WESTERN DIGITAL CORP
Form 10-Q
November 10, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended October 2, 2015
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 1-8703

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

Delaware (State or other jurisdiction of incorporation or organization)	33-0956711 (I.R.S. Employer Identification No.)
3355 Michelson Drive, Suite 100 Irvine, California	92612
(Address of principal executive offices)	(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 ý 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 ý 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	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 ý
As of the close of business on November 4, 2015, 231,715,839 shares of common stock, par value $.01 per share, were outstanding.

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Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Our fiscal first quarters ended October 2, 2015 and October 3, 2014 consisted of 13 weeks and 14 weeks, respectively. Fiscal year 2015 was comprised of 53 weeks and ended on July 3, 2015. Fiscal year 2016 will be comprised of 52 weeks and will end on July 1, 2016. Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms “we,” “us,” “our,” the “Company,” “WDC” and “Western Digital” refer to Western Digital Corporation and its subsidiaries, unless, we state, or the context indicates, otherwise.

WDC, a Delaware corporation, is the parent company of our data storage business. Our principal executive offices are located at 3355 Michelson Drive, Suite 100, Irvine, California 92612. Our telephone number is (949) 672-7000 and our website is www.westerndigital.com. The information on our website is not incorporated in this Quarterly Report on Form 10-Q.

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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except par values; unaudited)

	October 2, 2015	July 3, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$5,081	$5,024
Short-term investments	347	262
Accounts receivable, net	1,616	1,532
Inventories	1,260	1,368
Other current assets	351	331
Total current assets	8,655	8,517
Property, plant and equipment, net	2,890	2,965
Goodwill	2,766	2,766
Other intangible assets, net	319	332
Other non-current assets	631	601
Total assets	$15,261	$15,181
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,799	$1,881
Accrued expenses	528	470
Accrued compensation	336	330
Accrued warranty	141	150
Revolving credit facility	255	255
Current portion of long-term debt	172	156
Total current liabilities	3,231	3,242
Long-term debt	2,109	2,156
Other liabilities	585	564
Total liabilities	5,925	5,962
Commitments and contingencies (Notes 4 and 5)		
Shareholders' equity:		
Preferred stock, $.01 par value; authorized — 5 shares; issued and outstanding — none	—	—
Common stock, $.01 par value; authorized — 450 shares; issued — 261 shares; outstanding — 231 and 230 shares, respectively	3	3
Additional paid-in capital	2,407	2,428
Accumulated other comprehensive loss	(44)	(20)
Retained earnings	9,273	9,107
Treasury stock — common shares at cost; 30 and 31 shares, respectively	(2,303)	(2,299)
Total shareholders' equity	9,336	9,219
Total liabilities and shareholders' equity	$15,261	$15,181

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)

	Three Months Ended	
	October 2, 2015	October 3, 2014
Revenue, net	$3,360	$3,943
Cost of revenue	2,405	2,794
Gross profit	955	1,149
Operating expenses:		
Research and development	385	437
Selling, general and administrative	192	220
Charges related to arbitration award	—	14
Employee termination, asset impairment and other charges	56	9
Total operating expenses	633	680
Operating income	322	469
Other income (expense):		
Interest and other income	5	4
Interest and other expense	(13)	(13)
Total other expense, net	(8)	(9)
Income before income taxes	314	460
Income tax provision	31	37
Net income	$283	$423
Income per common share:		
Basic	$1.23	$1.81
Diluted	$1.21	$1.76
Weighted average shares outstanding:		
Basic	231	234
Diluted	234	240
Cash dividends declared per share	$0.50	$0.40

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

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WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in millions; unaudited)

	Three Months Ended	
	October 2, 2015	October 3, 2014
Net income	$283	$423
Other comprehensive loss, net of tax:		
Net unrealized loss on foreign exchange contracts	(25)	(26)
Net unrealized gain on available-for-sale securities	1	—
Other comprehensive loss, net of tax	(24)	(26)
Total comprehensive income	$259	$397

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)

	Three Months Ended	
	October 2, 2015	October 3, 2014
Operating Activities		
Net income	$283	$423
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	236	289
Stock-based compensation	42	39
Deferred income taxes	(7)	10
Loss on disposal of assets	—	4
Non-cash portion of employee termination, asset impairment and other charges	18	1
Changes in:		
Accounts receivable, net	(84)	74
Inventories	105	(46)
Accounts payable	(71)	49
Accrued arbitration award	—	14
Accrued expenses	18	16
Accrued compensation	6	(22)
Other assets and liabilities, net	(1)	(24)
Net cash provided by operating activities	545	827
Investing Activities		
Purchases of property, plant and equipment	(151)	(160)
Proceeds from sales and maturities of investments	124	166
Purchases of investments	(236)	(120)
Other investing activities, net	(10)	(12)
Net cash used in investing activities	(273)	(126)
Financing Activities		
Issuance of stock under employee stock plans	15	39
Taxes paid on vested stock awards under employee stock plans	(43)	(57)
Excess tax benefits from employee stock plans	19	20
Repurchases of common stock	(60)	(223)
Dividends paid to shareholders	(115)	(94)
Repayment of debt	(31)	(31)
Net cash used in financing activities	(215)	(346)
Net increase in cash and cash equivalents	57	355
Cash and cash equivalents, beginning of period	5,024	4,804
Cash and cash equivalents, end of period	$5,081	$5,159
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$8	$10
Cash paid for interest	$11	$12
Supplemental disclosure of non-cash financing activities:		
Accrual of cash dividend declared	$116	$94

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

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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 3, 2015. 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 3, 2015. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

The Company's fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, the Company reports a 53-week fiscal year to align its fiscal year with the foregoing policy. The Company's fiscal first quarters ended October 2, 2015 and October 3, 2014 consisted of 13 and 14 weeks, respectively. Fiscal 2015 was comprised of 53 weeks and ended on July 3, 2015. Fiscal year 2016 will be comprised of 52 weeks and will end on July 1, 2016.

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

Accounts Receivable

From time to time, in connection with a factoring agreement, the Company sells trade accounts receivable without recourse to a third party purchaser in exchange for cash. The Company sold trade accounts receivable and received cash proceeds of $200 million during the three months ended October 2, 2015. The Company did not sell trade accounts receivable during the three months ended October 3, 2014. The discounts on the sales of trade accounts receivable were not material and were recorded within interest and other expense in the condensed consolidated statements of income.

Inventories; Property, Plant and Equipment; and Other Intangible Assets

	October 2, 2015	July 3, 2015
	(in millions)	
Inventories:		
Raw materials and component parts	$135	$168
Work-in-process	507	500
Finished goods	618	700
Total inventories	$1,260	$1,368
Property, plant and equipment:		
Property, plant and equipment	$8,635	$8,604
Accumulated depreciation	(5,745)	(5,639)
Property, plant and equipment, net	$2,890	$2,965
Other intangible assets:		
Other intangible assets	$1,018	$1,008
Accumulated amortization	(699)	(676)
Other intangible assets, net	$319	$332

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 replacement costs, estimated repair costs which include scrap 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 assist

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the Company in exercising judgment in determining the underlying estimates. The statistical tracking model captures specific detail on product 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 profit 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):

	Three Months Ended	
	October 2, 2015	October 3, 2014
Warranty accrual, beginning of period	$221	$182
Charges to operations	45	49
Utilization	(54)	(49)
Changes in estimate related to pre-existing warranties	6	19
Warranty accrual, end of period	$218	$201

The long-term portion of the warranty accrual classified in other liabilities was $77 million as of October 2, 2015 and $71 million as of July 3, 2015.

Investments

The following tables summarize, by major type, the fair value and cost basis of the Company's investments (in millions):

	As of October 2, 2015		
	Cost Basis	Unrealized Gains	Fair Value
Available-for-sale securities:			
U.S. Treasury securities	279	1	280
U.S. Government agency securities	116	—	116
Commercial paper	86	—	86
Certificates of deposit	221	—	221
Total	$702	$1	$703

	As of July 3, 2015		
	Cost Basis	Unrealized Gains (Losses)	Fair Value
Available-for-sale securities:			
U.S. Treasury securities	$287	$—	$287
U.S. Government agency securities	95	—	95
Commercial paper	109	—	109
Certificates of deposit	99	—	99
Total	$590	$—	$590

The fair value of the Company's investments classified as available-for-sale securities at October 2, 2015, by remaining contractual maturity, were as follows (in millions):

	Cost Basis	Fair Value
Due in less than one year (short-term investments):	$347	$347
Due in one to five years (included in other non-current assets):	355	356
Total	$702	$703

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The Company determined no available-for-sale securities were other-than-temporarily impaired during the three months ended October 2, 2015 and October 3, 2014. For more information on the Company's available-for-sale securities, see Note 7 to these condensed consolidated financial statements.

From time to time, the Company enters into certain strategic investments for the promotion of business and strategic objectives. These strategic investments are recorded at cost within other non-current assets in the condensed consolidated balance sheets and were not material to the condensed consolidated financial statements as of October 2, 2015 and July 3, 2015.

Other Comprehensive Loss, Net of Tax

Other comprehensive loss, net of tax refers to revenue, expenses, gains and losses that are recorded as an element of shareholders' equity but are excluded from net income. The income tax impact on components of other comprehensive income is immaterial for all periods presented.

The following table illustrates the changes in the balances of each component of accumulated other comprehensive loss for the three months ended October 2, 2015 (in millions):

	Actuarial Pension Gain	Unrealized Gain (Loss) on Foreign Exchange Contracts	Unrealized Gain on Available for Sale Securities	Accumulated Other Comprehensive Income (Loss)
Balance at July 3, 2015	$5	$(25)	$—	$(20)
Other comprehensive loss before reclassifications	—	(53)	1	(52)
Amounts reclassified from accumulated other comprehensive income	—	28	—	28
Net current-period other comprehensive loss	—	(25)	1	(24)
Balance at October 2, 2015	$5	$(50)	$1	$(44)

The following table illustrates the changes in the balances of each component of accumulated other comprehensive loss for the three months ended October 3, 2014 (in millions):

	Actuarial Pension Gain	Unrealized Gain (Loss) on Foreign Exchange Contracts	Unrealized Gain (Loss) on Available for Sale Securities	Accumulated Other Comprehensive Income (Loss)
Balance at June 27, 2014	$7	$5	$—	$12
Other comprehensive loss before reclassifications	—	(22)	—	(22)
Amounts reclassified from accumulated other comprehensive loss	—	(4)	—	(4)
Net current-period other comprehensive loss	—	(26)	—	(26)
Balance at October 3, 2014	$7	$(21)	$—	$(14)

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 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 ("RSUs").

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

	Three Months Ended	
	October 2, 2015	October 3, 2014
Net income	$283	$423
Weighted average shares outstanding:		
Basic	231	234
Employee stock options and other	3	6
Diluted	234	240
Income per common share:		
Basic	$1.23	$1.81
Diluted	$1.21	$1.76
Anti-dilutive potential common shares excluded*	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

The Company's credit agreement, which was entered into in January 2014 and subsequently amended (the "Credit Agreement"), provides for $4.0 billion of unsecured loan facilities consisting of a $2.5 billion term loan facility and a $1.5 billion revolving credit facility. The loans under the Credit Agreement have a five-year term. Subject to certain conditions, the credit facilities may be expanded by, or incremental term loans may be obtained for, up to $1.0 billion if existing or new lenders provide additional term or revolving commitments.

