product defects, 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.

We warrant the majority of our products for periods of one to five years. We test our hard drives in our manufacturing facilities through a variety of means. However, there can be no assurance that our testing will reveal defects in our products, which may not become apparent until after the products have been sold into the market. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement and, if a product recall occurs during the product's warranty period, we may be required 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, a product recall or epidemic failure may damage our reputation or customer relationships, and may cause us to lose market share with our customers, including our OEM and ODM customers.

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 operating expenses if our warranty provision does 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.

Dependence on a limited number of qualified suppliers of components and manufacturing equipment could lead to delays, lost revenue or increased costs.

Our future operating results may depend substantially on our suppliers' ability to timely qualify their components in our programs, and their ability to supply us with these components in sufficient volumes to meet our production requirements. A number of the components that we use are available from only a single or limited number of qualified suppliers, and may be used across multiple product lines. As such, the success of our products depends on our ability to gain access to and integrate parts from reliable component suppliers. To do so, we must maintain effective relationships with our supply base to source our component needs, develop compatible technology, and maintain continuity of supply at reasonable costs. If we fail to maintain effective relationships with our supply base, or if we fail to integrate components from our suppliers effectively, this may adversely affect our ability to develop and deliver the best products to our customers and our profitability could suffer.

Certain equipment and consumables we use in our manufacturing or testing processes are available only from a limited number of suppliers. Some of this equipment and consumables use materials that at times could be in short supply. If these materials are not available, or are not available in the quantities we require for our manufacturing and testing processes, our ability to manufacture our products could be impacted, and we could suffer significant loss of revenue.

Each of the following could also significantly harm our operating results:

an unwillingness of a supplier to supply such components or equipment to us;

consolidation of key suppliers;

failure of a key supplier's business process;

a key supplier's or sub-supplier's inability to access credit necessary to operate its business; or

failure of a key supplier to remain in business, to remain an independent merchant supplier, or to adjust to market conditions.

Shortages of commodity materials or commodity components, price volatility, or use by other industries of materials and components used in the hard drive industry, may negatively impact our operating results.

Increases in the cost for certain commodity materials or commodity components may increase our costs of manufacturing and transporting hard drives and key components. Shortages of commodity components such as DRAM and NAND flash, or commodity 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, 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 and/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 commodity 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. The volatility in the cost of oil also affects our costs and may result in lower operating margins if we are unable to pass these increased costs on to our customers.

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.

Failure by certain suppliers to effectively and efficiently develop and manufacture components, technology or production equipment for our products may adversely affect our operations.

We rely on suppliers for various component parts that we integrate into our hard drives but do not manufacture ourselves, such as semiconductors, motors, flex circuits and suspensions. Likewise, we rely on suppliers for certain technology and equipment necessary for advanced development technology for future products. Some of these components, and most of this technology and production equipment, 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 with whom we are sole sourced. 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 with our products, and technology and production equipment that can be used to develop and manufacture our next-generation products efficiently. The failure of these suppliers to effectively and efficiently develop and manufacture components that can be integrated into our products or technology and production equipment that can be used to develop or manufacture next generation products may cause us to experience inability or delay in our manufacturing and shipment of hard drive products, our expansion into new technology and markets, or our ability to remain competitive with alternative storage technologies, therefore adversely affecting our business and financial results.

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. 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.

A fundamental change in recording technology could result in significant increases in our operating expenses and could put us at a competitive disadvantage.

Historically, when the industry experiences a fundamental change in technology, any manufacturer that fails to successfully and timely adjust its designs and processes to accommodate the new technology fails to remain competitive. There are some revolutionary technologies, such as current-perpendicular-to-plane giant magnetoresistance, shingle magnetic recording, energy 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. As a result of these technology shifts, we could incur substantial costs in developing new technologies, such as heads, magnetic media, and tools to remain competitive. If we fail to successfully implement these new technologies, or if we are significantly slower than our competitors at implementing new technologies, we may not be able to offer products with capacities that our customers desire.

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 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 hard drive 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 testing equipment needed as a result of an increased number of GB per platter. Our inability to achieve cost reductions could adversely affect our operating results.