The term loans and the revolving credit loans may be prepaid in whole or in part at any time without premium or penalty, subject to certain conditions. As of October 2, 2015, the revolving credit facility had a variable interest rate of 1.7% and an outstanding balance of $255 million. The revolving credit facility is classified within current liabilities as of October 2, 2015 due to the Company's intent to repay the borrowings within the next 12 months. As of October 2, 2015, the term loan facility had a variable interest rate of 1.7% and a remaining outstanding balance of $2.3 billion. The Company is required to make quarterly principal payments on the term loan facility totaling $125 million for the remainder of fiscal 2016, $219 million in fiscal 2017, $250 million in fiscal 2018 and the remaining balance of $1.7 billion in fiscal 2019.

The Credit Agreement requires the Company to comply with a leverage ratio and an interest coverage ratio calculated on a consolidated basis for the Company and its subsidiaries. In addition, the Credit Agreement contains customary covenants, including covenants that limit or restrict the Company’s and its subsidiaries’ ability to incur liens, incur indebtedness, make certain restricted payments, merge or consolidate and enter into certain speculative hedging arrangements, and customary events of default.

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

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

Intellectual Property Litigation

In June 2008, Convolve, Inc. (“Convolve”) filed a complaint in the Eastern District of Texas against WD, HGST, and two other companies alleging infringement of U.S. Patent Nos. 6,314,473 and 4,916,635. The complaint sought unspecified monetary damages and injunctive relief. In October 2008, Convolve amended its complaint to allege infringement of only the ‘473 patent. The ‘473 patent allegedly relates to interface technology to select between certain modes of a disk drive’s operations relating to speed and noise. In July 2011, a verdict was rendered against WD and HGST in an amount that is not material to the Company’s financial position, results of operations or cash flows, for which the Company previously recorded an accrual. In March 2015, WD and HGST filed Notices of Appeal with the United States District Court for the Federal Circuit (“Federal Circuit”). In April 2015, Convolve filed a motion for reconsideration of the final judgment, and in May 2015, the Federal Circuit deactivated the appeal pending the Court’s decision on reconsideration. WD and HGST intend to continue to defend themselves vigorously in this matter.

Seagate Matter

In October 2006, Seagate Technology LLC (“Seagate”) brought an action against the Company and a now former employee, alleging misappropriation of confidential information and trade secrets. In January 2012, an arbitrator issued a final award against the Company, including pre-award interest, of $630.4 million. The matter was appealed and, in October 2014, the Minnesota Supreme Court upheld the arbitrator’s award. In October 2014, the Company paid Seagate $773.4 million to satisfy the full amount of the final arbitration award plus interest accrued through October 2014. This amount was paid by one of the Company’s foreign subsidiaries using cash held outside of the United States. Seagate disputes the method the Company used for calculating post-award interest and contends that the Company owes Seagate approximately $29 million in additional interest. The Company denies Seagate’s contention and believes it calculated interest properly in accordance with the arbitration award. In April 2015, the District Court declared that all amounts due and owing from the Company to Seagate have been paid, and a corresponding judgment was entered. In May 2015, Seagate appealed the decision and judgment to the Minnesota Court of Appeals, where the matter remains pending. The Company intends to continue to defend itself vigorously in this matter.

Other Matters

In December 2011, the German Central Organization for Private Copying Rights (Zentralstelle für private Überspielungsrechte), (“ZPÜ”), an organization consisting of several copyright collecting societies, instituted arbitration proceedings against Western Digital's German subsidiary (“WD Germany”) before the Copyright Arbitration Board (“CAB”) claiming copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce in Germany by WD Germany from January 2008 through December 2010. In February 2013, WD Germany filed a declaratory relief action against ZPÜ in the Higher Regional Court of Munich (the “Higher Court”), seeking an order from the court to determine the copyright levy issue. On May 21, 2013, ZPÜ filed a counter-claim against WD Germany with the Higher Court, seeking copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce from January 2008 through December 2010 based on tariffs published by ZPÜ on November 3, 2011. In January 2015, the Higher Court ruled in favor of ZPÜ. In its ruling, the Higher Court declared that WD Germany must pay certain levies on certain WD products which it sold in Germany between January 2008 and December 2010. The judgment specifies levy amounts on certain WD products sold from January 2008 through December 2010 and directs WD Germany to provide applicable sales data to the ZPÜ. The exact amount of the judgment has not been determined. ZPÜ and WD Germany filed appeals with the German Federal Court of Justice in February 2015. WD intends to defend itself vigorously in this matter.

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

The Company has recorded an accrual for German copyright levies in an amount that is not material to the Company's financial position, results of operations or cash flows. It is reasonably possible that the Company may incur losses totaling up to $101 million, including the amounts accrued.

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

6. Income Taxes

The Company’s income tax provision for the three months ended October 2, 2015 was $31 million as compared to $37 million in the prior-year period. This decrease was primarily a result of lower income before income taxes. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2025 and the current year generation of income tax credits.

In the three months ended October 2, 2015, the Company recorded a net increase of $10 million in its liability for unrecognized tax benefits. As of October 2, 2015, the Company's liability for unrecognized tax benefits was approximately $360 million. Interest and penalties recognized on such amounts were not material to the condensed consolidated financial statements during the three months ended October 2, 2015.

The Internal Revenue Service (“IRS”) previously completed its field examination of the Company's federal income tax returns for fiscal years 2006 through 2009 and proposed certain adjustments. The Company has received Revenue Agent Reports (“RARs”) from the IRS that seek to increase the Company's U.S. taxable income which would result in additional federal tax expense totaling approximately $795 million, subject to interest. The issues in dispute relate primarily to transfer pricing with the Company’s foreign subsidiaries and intercompany payable balances. The Company disagrees with the proposed adjustments and in September 2015, filed a protest with the IRS Appeals Office. The Company believes that its tax positions are properly supported and will vigorously contest the position taken by the IRS. In September 2015, the IRS commenced an examination of the Company’s fiscal years 2010 through 2012. During the three months ended October 2, 2015, the IRS completed the examination of the fiscal period ended September 5, 2007 of Komag, Incorporated, which the Company acquired on September 5, 2007, with no material adjustments.

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax examinations cannot be predicted with certainty. If any issues addressed in the Company’s tax examinations are resolved in a manner not consistent with management’s expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of October 2, 2015, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company’s liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company’s tax returns.

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 tables present information about the Company’s financial assets and liabilities that are measured at fair value on a recurring basis as of October 2, 2015 and July 3, 2015, respectively, and indicate the fair value hierarchy of the valuation techniques utilized to determine such values (in millions):

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	Fair Value Measurements at October 2, 2015 Using			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	$643	$—	$—	$643
Total cash equivalents	643	—	—	643
Short-term investments:				
U.S. Treasury securities	—	39	—	39
U.S. Government agency securities	—	1	—	1
Commercial paper	—	86	—	86
Certificates of deposit	—	221	—	221
Total short-term investments	—	347	—	347
Long-term investments:				
U.S. Treasury securities	—	241	—	241
U.S. Government agency securities	—	115	—	115
Total long-term investments	—	356	—	356
Foreign exchange contracts	—	1	—	1
Total assets at fair value	$643	$704	$—	$1,347
Liabilities:				
Foreign exchange contracts	$—	$62	$—	$62
Total liabilities at fair value	$—	$62	$—	$62

	Fair Value Measurements at July 3, 2015 Using			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	$135	$—	$—	$135
Total cash equivalents	135	—	—	135
Short-term investments:				
U.S. Treasury securities	—	50	—	50
U.S. Government agency securities	—	4	—	4
Commercial paper	—	109	—	109
Certificates of deposit	—	99	—	99
Total short-term investments	—	262	—	262
Long-term investments:				
U.S. Treasury securities	—	237	—	237
U.S. Government agency securities	—	91	—	91
Total long-term investments	—	328	—	328
Total assets at fair value	$135	$590	$—	$725
Liabilities:				
Foreign exchange contracts	$—	$31	$—	$31
Total liabilities at fair value	$—	$31	$—	$31

Money Market Funds. The Company’s money market funds are funds that invest in U.S. Treasury and U.S. Government Agency securities. Money market funds are valued based on quoted market prices.

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U.S. Treasury Securities. The Company’s U.S. Treasury securities are direct obligations of the U.S. federal government and are held in custody by a third party. 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 and are held in custody by a third party. 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.
Commercial Paper. The Company’s commercial paper securities are investments issued by corporations which are held in custody by a third party. Commercial paper securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.
Certificates of Deposit. The Company’s certificates of deposit are investments which are held in custody by a third party. Certificates of deposit are valued using fixed interest rates.
Foreign Exchange Contracts. The Company’s foreign exchange contracts are short-term contracts to hedge the Company’s foreign currency risk. For contracts that have a right of offset by its individual counterparties under master netting arrangements, the Company presents its foreign exchange contracts on a net basis by counterparty in the 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. For more information on the Company's foreign exchange contracts, see Note 8 to these condensed consolidated financial statements.
In the three months ended October 2, 2015, there were no transfers between levels. 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, 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 speculative or trading purposes. As of October 2, 2015, the Company had outstanding foreign exchange contracts with commercial banks for British Pound Sterling, Euro, Japanese Yen, Malaysian Ringgit, Philippine Peso, Singapore Dollar and Thai Baht, which were designated as either cash flow or 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 and presented within cash flow from operations. 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. The Company determined the ineffectiveness associated with its cash flow hedges to be immaterial to the condensed consolidated financial statements for the three months ended October 2, 2015 and October 3, 2014.
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 cost of revenue or operating expenses, depending on the nature of the underlying hedged item. All fair value hedges were determined to be effective as of October 2, 2015 and July 3, 2015. The changes in fair value on these contracts were immaterial to the condensed consolidated financial statements during the three months ended October 2, 2015 and October 3, 2014.
As of October 2, 2015, the net amount of unrealized losses with respect to the Company’s foreign exchange contracts that is expected to be reclassified into earnings within the next 12 months was $50 million. In addition, as of

October 2, 2015, the Company did not have any foreign exchange contracts with credit-risk-related contingent features. The Company opened $1.0 billion and closed $1.0 billion in foreign exchange contracts during each of the three months ended October 2, 2015 and October 3, 2014. The fair value and balance sheet location of the Company's foreign exchange contracts as of October 2, 2015 and July 3, 2015 were as follows (in millions):

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	Asset Derivatives				Liability Derivatives			
	October 2, 2015		July 3, 2015		October 2, 2015		July 3, 2015	
Derivatives Designated as Hedging Instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign exchange contracts	Other current assets	$1	Other current assets	$—	Accrued expenses	$62	Accrued expenses	$31

The following table presents the gross amounts of the Company's derivative instruments, amounts offset due to master netting arrangements with the Company's various counterparties, and the net amounts recognized in the condensed consolidated balance sheet as of October 2, 2015 (in millions):

Derivatives Designated as Hedging Instruments	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets (Liabilities) Presented in the Balance Sheet
Foreign exchange contracts			
Financial assets	$2	$(1)	$1
Financial liabilities	(63)	1	(62)
Total derivative instruments	$(61)	$—	$(61)

The Company had a gross and net liability of $31 million related to its derivative instruments outstanding at July 3, 2015. There were no amounts offset due to master netting arrangements in place at July 3, 2015.
The impact on the condensed consolidated financial statements was as follows (in millions):

	Amount of Loss Recognized in Accumulated OCI on Derivatives		Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Amount of Gain (Loss) Reclassified From Accumulated OCI into Income	
Derivatives in Cash Flow Hedging Relationships	Three Months Ended October 2, 2015	Three Months Ended October 3, 2014		Three Months Ended October 2, 2015	Three Months Ended October 3, 2014
Foreign exchange contracts	$(53)	$(22)	Cost of revenue	$28	$(4)

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 months ended October 2, 2015 and October 3, 2014.

9. Shareholders' Equity

Stock-Based Compensation Expense

The following table presents the Company's stock-based compensation and related tax benefit for the three months ended October 2, 2015 and October 3, 2014 (in millions):

	Three Months Ended October 2, 2015		Three Months Ended October 3, 2014	
	Expense	Tax Benefit	Expense	Tax Benefit
Options and ESPP	$19	$4	$19	$5
RSUs	23	6	20	5
Total	$42	$10	$39	$10

As of October 2, 2015, total compensation cost related to unvested stock options and ESPP rights issued to employees but not yet recognized was $118 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.5 years.

For purposes of this footnote, references to RSUs include performance stock unit awards. As of October 2, 2015, the aggregate unamortized fair value of all unvested RSUs was $181 million, which will be recognized on a straight-line basis over a weighted average vesting period of approximately 2.1 years.

Stock Option Activity

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

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding at July 3, 2015	6.8	$50.00		
Granted	1.6	84.41		
Exercised	(0.5)	29.49		
Forfeited or expired	(0.1)	49.08		
Options outstanding at October 2, 2015	7.8	$58.58	4.7	$201
Exercisable at October 2, 2015	3.6	$41.37	3.4	$149
Vested and expected to vest after October 2, 2015	7.6	$57.89	4.7	$201

Options granted during the three months ended October 2, 2015 had a weighted average fair value per share of $23.09. As of October 2, 2015, the Company had options outstanding to purchase an aggregate of 4.9 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 $201 million at that date. During the three months ended October 2, 2015, the aggregate intrinsic value of options exercised under the Company’s stock option plans was $27 million, determined as of the date of exercise, as compared to $86 million in the prior-year period.

RSU Activity

The following table summarizes RSU activity under the Company's stock plans (in millions, except weighted average grant date fair value):

	Number of Shares	Weighted Average Grant-Date Fair Value
RSUs outstanding at July 3, 2015	3.0	$73.80
Granted	1.2	84.39
Vested	(1.5)	62.14
Forfeited	(0.1)	81.55
RSUs outstanding at October 2, 2015	2.6	84.43
Expected to vest after October 2, 2015	2.5	$84.24

The fair value of each RSU is the market price of the Company’s stock on 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 fair value of the shares underlying the RSU awards at the date of grant or assumption was $99 million for awards granted in the three months ended October 2, 2015. These amounts are being recognized to expense over the corresponding vesting periods.

SARs Activity

During the three months ended October 2, 2015, the Company recognized a $1 million benefit related to adjustments to fair market value as well as the vesting of stock appreciation rights ("SARs"), as compared to $4 million of expense in the prior-year period. There was no tax expense or benefit realized as a result of the aforementioned SARs benefit during the three months ended October 2, 2015, as compared to $1 million during the three months ended October 3, 2014. The Company's SARs will be settled in cash upon exercise. The Company had a total liability of $40 million related to SARs included in accrued expenses in the condensed consolidated balance sheet as of October 2, 2015. As of October 2, 2015, all SARs issued to employees were fully vested, and the fair values are now solely subject to market price fluctuations. As of October 2, 2015, 0.6 million SARs were outstanding with a weighted average exercise price of $7.89. There were no SARs granted during the three months ended October 2, 2015.

Stock Repurchase Program

The Company's Board of Directors previously authorized $5.0 billion for the repurchase of the Company's common stock and approved the extension of its stock repurchase program to February 3, 2020. The Company repurchased 0.7 million for a total cost of $60 million during the three months ended October 2, 2015. The remaining amount available to be purchased under the

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Company’s stock repurchase program as of October 2, 2015 was $2.1 billion. Effective October 21, 2015, in connection with the Company's planned acquisition of SanDisk Corporation ("SanDisk"), the stock repurchase program has been suspended.

Dividends to Shareholders

On September 13, 2012, the Company announced that its Board of Directors had authorized the adoption of a quarterly cash dividend policy. Under the cash dividend policy, holders of the Company’s common stock receive dividends when and as declared by the Company’s Board of Directors. In the three months ended October 2, 2015, the Company declared a cash dividend of $0.50 per share to shareholders of record as of October 2, 2015, totaling $116 million, which was paid on October 15, 2015. Subsequent to October 2, 2015, on November 3, 2015, the Company declared a cash dividend of $0.50 per share of its common stock to shareholders of record as of January 1, 2016, which will be paid on January 15, 2016. The Company may modify, suspend or cancel its cash dividend policy in any manner and at any time.

Investment by Unisplendour Corporation Limited ("Unis")

On September 30, 2015, the Company announced that it had entered into an agreement with Unis and Unis Union Information System Ltd., a subsidiary of Unis ("Investor"), pursuant to which Investor will make a $3.8 billion equity investment in the Company (the "Unis Investment"). Under the terms of the agreement for the Unis Investment, Investor has agreed to purchase 40,814,802 shares of newly issued common stock of the Company at a price of $92.50 per share and has agreed to a five-year position standstill, voting restrictions, and a five-year lock-up on its shares, with a limited number becoming available for transfer each year. Following the closing of the investment, Unis will have the right to nominate one representative for election to the Company's Board of Directors, so long as Unis holds more than 10% of the issued and outstanding shares of the Company's common stock. The performance of Investor’s obligations pursuant to the agreement, including payment of the purchase price for the shares, is guaranteed by Unis. The closing of the Unis Investment is subject to clearance by the U.S. Committee on Foreign Investment in the United States ("CFIUS"), the receipt of requisite regulatory approvals, including clearance by U.S. antitrust authorities and certain Chinese regulatory approvals, approval of the transaction by shareholders of Unis and other customary closing conditions.

10. Pensions and Other Post-retirement Benefit Plans

The Company’s principal pension and other post-retirement benefit plans are in Japan. All pension and other post-retirement benefit plans outside of the Company’s Japanese plans were immaterial to the Company’s condensed consolidated financial statements for the three months ended October 2, 2015 and October 3, 2014. The expected long-term rate of return on the Japanese plan assets is 2.5%.

The following table presents the unfunded status of the benefit obligations and Japanese plan assets (in millions):

	October 2, 2015	July 3, 2015
Benefit obligation	$239	$231
Fair value of plan assets	(193)	(185)
Unfunded status	$46	$46

The following table presents the unfunded amounts as recognized on the Company’s condensed consolidated balance sheets (in millions):

	October 2, 2015	July 3, 2015
Current liabilities	$1	$1
Non-current liabilities	45	45
Net amount recognized	$46	$46

The net periodic benefit cost of the Company’s pension plans was not material to the condensed consolidated financial statements for the three months ended October 2, 2015 and October 3, 2014. The Company’s expected employer contribution for its Japanese defined benefit pension plans is $10 million in fiscal 2016.

11. Acquisitions

The condensed consolidated financial statements include the results of operations of acquired companies commencing after their respective acquisition dates.

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Acquisition of Amplidata

On March 9, 2015, the Company acquired Amplidata NV (“Amplidata”), a developer of object storage software for public and private cloud data centers. As a result of the acquisition, Amplidata was fully integrated and became a wholly owned indirect subsidiary of the Company. The purchase price of the acquisition was approximately $267 million, consisting of $245 million funded with available cash at the time of the acquisition, $19 million related to the fair value of a previously-held cost method investment and $3 million related to the fair value of stock options assumed. The acquisition furthers the Company's strategy to expand into higher value data storage platforms and systems that address the growth in storage requirements in cloud data centers.

The Company identified and recorded the assets acquired and liabilities assumed at their estimated fair values at the date of acquisition, and allocated the remaining value of $215 million to goodwill. The values assigned to the acquired assets and liabilities are based on preliminary estimates of fair value available as of the date of this Quarterly Report on Form 10-Q, and may be adjusted during the measurement period of up to 12 months from the date of the acquisition as further information becomes available with any changes in the fair values potentially resulting in adjustments to goodwill. The individual tangible and intangible assets acquired as well as the liabilities assumed in the acquisition were immaterial to the Company's condensed consolidated financial statements.

The preliminary purchase price allocation for Amplidata is as follows (in millions):

	March 9, 2015
Tangible assets acquired and liabilities assumed	$(24)
Intangible assets	76
Goodwill	215
Total	$267

Since the date of acquisition, the Company recorded an increase of $42 million to goodwill which primarily related to an adjustment to the value of deferred taxes acquired, an adjustment to the value of intangible assets acquired, and an adjustment for the fair value of stock options assumed in the acquisition of Amplidata. The primary area of the preliminary purchase price allocation that is not yet finalized due to information that may become available subsequently is income taxes. Any changes in the fair value could potentially result in adjustments to goodwill.

The $215 million of goodwill recognized is primarily attributable to the benefits the Company expects to derive from an ability to create HDD storage solutions leveraging the core software acquired and is not expected to be deductible for tax purposes. The impact to revenue and net income attributable to Amplidata was immaterial to the Company’s condensed consolidated financial statements for the three months ended October 2, 2015.

12. Employee Termination, Asset Impairment and Other Charges

The Company periodically incurs charges to realign its operations with anticipated market demand. The employee termination, asset impairment and other charges line item within the Company's condensed consolidated statements of income consisted of the following:

	Three Months Ended	
	October 2, 2015	October 3, 2014
Employee termination benefits	$38	$8
Impairment of assets	8	1
Contract termination and other	10	—
Total	$56	$9

Impairment charges during the three months ended October 2, 2015 primarily relate to equipment.

The following table provides those amounts recorded as liabilities within the Company's condensed consolidated balance sheets:

	July 3, 2015	Accruals	Payments	October 2, 2015
Employee termination benefits	$10	$38	$(12)	$36

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13. Recent Accounting Pronouncements

In September 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ("ASU") No. 2015-16, “Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments” (ASU 2015-16”), which eliminates the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. Acquirers must recognize measurement-period adjustments during the period of resolution, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. This ASU is effective for fiscal years beginning after December 15, 2015, which for the Company is the first quarter of fiscal 2017. Earlier adoption is permitted for any interim and annual financial statements that have not yet been issued. The Company is currently evaluating the impact ASU 2015-16 will have on its consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"). The new standard requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The new standard is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2015, which for the Company is the first quarter of fiscal 2017. The Company is currently evaluating the impact ASU 2015-03 will have on its consolidated financial statements and related disclosures.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which amends the guidance in former Accounting Standards Codification Topic 605, "Revenue Recognition," to provide a single, comprehensive revenue recognition model for all contracts with customers. The new standard requires an entity to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration to which an entity expects to be entitled in exchange for those goods or services. The new standard also requires entities to enhance disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of this ASU by one year. The new standard allows for either a full retrospective or a modified retrospective transition method and is effective for fiscal years and interim periods within those years beginning after December 15, 2017, which for the Company is the first quarter of fiscal 2019, and early adoption is permitted beginning after December 15, 2016. The Company has not yet selected a transition method and is currently evaluating the impact ASU 2014-09 will have on its consolidated financial statements and related disclosures.

14. Subsequent Events

Joint Venture

On November 9, 2015, the Company announced an agreement to form a joint venture with Unis to market and sell the Company's current data center storage systems in China and to develop data storage systems for the Chinese market in the future. The joint venture will be 51% owned by Unis and its subsidiary, Unissoft (Wuxi) Group Co. Ltd., and 49% by the Company. The joint venture is expected to become operational by the fourth quarter of fiscal 2016, pending regulatory approvals.