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

The storage markets in which we offer our products continuously undergo technology transitions which we must anticipate and adapt our products to address in a timely manner. If we fail to implement these 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, which could harm our operating results.

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; and

quality problems or other defects in the early stages of new product introduction that were not anticipated in the design of those products.

Our business may suffer if we fail to successfully anticipate and manage these issues associated with our product development.

If we fail to develop and introduce new hard drives that are competitive against alternative storage technologies, our business may suffer.

Our success depends in part on our ability to develop and introduce new products in a timely manner in order to keep pace with competing technologies. Alternative storage technologies like solid-state storage technology have successfully served digital entertainment markets for products such as digital cameras, MP3 players, USB flash drives, mobile phones and tablet devices that cannot be economically serviced using hard drive technology. Advances in semiconductor technology have resulted in solid-state storage emerging as a technology that is competitive with hard drives for high performance needs in advanced digital computing markets such as enterprise servers and storage. Solid-state storage is produced by large semiconductor companies who can then sell their storage products at lower prices while still remaining profitable overall. This can help them improve their market share at the expense of the competition. In addition, these semiconductor companies may choose to supply companies like us with semiconductor media at prices that make it difficult, if not impossible, for us to compete with them on a profitable basis. As a result, there can be no assurance that we will be successful in anticipating and developing new products for the desktop, mobile, enterprise, CE and external storage markets in response to solid-state storage, as well as other competing technologies. If our hard drive technology fails to offer higher capacity, performance and reliability with lower cost-per-gigabyte than solid-state storage for the desktop, mobile, enterprise, CE and external storage markets, we will be at a competitive disadvantage to companies using semiconductor technology to

serve these markets and our business will suffer.

Our manufacturing operations, and those of certain of our suppliers and customers, are concentrated in large, purpose-built facilities, which subjects 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 manufacturing operations at large, high volume, purpose-built facilities. For example, a substantial majority of our overall requirement for heads is satisfied by wafers fabricated in our Fremont, California facility. Also, we manufacture the majority of our substrates for magnetic media in our Johor, Malaysia facility, and we finish a majority of our magnetic media in our facilities in Penang, Malaysia and Tuas, Singapore. A majority of our high volume hard drive manufacturing operations are conducted in our two facilities in Thailand, with the balance conducted in our Kuala Lumpur, Malaysia facility and the facilities of our contract manufacturers in Asia, Brazil, Europe and the United States. As part of our planned acquisition of HGST, we will also acquire manufacturing facilities located in Japan, China and the Philippines (as well as additional factories in Singapore, Thailand and Malaysia). The manufacturing facilities of many of our customers, our suppliers and our customers' suppliers are also concentrated in certain geographic locations in 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 the Influenza A (H1N1) or a new pandemic influenza, could impair the total volume of hard drives that we are able to manufacture and/or sell, which would result in substantial harm to our operating results. Similarly, a fire, flood, earthquake, tsunami or other 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 operations, would significantly affect our ability to manufacture and/or sell hard drives, which would result in a substantial loss of sales and revenue and a substantial harm to our operating results. Please see the risk factor above regarding the impact of the recent flooding in Thailand on our manufacturing operations.

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

We are subject to risks associated with our global manufacturing operations and global marketing efforts, including:

obtaining requisite governmental permits and approvals;

currency exchange rate fluctuations or restrictions;

political instability and civil unrest;

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

higher freight rates;

labor challenges;

trade restrictions or higher tariffs;

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; and

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

Terrorist attacks may adversely affect our business and operating results.

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 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 or shipments of our products, our business, operating results and financial condition could be adversely affected.

Sudden disruptions to the availability of 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 cargo operations or freight lanes, such as due to 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 deliver our products.

We are vulnerable to system failures or attacks, which could harm our business.

We are heavily dependent on our technology infrastructure, among other functions, to operate our factories, sell our products, fulfill orders, manage inventory and bill, collect and make payments. Our systems are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, computer viruses, computer denial-of-service attacks and other events. Our business is also subject to break-ins, sabotage and intentional acts of vandalism by third parties as well as employees. Despite any precautions we may take, such problems could result in, among other consequences, interruptions in our business, which could harm our reputation and financial condition.

If we fail to identify, manage, complete and integrate acquisitions, investment opportunities or other significant transactions, it may adversely affect our future results.

As part of our growth strategy, we may pursue acquisitions of, investment opportunities in or other significant transactions with companies that are complementary to our business. In order to pursue this strategy successfully, we must identify attractive acquisition or investment opportunities, successfully complete the transaction, 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 identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. 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. If we fail to successfully integrate an acquisition, we may not realize all or any of the anticipated benefits of the acquisition, and our future results of operations could be adversely affected. Please see the risk factors above for specific risks and uncertainties regarding our planned acquisition of HGST.

If we are unable to retain or hire key staff and skilled employees our business results may suffer.

Our success depends upon the continued contributions of our key 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 as well as attract, integrate and retain new skilled employees. 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 by global economic conditions, we are at a competitive disadvantage for retaining and hiring key staff and skilled employees versus other companies that pay a relatively higher fixed salary. If we are unable to retain our existing key staff or skilled employees, or hire and integrate new key staff or skilled employees, or if we fail to implement succession plans for our key staff, our operating results would likely be harmed.

Our reliance on intellectual property 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 intellectual property such as our process technology. 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. Also, the laws of some foreign countries may not protect our intellectual property to the same extent as do U.S. laws. In addition to patent protection of intellectual property 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 intellectual property rights may be challenged or exploited by others in the industry, which might harm our operating results.

The costs of compliance with state, federal and international legal and regulatory requirements, such as environmental, labor, trade and tax regulations, and customers' standards of corporate citizenship could cause an increase in our operating costs.

We may be or become subject to various state, federal and international laws and regulations governing our environmental, labor, trade 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 component suppliers timely comply with such laws and regulations, which may result in an increase in our operating costs. For example, the European Union (EU) has enacted the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive, which prohibits the use of certain substances in electronic equipment, and the Waste Electrical and Electronic Equipment (WEEE) directive, which obligates parties that place electrical and electronic equipment onto the market in the EU to put a clearly identifiable mark on the equipment, register with and report to EU member countries regarding distribution of the equipment, and provide a mechanism to take back and properly dispose of the equipment. Similar legislation may be enacted in other locations where we manufacture or sell our products. In addition, climate change and financial reform legislation in the United States is a significant topic of discussion and has generated and may continue to generate federal or other regulatory responses in the near future. If we or our component suppliers 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, which would have a materially adverse effect on our business, financial condition and operating results.

In connection with our compliance with such environmental laws and regulations, as well as our compliance with industry environmental initiatives, 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 or operating results to suffer.

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

We expect our suppliers to operate in compliance with applicable laws and regulations, including labor and environmental laws, and to otherwise meet our required supplier standards of conduct. While our internal operating guidelines promote ethical business practices, we do not control our suppliers or their labor or environmental practices. The violation of labor, environmental or other laws by any of our suppliers, or divergence of a supplier's business practices from those generally accepted as ethical in the United States, 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 supplier's wrongdoings.

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, 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 continues to weaken 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. If this occurs, it 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 United States. Therefore, as a substantial portion of our sales are from countries outside the United States, 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 United States.

We have attempted 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. Currently, we hedge the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling with foreign exchange contracts.

Increases in our customers' credit risk could result in credit losses and 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, 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:

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

our product mix;

changes in the prices of our products;

manufacturing delays or interruptions;

acceptance by customers of competing products in lieu of our products;

variations in the cost of and lead times for components for our products;

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

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

reserves for doubtful accounts;

accruals for product returns;

accruals for warranty costs related to product defects;

accruals for litigation and other contingencies;

liabilities for unrecognized tax benefits; and

expensing of stock-based compensation.

The market price of our common stock is volatile.

The market price of our common stock has been, and may continue to be, extremely 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;

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;

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

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;

conditions and trends in the hard drive, computer, 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;

changes in financial estimates by securities analysts relating specifically to us or the hard drive industry in general;

macroeconomic conditions that affect the market generally; and

uncertainties regarding our planned acquisition of HGST.