Planned Acquisition of SanDisk

On October 21, 2015, the Company entered into an Agreement and Plan of Merger with SanDisk, a global leader in NAND flash storage solutions, pursuant to which a subsidiary of the Company will merge with and into SanDisk, with SanDisk surviving as a wholly owned subsidiary of the Company. The planned acquisition is primarily intended to deepen the Company's expertise in non-volatile memory and enable the Company to vertically integrate into NAND, securing long-term access to solid state technology at a lower cost.

The merger agreement values SanDisk’s outstanding common stock at a value of $86.50 per share, or a total equity value of approximately $18.9 billion, based on the volume weighted average price of the Company’s common stock for the five trading days ending on October 20, 2015. If the Unis Investment closes prior to the acquisition, the Company will pay $85.10 per share in cash and issue 0.0176 shares of its common stock per share of SanDisk’s common stock; and if the Unis Investment has not occurred or has been terminated, the Company will pay $67.50 per share in cash and issue 0.2387 shares of its common stock per share of SanDisk’s common stock. The above allocation between cash and shares of the Company’s common stock is subject to reallocation, at the Company’s election, if the amount of cash that SanDisk has available at the closing of the planned merger falls below certain thresholds.

The planned acquisition will be financed by a mix of cash, new debt financing and issuance of the Company’s common stock. In connection with the planned acquisition, the Company expects to enter into new debt facilities totaling $18.1 billion. The Company has received commitments for a $1 billion revolving credit facility, $3 billion in amortizing term loans, $6 billion in other

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term loans and $8.1 billion in secured and unsecured bridge facilities. The Company expects to issue approximately $5.1 billion in secured and unsecured notes in lieu of drawing the bridge facilities at close, with the balance of the bridge facilities to be repaid with available cash. The proceeds from the new debt facilities are expected to be used to pay part of the purchase price, refinance existing debt of both the Company and SanDisk and pay transaction related fees and expenses.

Consummation of the merger is subject to customary closing conditions, including without limitation: (i) the required approval by SanDisk shareholders and, if the Unis Investment has not occurred or has been terminated, approval by the Company's shareholders; (ii) the expiration or early termination of the waiting period applicable to the consummation of the merger under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the receipt of regulatory clearance under certain foreign antitrust laws, including the European Union and China; and (iii) if the Unis Investment has not been terminated and is a "covered transaction" for CFIUS purposes, or if CFIUS otherwise requests or requires a filing with respect to the merger, the approval of CFIUS. In certain circumstances, a termination fee may be payable by either the Company or SanDisk upon termination of the transaction as more fully described in the merger agreement.

Ministry of Commerce of the People's Republic of China ("MOFCOM") Decision

In connection with the regulatory approval process of the Hitachi Global Storage Technologies Holdings Pte. Ltd. ("HGST") acquisition, which closed on March 8, 2012, the Company agreed to certain conditions required by MOFCOM, including adopting measures to maintain HGST as an independent competitor until MOFCOM agreed otherwise. Accordingly, since March 2012, the Company has operated its global business through two independent subsidiaries — HGST and WD. In March 2014, the Company submitted an application to MOFCOM to lift the condition it imposed on the Company to operate these businesses separately. On October 19, 2015, MOFCOM issued a decision in response to the Company's application that permits the Company to integrate its HGST and WD subsidiaries, except that the Company committed to continue to maintain two sales teams that will separately offer products under the WD or HGST brands for two years from the date of the decision.

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

You should read this information in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Part II, Item 7, contained in our Annual Report on Form 10-K for the year ended July 3, 2015.

Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters.

As used herein, the terms "we," "us," "our," and the "Company" refer to Western Digital Corporation and its subsidiaries.

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. Statement concerning current conditions may also be forward-looking if they imply a continuation of current conditions.

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

- expectations concerning our planned acquisition of SanDisk Corporation ("SanDisk");
- expectations regarding the planned equity investment by Unisplendour Corporation Limited ("Unis");
- expectations regarding the integration of our HGST and WD subsidiaries following the decision by the Ministry of Commerce of the People's Republic of China ("MOFCOM") in October 2015;
- expectations regarding the growth of digital data and demand for digital storage;
- our plans to develop and invest in new products and expand into new storage markets and into emerging economic markets;
- expectations regarding the PC market and the emergence of new storage markets for our products;
- our quarterly cash dividend policy;
- expectations regarding the outcome of legal proceedings in which we are involved;

- expectations regarding the repatriation of funds from our foreign operations;
- our beliefs regarding tax benefits and the timing of future payments, if any, relating to the unrecognized tax benefits, and the adequacy of our tax provisions;
- our beliefs regarding the sufficiency of our available liquidity to meet our working capital, debt, dividend and capital expenditure needs; and

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• expectations regarding our debt financing plans.

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 I, 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 leading developer, manufacturer and provider of data storage solutions that enable consumers, businesses, governments and other organizations to create, manage, experience and preserve digital content. Our product portfolio includes hard disk drives (“HDDs”), solid state drives ("SSDs"), direct attached storage solutions, personal cloud network attached storage solutions, and public and private cloud data center storage solutions. HDDs are our principal products and are today’s primary storage medium for the vast majority of digital content, with the use of solid-state storage products growing rapidly. Our products are marketed under the HGST and WD brand names.

In accordance with accounting principles generally accepted in the United States (“U.S. GAAP”), operating results for Amplidata NV ("Amplidata"), which we acquired on March 9, 2015, are included in our operating results only after the date of acquisition.

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Our fiscal first quarters ended October 2, 2015 and October 3, 2014 consisted of 13 and 14 weeks, respectively. Fiscal 2015 was comprised of 53 weeks and ended on July 3, 2015. Fiscal year 2016 will be comprised of 52 weeks and will end on July 1, 2016.

Recent Developments

Joint Venture

On November 9, 2015, we announced an agreement to form a joint venture with Unis to market and sell our current data center storage systems in China and to develop data storage systems for the Chinese market in the future. The joint venture will be 51% owned by Unis and its subsidiary, Unissoft (Wuxi) Group Co. Ltd., and 49% by us. The joint venture is expected to become operational by the fourth quarter of fiscal 2016, pending regulatory approvals.

Planned Acquisition of SanDisk

On October 21, 2015, we entered into an Agreement and Plan of Merger with SanDisk, a global leader in NAND flash storage solutions, pursuant to which a subsidiary of our company will merge with and into SanDisk, with SanDisk surviving as a wholly owned subsidiary of our company. The planned acquisition is primarily intended to deepen our expertise in non-volatile memory and enable us to vertically integrate into NAND, securing long-term access to solid state technology at a lower cost.

The merger agreement values SanDisk's outstanding common stock at a value of $86.50 per share, or a total equity value of approximately $18.9 billion, based on the volume weighted average price of our common stock for the five trading days ending on October 20, 2015. If the Unis Investment (see "Investment by Unis" below) closes prior to the acquisition, we will pay $85.10 per share in cash and issue 0.0176 shares of our common stock per share of SanDisk’s common stock; and if the Unis Investment has not occurred or has been terminated, we will pay $67.50 per share in cash and issue 0.2387 shares of our common stock per share of SanDisk’s common stock. The above allocation between cash and shares of our common stock is subject to reallocation, at our election, if the amount of cash that

SanDisk has available at the closing of the planned merger falls below certain thresholds.

The planned acquisition will be financed by a mix of cash, new debt financing and issuance of our common stock. In connection with the planned acquisition, we expect to enter into new debt facilities totaling $18.1 billion. The proceeds from the new debt facilities are expected to be used to pay part of the purchase price, refinance existing debt of both our company and SanDisk and pay transaction related fees and expenses.

Consummation of the merger is subject to customary closing conditions, including without limitation: (i) the required approval by SanDisk shareholders and, if the Unis Investment has not occurred or has been terminated, approval by our

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shareholders; (ii) the expiration or early termination of the waiting period applicable to the consummation of the merger under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the receipt of regulatory clearance under certain foreign antitrust laws, including the European Union and China; and (iii) if the Unis Investment has not been terminated and is a “covered transaction” for U.S. Committee on Foreign Investment in the United States ("CFIUS") purposes, or if CFIUS otherwise requests or requires a filing with respect to the merger, the approval of CFIUS. In certain circumstances, a termination fee may be payable by either us or SanDisk upon termination of the transaction as more fully described in the merger agreement. The acquisition is expected to close in the first quarter of fiscal 2017.

MOFCOM Decision

In connection with the regulatory approval process of the Hitachi Global Storage Technologies Holdings Pte. Ltd. ("HGST") acquisition, which closed on March 8, 2012, we agreed to certain conditions required by MOFCOM, including adopting measures to maintain HGST as an independent competitor until MOFCOM agreed otherwise. Accordingly, since March 2012, we have operated our global business through two independent subsidiaries — HGST and WD. In March 2014, we submitted an application to MOFCOM to lift the condition it imposed on us to operate these businesses separately. On October 19, 2015, MOFCOM issued a decision in response to our application that permits us to integrate our HGST and WD subsidiaries, except that we committed to maintain two sales teams that will separately offer products under the WD or HGST brands for two years from the date of the decision. We began integration planning activities immediately following the MOFCOM decision and integration is expected to occur in phases through October 2017.

Investment by Unis

On September 30, 2015, we announced that we had entered into an agreement with Unis and Unis Union Information System Ltd., a subsidiary of Unis ("Investor"), pursuant to which Investor will make a $3.8 billion equity investment in our company (the "Unis Investment"). Under the terms of the agreement for the Unis Investment, Investor has agreed to purchase 40,814,802 shares of newly issued common stock at a price of $92.50 per share and has agreed to a five-year position standstill, voting restrictions, and a five-year lock-up on its shares, with a limited number becoming available for transfer each year. Following the closing of the investment, Unis will have the right to nominate one representative for election to our Board of Directors, so long as Unis holds more than 10% of the issued and outstanding shares of our common stock. The performance of Investor’s obligations pursuant to the agreement, including payment of the purchase price for the shares, is guaranteed by Unis. The closing of the Unis Investment is subject to clearance by CFIUS, the receipt of requisite regulatory approvals, including clearance by U.S. antitrust authorities and certain Chinese regulatory approvals, approval of the transaction by shareholders of Unis and other customary closing conditions. The investment is expected to close in the second or third quarter of fiscal 2016.

First Quarter Overview

For the quarter ended October 2, 2015, we believe that overall HDD industry shipments totaled approximately 119 million units, down 19% from the prior-year period and up 7% from the quarter ended July 3, 2015.

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

	Three Months Ended					
	October 2, 2015			October 3, 2014		
Net revenue	$3,360	100.0	%	$3,943	100.0	%
Gross profit	955	28.4		1,149	29.1	
Total operating expenses	633	18.8		680	17.2	
Operating income	322	9.6		469	11.9	

Net income	283	8.4	423	10.7

The following is a summary of our financial performance for the first quarter of fiscal 2016:

- Consolidated net revenue totaled $3.4 billion.
- Net revenue derived from enterprise SSDs was $233 million as compared to $156 million in the prior-year period.
- HDD shipments decreased 20% from the prior-year period to 51.7 million units.
- Gross margin decreased to 28.4% as compared to 29.1% in the prior-year period.

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- Operating income decreased to $322 million as compared to $469 million in the prior-year period.
- We generated $545 million in cash flow from operations and ended the quarter with $5.1 billion in cash and cash equivalents.

Results of Operations

Net Revenue

(in millions, except percentages and average selling price)	Three Months Ended October 2, 2015	October 3, 2014	Percentage Change
Net revenue	$3,360	$3,943	(15)%
Average selling price (per unit)*	$60	$58	3 %
Revenues by Geography (%)			
Americas	30 %	27 %	
Europe, Middle East and Africa	21	21	
Asia	49	52	
Revenues by Channel (%)			
OEM	67 %	63 %	
Distributors	21	24	
Retailers	12	13	
Unit Shipments*			
PC	27.5	39.7	
Non-PC	24.2	25.0	
Total units shipped	51.7	64.7	(20)%

* Based on sales of HDD units only.

For the quarter ended October 2, 2015, net revenue was $3.4 billion, a decrease of 15% from the prior-year period. This decrease in revenue was primarily the result of a softer demand environment largely driven by a decline in PC markets, partially offset by an increase in the average selling price ("ASP") for HDDs due to changes in product mix. Total hard drive shipments decreased to 51.7 million units for the quarter ended October 2, 2015 as compared to 64.7 million units in the prior-year period. For the quarter ended October 2, 2015, the ASP for HDDs increased to $60 compared to the prior-year period ASP for HDDs of $58.

Changes in net revenue by geography and channel generally reflect normal fluctuations in market demand and competitive dynamics. For the three months ended October 2, 2015 and October 3, 2014, Hewlett-Packard Company accounted for approximately 13% and 11% of our net revenue, respectively.

Consistent with standard industry practice, we have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. Generally, total sales incentive and marketing programs range from 7% to 11% of gross revenues per quarter. For the three months ended October 2, 2015, these programs represented 11% of gross revenues, as compared to 9% in the 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. 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 0.6% of quarterly gross revenue since the first quarter of fiscal 2014.

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Gross Margin

(in millions, except percentages)	Three Months Ended October 2, 2015	October 3, 2014	Percentage Change
Net revenue	$3,360	$3,943	(15)%
Gross profit	955	1,149	(17)%
Gross margin	28.4 %	29.1 %	

For the three months ended October 2, 2015, gross margin decreased to 28.4%, as compared to 29.1% for the prior-year period. This decrease in gross margin was primarily the result of a change in product mix.

Operating Expenses

(in millions, except percentages)	Three Months Ended October 2, 2015	October 3, 2014	Percentage Change
R&D expense	$385	$437	(12)%
SG&A expense	192	220	(13)%
Charges related to arbitration award	—	14	(100)%
Employee termination, asset impairment and other charges	56	9	522 %
Total operating expenses	$633	$680	

Research and development ("R&D") expense was $385 million for the three months ended October 2, 2015, a decrease of $52 million from the prior-year period. This decrease was primarily the result of an additional week of operating expenses during the first fiscal quarter of the prior-year period and lower incentive compensation in the three months ended October 2, 2015 as compared to the prior-year period. As a percentage of net revenue, R&D expense was 11.5% in the three months ended October 2, 2015, as compared to 11.1% in the prior-year period.

Selling, general and administrative ("SG&A") expense was $192 million for the three months ended October 2, 2015, a decrease of $28 million from the prior-year period. This decrease was primarily the result of an additional week of operating expenses during the first fiscal quarter of the prior-year period and lower incentive compensation in the three months ended October 2, 2015 as compared to the prior-year period. SG&A expense as a percentage of net revenue was 5.7% in the three months ended October 2, 2015, as compared to 5.6% in the prior-year period.

During the three months ended October 3, 2014, we recorded $14 million of interest charges related to an arbitration award for claims brought against us and a now former employee of ours by Seagate Technology LLC. In October 2014, we paid Seagate $773.4 million to satisfy the full amount of the final arbitration award plus interest accrued through October 2014. For additional information, refer to Part I, Item 1, Note 5 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

During the three months ended October 2, 2015, we recorded employee termination, asset impairment and other charges of $56 million in order to realign our operations with anticipated market demand, as compared to $9 million in the prior-year period. For additional information, refer to Part I, Item 1, Note 12 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Other Income (Expense)

Other expense, net for the three months ended October 2, 2015 was $8 million, as compared to $9 million in the prior-year period. This decrease was a result of a slight increase in interest and other income due to a higher average daily invested cash balance, as compared to the prior-year period. Interest and other expense remained flat compared to the prior-year period.

Income Tax Provision

Our income tax provision for the three months ended October 2, 2015 was $31 million, as compared to $37 million in the prior-year period. This decrease was primarily a result of lower income before income taxes. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2025 and the current year generation of income tax credits. For additional

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information, refer to Part I, Item 1, Note 6 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Liquidity and Capital Resources

We ended the first quarter of fiscal 2016 with total cash and cash equivalents of $5.1 billion. The following table summarizes our statements of cash flows (in millions):

	Three Months Ended	
	October 2, 2015	October 3, 2014
Net cash flow provided by (used in):		
Operating activities	$545	$827
Investing activities	(273)	(126)
Financing activities	(215)	(346)
Net increase in cash and cash equivalents	$57	$355

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

As discussed above under Recent Developments, in connection with our planned acquisition of SanDisk, we expect to enter into new debt facilities totaling $18.1 billion. We have received commitments for a $1.0 billion revolving credit facility, $3.0 billion in amortizing term loans, $6.0 billion in other term loans and $8.1 billion in secured and unsecured bridge facilities. We expect to issue approximately $5.1 billion in secured and unsecured notes in lieu of drawing the bridge facilities at close, with the balance of the bridge facilities to be repaid with available cash. The proceeds from the new debt facilities are expected to be used to pay a portion of the purchase price for our planned acquisition of SanDisk, refinance existing debt of both our company and SanDisk and pay transaction related fees and expenses. Also as discussed above under Recent Developments, on September 29, 2015, we entered into an agreement with Unis under which a subsidiary of Unis will make a $3.8 billion equity investment in our company, which we expect will close in the second or third quarter of fiscal 2016.

A total of $4.5 billion and $4.3 billion of our cash and cash equivalents was held outside of the United States as of October 2, 2015 and July 3, 2015, respectively. Substantially all of the amounts held outside of the United States are intended to be indefinitely reinvested in foreign operations. Our current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations or dividends to our shareholders pursuant to our quarterly cash dividend policy. 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 was $545 million during the three months ended October 2, 2015 as compared to $827 million provided by operating activities in the prior-year period. 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. The decline in cash provided by operating activities compared to the prior-year period was primarily attributable to the lower net income in the current period. Net cash used by working capital changes was $27 million for the three months ended October 2, 2015 as compared to $61 million provided by working capital changes in the prior-year period.

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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:

	Three Months Ended	
	October 2, 2015	October 3, 2014
Days sales outstanding	44	48
Days in inventory	48	45
Days payables outstanding	(68)	(71)
Cash conversion cycle	24	22

For the three months ended October 2, 2015, our days sales outstanding ("DSOs") decreased by 4 days, days in inventory ("DIOs") increased by 3 days, and days payable outstanding ("DPOs") decreased by 3 days compared to the prior year period. Changes in DSOs are generally due to both the linearity of shipments and the sale of trade receivables in connection with our factoring agreement. Changes in DIOs are generally related to the timing of inventory builds. Changes in DPOs are generally related to production volume and the timing of purchases during the period. From time to time, we modify the timing of payments to our vendors. We make modifications primarily to manage our vendor relationships and to manage our cash flows, including our cash balances. Generally, we make the payment term modifications through negotiations with our vendors or by granting to, or receiving from, our vendors' payment term accommodations.

Investing Activities

Net cash used in investing activities for the three months ended October 2, 2015 was $273 million as compared to $126 million used in investing activities in the prior-year period. Net cash used in investing activities for the three months ended October 2, 2015 consisted of $236 million related to the purchase of investments, $151 million of capital expenditures and a net $10 million of other investing activities, partially offset by $124 million of proceeds from sales and maturities of investments. Net cash used in investing activities for the three months ended October 3, 2014 consisted of $160 million of capital expenditures, $120 million related to the purchase of investments and a net $12 million of other investing activities, offset by $166 million of proceeds from sales and maturities of investments.

Financing Activities

Net cash used in financing activities for the three months ended October 2, 2015 was $215 million as compared to $346 million used in financing activities in the prior-year period. Net cash used in financing activities for the three months ended October 2, 2015 consisted of $115 million used to pay dividends on our common stock, $60 million used to repurchase shares of our common stock, $31 million used to make principal payments on the term loan facility and a net $9 million used by employee stock plans. Net cash used in financing activities for the three months ended October 3, 2014 consisted of $223 million used to repurchase shares of our common stock, $31 million used to make principal payments on the term loan and $94 million used to pay dividends on our common stock, offset by a net $2 million provided by 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 condensed consolidated financial statements. Additionally, we do not have an interest in, or relationships with, any special-purpose entities.

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Contractual Obligations and Commitments

Debt — As of October 2, 2015, we had $255 million outstanding on our revolving credit facility and $2.3 billion outstanding on our term loan facility. We are required to make quarterly principal payments on the term loan facility totaling $125 million for the remainder of fiscal 2016, $219 million in fiscal 2017, $250 million in fiscal 2018 and the remaining balance of $1.7 billion in fiscal 2019. As of October 2, 2015, under our credit agreement, we were in compliance with all covenants. In connection with our planned acquisition of SanDisk, we expect to enter into debt facilities totaling $18.1 billion, including a $1.0 billion revolving credit facility. The proceeds from the debt facilities are expected to be used to pay a portion of the purchase price for our planned acquisition of SanDisk, refinance existing debt of both our company and SanDisk and pay transaction-related fees and expenses. For additional information on our outstanding debt, refer to Part I, Item 1, Note 4 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Purchase Orders — In the normal course of business, we enter into purchase orders with suppliers for the purchase of 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, containing 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.

Refer to Part II, Item 7 of our Annual Report on Form 10-K for the year ended July 3, 2015, 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, 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 October 2, 2015, the amount of unrecognized tax benefits was $360 million, of which $299 million could result in potential cash payments. We are not able to provide a reasonable estimate of the timing of future tax payments related to these obligations. 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.

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Stock Repurchase Program — Our Board of Directors previously authorized a stock repurchase program. Effective October 21, 2015, in connection with our planned acquisition of SanDisk, we suspended this stock repurchase program. For additional information, refer to Part II, Item 2, Issuer Purchases of Equity Securities in this Quarterly Report on Form 10-Q.

Cash Dividend Policy — During the three months ended October 2, 2015, we declared a cash dividend of $0.50 per share of our common stock to shareholders of record as of October 2, 2015, totaling $116 million, which we paid on October 15, 2015. Subsequent to October 2, 2015, on November 3, 2015, we declared a cash dividend of $0.50 per share of our common stock to shareholders of record as of January 1, 2016, which will be paid on January 15, 2016. We may modify, suspend or cancel our cash dividend policy in any manner and at any time. For additional information, refer to Part I, Item 1, Note 9 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Critical Accounting Policies and Estimates

We have prepared the unaudited condensed consolidated financial statements in accordance with U.S. GAAP. The preparation of the financial statements requires the use of judgments and estimates that affect the reported amounts of revenues, expenses, assets, liabilities and shareholders' equity. We have adopted accounting policies and practices that are generally accepted in the industry in which we operate. If these estimates differ significantly from actual results, the impact to the condensed consolidated financial statements may be material. There have been no material changes in our critical accounting policies and estimates from those disclosed in our Annual Report on Form 10-K for the year ended July 3, 2015. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended July 3, 2015 for a discussion of our critical accounting policies and estimates.