In addition, 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 often appear to be unrelated to the operating performance of the companies.

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.

Current economic conditions have caused us difficulty in adequately protecting our increased cash and cash equivalents from financial institution failures.

The uncertain global economic conditions and volatile investment markets have caused us to hold more cash and cash equivalents than we would hold under normal circumstances. Since there has been an overall increase in demand for low-risk, U.S. government-backed securities with a limited supply in the financial marketplace, we face increased difficulty in adequately protecting our increased cash and cash equivalents from possible sudden and unforeseeable failures by banks and other financial institutions. A failure of any of these financial institutions in which deposits exceed FDIC limits could have an adverse impact on our financial position.

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

Our most recent evaluation resulted in our conclusion that as of July 1, 2011, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal control over financial reporting was effective. We believe that we currently have adequate internal control procedures in place for future periods; however, if our internal control over financial reporting is found to be ineffective or if we identify a material weakness in our financial reporting, investors may lose confidence in the reliability of our financial statements, which may adversely affect our financial results or our stock price.

From time to time we may become subject to income tax audits 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 United States 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 Revenue Agent Reports seeking certain adjustments to income as disclosed in Part I, Item 1, Note 6 in 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 the notice of proposed adjustment and the audits 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, net income or cash flows.

Item 6. EXHIBITS

Pursuant to the rules and regulations of the SEC, we have filed or incorporated by reference certain agreements as exhibits to this Quarterly Report on Form 10-Q. These agreements 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.

Exhibit No.	Description
2.1	Stock Purchase Agreement, dated March 7, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on May 2, 2011)
2.2	First Amendment to Stock Purchase Agreement, dated May 21, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd. and Viviti Technologies Ltd. (Incorporated by reference to the Company's Annual Report on Form 10-K (File No. 1-08703), as filed with the Securities and Exchange Commission on August 12, 2011)
2.3	Second Amendment to Stock Purchase Agreement, dated November 23, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd. and Viviti Technologies Ltd.
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on February 8, 2006)
3.2	Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 5, 2007 (Incorporated by reference to the Company's Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on November 8, 2007)
10.1	Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors *
10.2	Letter Agreement, dated November 15, 2011, between Western Digital Technologies, Inc. and SAE Magnetics (H.K.) Ltd. and its affiliates ⁺
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
Exhibit No.	Description
101.INS	XBRL Instance Document**
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.

- + Certain portions of this exhibit are omitted and have been filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request.
- * Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.
- ** Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.

SIGNATURES

Pursuant to the requirements 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

Registrant

/s/ WOLFGANG U. NICKL

Wolfgang U. Nickl

Senior Vice President and Chief Financial Officer

(Principal Financial Officer)

/s/ JOSEPH R. CARRILLO

Joseph R. Carrillo

Vice President and Chief Accounting Officer

(Principal Accounting Officer)

Date: January 27, 2012

Item 6. EXHIBITS

Pursuant to the rules and regulations of the SEC, we have filed or incorporated by reference certain agreements as exhibits to this Quarterly Report on Form 10-Q. These agreements 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.

Exhibit No.	Description
2.1	Stock Purchase Agreement, dated March 7, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on May 2, 2011)
2.2	First Amendment to Stock Purchase Agreement, dated May 21, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd. and Viviti Technologies Ltd. (Incorporated by reference to the Company's Annual Report on Form 10-K (File No. 1-08703), as filed with the Securities and Exchange Commission on August 12, 2011)
2.3	Second Amendment to Stock Purchase Agreement, dated November 23, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd. and Viviti Technologies Ltd.
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on February 8, 2006)
3.2	Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 5, 2007 (Incorporated by reference to the Company's Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on November 8, 2007)
10.1	Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors *
10.2	Letter Agreement, dated November 15, 2011, between Western Digital Technologies, Inc. and SAE Magnetics (H.K.) Ltd. and its affiliates ⁺
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
Exhibit No.	Description
101.INS	XBRL Instance Document**
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.

- + Certain portions of this exhibit are omitted and have been filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request.
- * Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.
- ** Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.