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 1, Note 13 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Disclosure About Foreign Currency Risk

Although the majority of our transactions are in U.S. dollars, some transactions are based in various foreign currencies. We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for 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 speculative or trading purposes. For additional information, refer to 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 October 2, 2015, we had outstanding the following purchased foreign exchange contracts (in millions, except weighted average contract rate):

	Contract Amount	Weighted Average Contract Rate*	Unrealized Gains (Losses)
Foreign exchange contracts:			
Cash flow hedges:			
Japanese Yen	$154	$ 120.50	$1
Malaysian Ringgit	$146	$ 3.84	$(16)
Philippine Peso	$51	$ 45.92	$(1)
Singapore Dollar	$42	$ 1.38	$(1)
Thai Baht	$654	$ 34.59	$(33)
Fair value hedges:			
British Pound Sterling	$(6)	$ 0.66	$—
Euro	$(16)	$ 0.90	$—
Japanese Yen	$76	$ 119.72	$—

Philippine Peso	$32	$ 46.73	$—
Singapore Dollar	$12	$ 1.39	$—
Thai Baht	$52	$ 36.49	$—

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

During the three months ended October 2, 2015, total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements.

Disclosure About Other Market Risks

Variable Interest Rate Risk

Borrowings under our credit agreement bear interest at a rate equal to, at our option, either (a) a customary London interbank offered rate (a “Eurodollar Rate”) or (b) a customary base rate (a “Base Rate”), in each case plus an applicable margin. The applicable margins range from 1.25% to 2.00% with respect to Eurodollar Rate borrowings and 0.25% to 1.00% with respect to Base Rate borrowings. We are also required to pay a commitment fee for the unused portion of the revolving credit facility, which ranges from 0.175% to 0.300% per annum. The applicable margins for borrowings and the commitment fee ranges are determined based upon a leverage ratio of us and our subsidiaries calculated on a consolidated basis. A one percent increase in the variable rate of interest on the term loan and revolving credit facility would increase interest expense by approximately $25 million annually. For additional information on our credit agreement, see Part I, Item 1, Note 4 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

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 first fiscal quarter ended October 2, 2015 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

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

The risks and uncertainties discussed below update and supersede the risks and uncertainties previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended July 3, 2015. Other than the addition of the risk factors below under the section titled "Risks Related to Our Planned Acquisition of SanDisk, the Planned Investment by Unis and Integration of Our HGST Acquisition," we do not believe any of the changes constitute material changes to the risk factors previously disclosed in such prior Annual Report on Form 10-K.

Risks Related to Our Planned Acquisition of SanDisk, the Planned Investment by Unis and Integration of Our HGST Acquisition

The failure to complete our planned acquisition of SanDisk, in a timely manner or at all, may adversely affect our business and our stock price.

Our and SanDisk's obligations to consummate our planned acquisition of SanDisk are subject to the satisfaction or waiver of certain customary conditions, including, among others, (i) the approval of the merger agreement by the shareholders of SanDisk and, if the planned Unis Investment has not closed or has been terminated, approval by our shareholders; (ii) the expiration or early termination of the waiting period applicable to the consummation of the merger under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the receipt of regulatory clearance under certain foreign antitrust laws, including the European Union and China; (iii) the absence of (A) any order prohibiting the merger or (B) the enactment of any law that makes consummation of the merger illegal; (iv) subject to certain exceptions, the accuracy of the representations and warranties of the parties and compliance by the parties with their respective obligations under the merger agreement; (v) if the planned Unis Investment has not been terminated and is a "covered transaction" for CFIUS purposes, or if CFIUS otherwise requests or requires a filing with respect to the planned merger with SanDisk, the approval of CFIUS; and (vi) the absence of any material adverse effect on SanDisk or our company since the date of the merger agreement that is continuing. We cannot provide assurance that the conditions to the completion of the planned acquisition of SanDisk will be satisfied in a timely manner or at all. In addition, other factors, such as our ability to obtain the debt financing we need to consummate the planned acquisition of SanDisk, may affect when and whether the merger will occur. If our planned acquisition of SanDisk is not completed, our share price could fall to the extent that our current price reflects an assumption that we will complete the planned acquisition. Furthermore, if the planned acquisition of SanDisk is not completed and the merger agreement is terminated, we may suffer other consequences that could adversely affect our business, results of operations and share price, including the following:

- we could be required to pay a termination fee to SanDisk of approximately: (A) $1.06 billion if the acquisition is not consummated by October 21, 2016 or, if extended pursuant to the terms of the merger agreement, January 21, 2017, or is enjoined or otherwise prohibited, in each case due to the failure to obtain certain required U.S. or foreign antitrust clearances; (B) $184 million if the planned Unis Investment has not closed or has been terminated and our company's shareholders fail to approve the issuance of shares of its common stock pursuant to the merger; and (C) $553 million if the merger agreement is terminated under certain other specified circumstances described in the merger agreement;

- 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;

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- matters relating to the planned acquisition (including integration planning) may 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;
- we may be subject to legal proceedings related to the acquisition or the failure to complete the acquisition;
- the failure to consummate the acquisition may result in negative publicity and a negative impression of us in the investment community; and
- any disruptions to our business resulting from the announcement and pendency of the acquisition, including any adverse changes in our relationships with our customers, suppliers, joint development partners and employees, may continue or intensify in the event the merger is not consummated.

Uncertainty about our planned acquisition of SanDisk may adversely affect our business and stock price, whether or not the planned acquisition is completed.
We are subject to risks in connection with the announcement and pendency of our planned acquisition of SanDisk, including the pendency and outcome of any legal proceedings against us, our directors and others relating to the planned acquisition and the risks from possibly foregoing opportunities we might otherwise pursue absent the planned acquisition of SanDisk. Furthermore, uncertainties about the planned acquisition may cause our current and prospective employees to experience uncertainty about their future with us. These uncertainties may impair our ability to retain, recruit or motivate key management, sales, marketing, engineering, technical and other personnel.
In addition, in response to the announcement of our planned acquisition of SanDisk, our existing or prospective customers, suppliers or joint development partners may:

- delay, defer or cease purchasing goods or services from or providing goods or services to us;
- delay or defer other decisions concerning us, or refuse to extend credit to us;
- cease further joint development activities; or
- otherwise seek to change the terms on which they do business with us.

While we are attempting to address these risks through communications with our existing and prospective customers, suppliers or joint development partners, they may be reluctant to purchase our products, supply us with goods and service or continue joint development due to the potential uncertainty about the direction of our product offerings and the support and service of our products after we complete the planned acquisition of SanDisk.
We may fail to realize the benefits expected from our planned acquisition of SanDisk, which could adversely affect our stock price.

Our planned acquisition of SanDisk, if completed, will be our largest acquisition to date. The anticipated benefits we expect from the planned acquisition are, necessarily, based on projections and assumptions about the combined businesses of our company and SanDisk, which may not materialize as expected or which may prove to be inaccurate. The value of our common stock following the completion of the planned acquisition could be adversely affected if we are unable to realize the anticipated benefits from the acquisition on a timely basis or at all. Achieving the benefits of the planned acquisition of SanDisk will depend, in part, on our ability to integrate the business and operations of SanDisk successfully and efficiently with our business. The challenges involved in this integration, which will be complex and time-consuming, include the following:

- difficulties entering new markets or manufacturing in new geographies where we have no or limited direct prior experience;
- successfully managing relationships with our combined supplier and customer base;
- coordinating and integrating independent research and development and engineering teams across technologies and product platforms to enhance product development while reducing costs;

- consolidating and integrating corporate, information technology, finance and administrative infrastructures and integrating and harmonizing business systems;
- coordinating sales and marketing efforts to effectively position our capabilities and the direction of product development;
- limitations prior to the completion of the acquisition on the ability of management of our company and of SanDisk to conduct planning regarding the integration of the two companies;
- the increased scale and complexity of our operations resulting from the acquisition;
- retaining key employees of our company and SanDisk;
- obligations that we will have to counterparties of SanDisk that arise as a result of the change in control of SanDisk; and
- minimizing the diversion of management attention from other important business objectives.

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

The acquisition of SanDisk may result in significant charges or other liabilities 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 our integration of the business and operations of SanDisk. The amount and timing of these possible charges are not yet known. Further, our failure to identify or accurately assess the magnitude of certain liabilities we are assuming in the acquisition could result in unexpected litigation or regulatory exposure, unfavorable accounting charges, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition. The price of our common stock following the acquisition could decline to the extent the combined company’s financial results are materially affected by any of these events.

The regulatory approvals required in connection with our planned acquisition of SanDisk may not be obtained or may contain materially burdensome conditions.

Completion of our planned acquisition of SanDisk is conditioned upon the receipt of certain regulatory approvals, and we cannot provide assurance that these approvals will be obtained. If any conditions or changes to the proposed structure of the acquisition are required to obtain these regulatory approvals, they may 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.

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The use of cash and incurrence of substantial indebtedness in connection with the financing of our planned SanDisk acquisition 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 SanDisk will be financed in part by the use of our cash on hand and the incurrence of a significant amount of indebtedness. As of October 2, 2015, we had approximately $5.1 billion of cash and cash equivalents, approximately $350 million of short-term investments, approximately $356 million of long-term investments and approximately $2.5 billion of total debt outstanding. In connection with the planned acquisition, we expect to enter into new debt facilities totaling $18.1 billion. The proceeds from the new debt facilities are expected to be used to pay part of the purchase price, refinance existing debt of both our company and SanDisk and pay transaction related fees and expenses. 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 generated from operations to pay principal and interest on our debt, thereby reducing the availability of our cash flow for working capital, dividend and capital expenditure needs or to pursue other potential strategic plans. We expect that the agreements we will enter into with respect to the indebtedness we will incur to finance the planned acquisition will contain restrictive covenants, including financial covenants requiring us to maintain specified financial ratios and limitations on our ability to incur additional liens and indebtedness or to pay dividends and make certain investments. Our ability to comply with 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 limiting 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 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.

Because of high debt levels, we may not be able to service our debt obligations in accordance with their terms after the completion of the planned acquisition of SanDisk.

Our ability to meet our expense and debt service obligations contained in the agreements we expect to enter into with respect to the indebtedness we will incur to finance the planned acquisition will depend on our future performance, which will be affected by financial, business, economic and other factors, including potential changes in industry conditions, customer preferences, the success of our products and pressure from competitors. Should our revenues decline after the planned acquisition of SanDisk, we may not be able to generate sufficient cash flow to pay our debt service obligations when due. If we are unable to meet our debt service obligations after the planned acquisition or should we fail to comply with our financial and other restrictive covenants contained in the agreements governing our indebtedness, we may be required to refinance all or part of our debt, sell important strategic assets at unfavorable prices, incur additional indebtedness or issue common stock or other equity securities. We may not be able to, at any given time, refinance our debt, sell assets, incur additional indebtedness or issue equity securities on terms acceptable to us, in amounts sufficient to meet our needs or at all. If we were able to raise additional funds through the issuance of equity securities, such issuance would also result in dilution to our shareholders. Our inability to refinance our debt could have a material adverse effect on our business, financial conditions or operating results after the planned acquisition.

The failure to complete the planned equity investment by Unis, in a timely manner or at all, may adversely affect our business and our stock price.

The closing of our planned issuance of additional shares of our common stock to a subsidiary of Unis in connection with Unis’s $3.8 billion equity investment in us is subject to certain closing conditions, including (i) clearance by CFIUS, (ii) the receipt of requisite regulatory approvals, including clearance by U.S. antitrust authorities and certain Chinese regulatory approvals, including clearance by MOFCOM, the Ministry of Education of the People’s Republic of China, the National Development and Reform Commission of the People’s Republic of China and the State Administration of Foreign Exchange of the People’s Republic of China, and (iii) approval of the transaction by Unis shareholders. We cannot provide assurance that these conditions to the completion of the planned Unis Investment will be satisfied in a timely manner or at all. If the planned Unis Investment is not completed, our share price could fall to the extent that our current price reflects an assumption that the transaction will be completed. Furthermore, if the planned equity investment is not completed, the proceeds of the investment will not be available to us to strengthen our balance sheet, provide financial flexibility or pursue long-term strategic growth initiatives, including the planned acquisition of SanDisk, which could adversely affect our business, results of operations and share price. In that event, we would be required to issue additional shares of our common stock to finance a portion of the purchase price for our planned acquisition of SanDisk. See “The issuance of shares of our common stock in connection with the planned investment by Unis and our planned acquisition of SanDisk, and any future offerings of securities by us, will dilute our shareholders’ ownership interest in the company.”

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The issuance of shares of our common stock in connection with the planned investment by Unis and our planned acquisition of SanDisk, and any future offerings of securities by us, will dilute our shareholders' ownership interest in the company.

We will issue additional shares of our common stock to a subsidiary of Unis in connection with Unis's $3.8 billion equity investment in us, comprising approximately 15% of our issued and outstanding shares of common stock (based on the number of shares of our common stock outstanding on September 25, 2015, as adjusted for the issuance of shares to the subsidiary of Unis in connection with the equity investment). Our planned acquisition of SanDisk will be financed in part by the issuance of additional shares of our common stock to shareholders of SanDisk, comprising approximately 1.6% of our issued and outstanding shares of common stock (if the planned Unis Investment closes prior to our planned acquisition of SanDisk), or approximately 22.2% of our issued and outstanding shares of common stock (if the planned Unis Investment has not closed or has been terminated), based on the number of issued and outstanding shares of our common stock on October 2, 2015 and SanDisk's estimated fully diluted shares of common stock outstanding on June 30, 2016. These issuances of additional shares of our common stock will dilute your ownership interest in our company, and you will have a reduced ownership and voting interest in our company following the completion of either or both of these transactions.

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

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

In connection with obtaining the regulatory approvals required to complete the acquisition of HGST, we agreed to certain conditions required by MOFCOM, including adopting measures to keep HGST as an independent competitor until MOFCOM agreed otherwise. On October 19, 2015, MOFCOM announced that it had made a decision allowing us to integrate substantial portions of our HGST and WD subsidiaries, provided that we continue to offer both HGST and WD product brands and maintain separate sales teams for two years from the date of the decision.

As a result of MOFCOM's decision, we immediately began planning for the integration of the substantial portions of our HGST and WD subsidiaries that we are now allowed to integrate (including corporate functions, research and development, heads and media operations, engineering and manufacturing). We expect the integration will occur in phases over the next 24 months. Our integration efforts during this time may involve significant management time and create uncertainty for employees and customers, and delays in the process could have a material adverse effect on our business, results of operations and financial condition. It is possible that the integration process could result in the loss of key employees, the loss of customers, the disruption of our company's ongoing business or in unexpected integration issues, higher than expected integration costs and an overall integration process that takes longer than originally anticipated. Additionally, the integration of the operations of our HGST and WD subsidiaries may also increase the risk that our internal controls are found to be ineffective. Further, until we are able to begin combining our HGST and WD product brands and sales teams on October 19, 2017, we will continue to incur additional costs to maintain separate brands and sales teams. These additional costs, any delay in the integration process and any higher than expected integration costs or other integration issues could adversely affect our ability to achieve the full operating expense synergies we expect from integration of the businesses of our HGST and WD subsidiaries, which could harm our business and financial condition.

Risks Related to Our Business

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

Adverse global economic conditions and uncertain conditions in the credit market have had, and in the future could have, a significant adverse effect on our company and on the storage industry as a whole. Several factors contribute to these conditions and this uncertainty, including, but not limited to, volatility in the financial and real estate markets, cost increases and other macroeconomic factors. Some of the risks and uncertainties we face as a result of these conditions include the following:

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- Volatile Demand. Our direct and indirect customers may delay or reduce their purchases of our products and systems containing our products. In addition, many of our customers rely on credit financing to purchase our products. If negative conditions in the global credit markets prevent our customers' access to credit, product orders may decrease, which could result in lower revenue. Likewise, if our suppliers, sub-suppliers and sub-contractors (collectively referred to as "suppliers") face challenges in obtaining credit, in selling their products or otherwise in operating their businesses, they may be unable to offer the materials we use to manufacture our products. These actions could result in reductions in our revenue and increased operating costs, which could adversely affect our business, results of operations and financial condition.
- Restructuring Activities. If demand for our products slows as a result of a deterioration in economic conditions, we may undertake restructuring activities to realign our cost structure with softening demand. The occurrence of restructuring activities could result in impairment charges and other expenses, which could adversely impact our results of operations 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 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 devices, software and solutions that we offer to our customers, which we refer to in this Item 1A as our "products", depends in large part on the demand for systems manufactured by our customers and on storage upgrades to existing systems. The demand for systems has been volatile in the past and often has had an exaggerated effect on the demand for our products in any given period. As a result, the storage 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 adversely impact revenue and gross margins. In addition, we compete based on our ability to offer our customers competitive solutions that provide the most current and desired product and service features. We expect that competition will continue to be intense, and there is a risk that our competitors' products may be less costly, provide better performance or include additional features when compared to our products. Our ASPs and gross margins also tend to decline when there is a shift in the mix of product sales, and sales of lower priced products increase relative to those of higher priced products. Further, we face potential gross margin pressures resulting from our ASPs declining more rapidly than our cost of goods sold. 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, including a substantial decrease in our market share.
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 industry consolidation, resulting in less availability of historical market data for certain product segments. Further, for many of our OEMs utilizing just-in-time inventory, we do not generally require firm order commitments and instead receive a periodic forecast of requirements, which may prove to be inaccurate. In addition, because our products are designed to be largely interchangeable with competitors' products, our demand forecasts may be impacted significantly by the strategic actions of our competitors. As forecasting demand becomes more difficult, the risk that our forecasts are not in line with demand increases. If our forecasts exceed actual market demand, then we could experience periods of product oversupply and price decreases, which could impact our financial performance. If market demand increases significantly beyond our forecasts or beyond our ability to add

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manufacturing capacity, then we may not be able to satisfy customer product needs, possibly resulting in a loss of market share if our competitors are able to meet customer demands.

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

Sales of computer systems, storage subsystems, gaming consoles and consumer electronics ("CE") tend to be seasonal and cyclical, and therefore we expect to continue to experience seasonality and cyclicality in our business as we respond to variations in our customers' demand for our products. However, changes in seasonal and cyclical patterns have made it, and could continue to make it, more difficult for us to forecast demand, especially as a result of the current macroeconomic environment. Changes in the product or channel mix of our business can also impact seasonal and cyclical patterns, adding complexity in forecasting demand. Seasonality and cyclicality also may lead to higher volatility in our stock price. It is difficult for us to evaluate the degree to which seasonality and cyclicality 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 sales to the CE, cloud computing, network attached storage (NAS), surveillance and enterprise markets, which have accounted for and may continue accounting for an increasing percentage of our overall revenue, may grow at a slower rate than current estimates or not at all, which could materially adversely impact our operating results.

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

- Mobile Devices. There has been and continues to be a rapid growth in devices that do not contain a hard drive such as tablet computers and smart phones. As tablet computers and smart phones provide many of the same capabilities as PCs, they have displaced or materially affected, and we expect will continue to displace or materially affect, the demand for PCs. If we are not successful in adapting our product offerings to include disk drives or alternative storage solutions that address these devices, including through completion of the planned acquisition of SanDisk, demand for our products in these markets may decrease and our financial results could be materially adversely affected.
- Cloud Computing. Consumers traditionally have stored their data on their PC, often supplemented with personal external storage devices. Most businesses also include similar local storage as a primary or secondary storage location. This storage is typically provided by HDDs. With cloud computing, applications and data are hosted, accessed and processed through a third-party provider over a broadband Internet connection, potentially reducing or eliminating the need for, among other things, significant storage inside the accessing computer. Even if we are successful at increasing revenues from sales to cloud computing customers, if we are not successful in manufacturing compelling products to address the cloud computing opportunity, demand for our products in these other markets may decrease and our financial results could be materially adversely affected. Demand for cloud computing solutions themselves may be volatile due to differing patterns of technology adoption and innovation, improved data storage efficiency by cloud computing service providers, and concerns about data protection by end users.
- Obsolete Inventory. In some cases, products we manufacture for these markets are uniquely configured for a single customer's application, creating a risk of obsolete inventory if anticipated demand is not actually realized. In addition, rapid technological change in our industry increases the risk of inventory obsolescence.
- Macroeconomic Conditions. Consumer spending has been, and may continue to be, adversely affected in many regions due to negative macroeconomic conditions and high unemployment levels. Please see the risk factor entitled "Adverse global economic conditions and credit market uncertainty could harm our business, results of operations and financial condition." for more risks and uncertainties relating to macroeconomic conditions.

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

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Deterioration in the client compute market ("the PC market") has accelerated, which could cause our operating results to suffer.
While sales to non-PC markets are becoming a more significant source of revenue, sales to the PC market remain an important part of our business. The PC market, however, has been, and may continue to be, adversely affected by the growth of tablet computers, smart phones and similar devices that perform many of the same capabilities as PCs, the lengthening of product life cycles and macroeconomic conditions. We believe that the deterioration of the PC market has accelerated recently, and that this accelerated deterioration may continue or further accelerate, which could cause our operating results to suffer. Additionally, if demand in the PC market is worse than expected as a result of these or other conditions, demand for our products in the PC market may decrease at a faster rate and our operating results may be adversely affected.

Selling to the retail market is an important part of our business, and if we fail to maintain and grow our market share or gain market acceptance of our branded products, our operating results could suffer.
Selling branded products is an important part of our business, and as our branded products revenue increases as a portion of our overall revenue, our success in the retail market becomes increasingly important to our operating results. Our success in the retail market depends in large part on our ability to maintain our brand image and corporate reputation and to expand into and gain market acceptance of our products in multiple channels. We must successfully respond to the rapid change away from traditional advertising media, marketing and sales methods to the use of Internet media and advertising, particularly social media, and online sales, or our brand and retail sales could be negatively affected. Adverse publicity, whether or not justified, or allegations of product or service quality issues, even if false or unfounded, could tarnish our reputation and cause our customers to choose products offered by our competitors. In addition, the proliferation of new methods of mass communication facilitated by the Internet makes it easier for false or unfounded allegations to adversely affect our brand image and reputation. If customers no longer maintain a preference for WD or HGST™ 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 our products weaken, our operating results could suffer.
Our distribution customers typically sell to small computer manufacturers, dealers, systems integrators and other resellers. We face significant competition in this channel as a result of limited product qualification programs and a significant focus on price and availability of product. In addition, the PC market is experiencing a shift to notebook and other mobile devices and, as a result, more computing devices are being delivered to the market as complete systems, which could weaken the distribution market. If we fail to respond to changes in demand in the distribution market, our operating results could suffer. Additionally, if the distribution market weakens as a result of a slowing PC growth rate, technology transitions or a significant change in consumer buying preference, or if we experience significant price declines due to demand changes in the distribution channel, then our operating results would be adversely affected.
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 October 2, 2015, 48% of our revenue came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, often resulting in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results 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.

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

Expansion into new markets may increase the complexity of our business, cause us to increase our research and development expenses to develop new products and technologies or cause our capital expenditures to increase, and if we are unable to successfully adapt our business processes and product offerings as required by these new markets, our ability to grow will be adversely affected.

To remain a significant supplier in the storage industry and to expand into new markets, we will need to offer a broad range of storage products to our customers. We currently offer a variety of 3.5-inch and 2.5-inch hard drives, solid state drives and systems and other products for the PC, enterprise, data center and other storage markets. As we expand our product lines to sell into new markets, such as our recent entry into active archive systems and particularly following our planned acquisition of SanDisk, the overall complexity of our business may increase at an accelerated rate and we may become subject to different market dynamics. These dynamics may include, among other things, different demand volume, seasonality, product requirements, sales channels, and warranty and return policies. In addition, expansion into other markets may result in increases in research and development expenses and substantial investments in manufacturing capability or technology enhancements. If we fail to successfully expand into new markets with products that we do not currently offer, we may lose business to our competitors or new entrants who offer these products.

Our vertical integration of 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, increasing capital expenditure costs and asset utilization risks for our business.

We develop and manufacture a substantial portion of the heads and magnetic media used in the hard drive products we produce. 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. We may be unsuccessful 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 underutilization that may impact our operating results. We are therefore subject to additional risks related to overall asset utilization, including the need to operate at high levels of utilization to drive competitive costs and the need for assured supply of components that we do not manufacture ourselves. In addition, as a result of adverse labor rates or availability, we may be required to increase investments in automation, which may cause our capital expenditures to increase. If we do not adequately address 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 or investments that are not cost effective could materially adversely affect our business, financial condition and results of operations.

As a leading supplier of hard drives and a major supplier of enterprise SSDs, we make significant investments to maintain our existing products and to lead innovation and development of new technologies. This strategy requires us to make significant investments in research and development and, in order to remain competitive, we may increase our capital expenditures and expenses above our historical run-rate model. The current inherent physical limitations associated with storage technologies are resulting in more costly capital expenditures that reduce the cost benefits of technology transitions and could limit our ability to keep pace with reductions in ASPs. These investments may not result in viable technologies or products, and even if they do result in viable technologies or products, they may not be profitable or accepted by the market. Significant investments in unsuccessful or cost-ineffective 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.

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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.

Consolidation within the data storage industry could provide competitive advantages to our competitors.
The data storage industry as a whole has experienced consolidation over the past several years through acquisitions, consolidations and decisions by industry players to exit the industry. Consolidation across the industry, including 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 of storage products, may, over extended periods of time, sell storage products at prices that we cannot profitably match.
Some of our competitors earn a significant portion of their revenue from business units outside of storage products. Because they do not depend solely on sales of storage products to achieve profitability, they may sell storage products at lower prices and operate their storage business unit at a loss over an extended period of time while still remaining profitable overall. In addition, if these competitors can increase sales of non-storage products to the same customers, they may benefit from selling their storage products at lower prices. Our operating results may be adversely affected if we cannot successfully compete with the pricing by these companies.
If we fail to qualify our products with our customers, it may have a significant adverse impact on our sales and margins.
We regularly engage in new product qualification with our customers. 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 or the unintended use of our products, which could result in product recalls or epidemic failures and could subject us to warranty claims in excess of our warranty provisions or which are greater than anticipated.
We warrant the majority of our products for periods of one to five years. We test our products in our manufacturing facilities through a variety of means. However, our testing may fail to reveal defects in our products that may not become apparent until after the products have been sold into the market. In addition, our products may be used in a manner that is not intended or anticipated by us, resulting in potential liability. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement. As part of a product recall, we may be required or choose to replace the defective product. Moreover, there is a risk that product defects may trigger an epidemic failure clause in a customer agreement. If an epidemic failure occurs, we may be required to replace or refund the value of the defective product and to cover certain other costs associated with the consequences of the epidemic failure. In addition, 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

expenses if our warranty provision do not reflect the actual cost of resolving issues related to defects in our products, whether as a result of a product recall, epidemic failure or otherwise. If these additional expenses are significant, it could adversely affect our business, financial condition and operating results.

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

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

We depend on an external supply base for technologies, software (including firmware), components, equipment and materials for use in our product design and manufacturing. We also depend on service suppliers for providing technical support for our products. In addition, we use logistics partners to manage our just-in-time hubs, distribution centers and freight from suppliers to our factories and from our factories to our customers throughout the world. Many of these components and much of this 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 whom are our sole-source suppliers. We are therefore dependent on these suppliers to be able and willing to dedicate adequate engineering resources to develop components that can be successfully integrated into our products, technology and equipment that can be used to develop and manufacture our next-generation products efficiently. Where we rely on a limited number of suppliers or a single supplier, the risk of supplier loss due to industry consolidation is enhanced.

Many of the risks that affect us also affect our supply base, including, but not limited to, having single site manufacturing locations based in high risk regions of the world, macro and local economic conditions, shortages of commodity materials, proper management of technology transitions, natural disasters, geo-political risks, compliance with legal requirements, financial instability and exposure to intellectual property and other litigation, including an injunction or other action that could delay shipping. If any of these risks were to affect our suppliers, we could also be adversely affected, especially in the case of products, components or services that are single-sourced. For example, if suppliers are facing increased costs due to the above risks, they may require us to enter into long-term volume agreements to shift the burden of fixed costs to us. Further, we work closely with many of our suppliers to develop new technologies and, as a result, we may become subject to litigation from our suppliers or third parties.

Without a capable and financially stable supply base that has established appropriate relationships within the supply chain and has implemented business processes, strategies and risk management safeguards, we would be unable to develop our products, manufacture them in high volumes, and distribute them to our customers to execute our business plans effectively. As PC demand declines, competition increases from NAND and other consumer devices, the total available market for HDDs decreases and costs increase, these suppliers may reevaluate their business models. Our suppliers may be acquired by our competitors, consolidate, or decide to exit the industry, redirect their investments and increase costs to us, each of which may have an adverse effect on our business and operations. In addition, moving to new technologies may require us to align to, and build, a new supply base, such as NAND flash. In the case of NAND suppliers, many of which are involved in developing storage products such as SSD that, in some cases, compete with our products. Our success in these new product areas may be dependent on our ability and their willingness to develop close relationships, with preferential agreements. Where this cannot be done, our business and operations may be adversely affected.

In addition to an external supply base, we also rely on an internal supply chain of heads, media and media substrate. Please see the risk factors entitled, "A fundamental change in storage technologies could result in significant increases in our costs and could put us at a competitive disadvantage," and "If we do not properly manage technology transitions, our competitiveness and operating results may be negatively affected," for a review of some of the risks related to our internal supply.

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

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

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and materials used in our customers' products could result in a decrease in demand for our products, which would negatively impact our operating results.

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

To reduce the risk of component shortages, we attempt to provide significant lead times when buying components, which may subject us to cancellation charges if we cancel orders as a result of technology transitions or changes in our component needs. In addition, we may from time to time enter into contractual commitments with component suppliers in an effort to increase and stabilize the supply of those components and enable us to purchase such components at favorable prices. Some of these commitments may require us to buy a substantial number of components from the supplier or make significant cash advances to the supplier; however, these commitments may not result in a satisfactory increase or stabilization of the supply of such components. Furthermore, as a result of uncertain global economic conditions, our ability to forecast our requirements for these components has become increasingly difficult, therefore increasing the risk that our contractual commitments may not meet our actual supply requirements, which could cause us to have inadequate or excess component inventory and adversely affect our operating results and increase our operating costs.

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

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

A fundamental change in storage technologies could result in significant increases in our costs and could put us at a competitive disadvantage.

Historically, when the industry experiences a fundamental change in storage technologies, 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, heat-assisted magnetic recording, patterned magnetic media and advanced signal processing that if implemented by a competitor on a commercially viable basis ahead of the industry, could put us at a competitive disadvantage. 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, which could harm our operating results.

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

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

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

The storage markets in which we offer our products continuously undergo technology transitions that we must anticipate and adapt our products to address in a timely manner. If we fail to implement new technologies successfully, or if we are slower than our competitors at implementing new technologies, we may not be able to competitively offer products that our customers desire, which could harm our operating results.

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

As advances in computer hardware and software are made, our customers have demanded a more diversified portfolio of products with new and additional features. In some cases, this demand results in investments in new products for a particular market that do not necessarily expand overall market opportunity, which may negatively affect our operating results.

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

- difficulties faced in manufacturing ramp;
- implementing at an acceptable cost product features expected by our customers;
- market acceptance/qualification;
- effective management of inventory levels in line with anticipated product demand;
- quality problems or other defects in the early stages of new product introduction and problems with compatibility between our products and those of our customers that were not anticipated in the design of those products; and
- our ability to increase our software development capability.

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

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

If we fail to develop and introduce new products 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 technology advancements. Newer storage technologies have successfully served mobility markets for products that cannot be serviced using traditional storage technologies. Advances in semiconductor technology have resulted in other emerging technologies that can be competitive with traditional storage technologies. For example, SSDs have significantly increased their penetration in notebook PCs in recent years. We believe that SSDs will increasingly replace HDDs in notebook and desktop PCs, and we currently do not offer client SSD solutions. We also expect that SSD penetration will increase in enterprise areas requiring high performance needs in advanced digital computing. We may be unsuccessful in anticipating and developing new and improved products for the client, enterprise and other storage markets in response to competing technologies. If our hard drive and solid state products fail to offer a superior value proposition to alternative storage products, we will be at a competitive disadvantage and our business will suffer.

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

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

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

We are subject to risks associated with our global manufacturing operations and global marketing and sales efforts, as well as risks associated with our utilization of and reliance on contract manufacturers, including:

- obtaining requisite governmental permits and approvals;
- 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, including difficulties finding and retaining talent or responding to labor disputes or disruptions;
- 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, our suppliers or our customers operate. Additionally, it is uncertain what impact the reactions to such acts by various governmental agencies and security regulators worldwide will have on shipping costs. Acts of terrorism, either domestically or abroad, could create further uncertainties and instability. To the extent this results in disruption or delays of our manufacturing capabilities or shipments of our products, our business, operating results and financial condition could be adversely affected.

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

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

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

We experience cyber attacks of varying degrees on our technology infrastructure and systems and, as a result, unauthorized parties have obtained in the past, and may in the future obtain, access to our computer systems and networks. Cyber attacks can include computer viruses, computer denial-of-service attacks, worms, and other malicious software programs or other attacks, covert introduction of malware to computers and networks, impersonation of authorized users, and efforts to discover and exploit any security vulnerabilities or security weaknesses, as well as intentional or unintentional acts by employees or other insiders with access privileges, intentional acts of vandalism by third parties and sabotage. We believe cyber attack attempts are increasing in number and that cyber attackers are developing increasingly sophisticated systems and means to not only attack systems, but also to evade detection or to obscure their activities. Our products are also targets for cyber attacks. While some of our products contain encryption or security algorithms to protect third-party content or user-generated data stored on our products, these products could still be hacked or the encryption schemes could be compromised, breached, or circumvented by motivated and sophisticated attackers.

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

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

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

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

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

We seek to be an industry-leading developer, manufacturer and provider of innovative storage solutions, balancing our core hard drive business with growing investments in newer areas that we believe will provide us with higher growth opportunities. Acquisitions of, investment opportunities in, or other significant transactions with companies that are complementary to our business are a key part of our overall business strategy. For example, we completed the acquisitions of Amplidata in March 2015, Virident in October 2013, and sTec in September 2013. In order to pursue this part of our growth strategy successfully, we must continue to identify attractive acquisition or investment opportunities, successfully complete the transactions, some of which may be large and complex, and manage post-closing issues such as integration of the acquired company or employees. We may not be able to continue to identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. Even if we identify and complete suitable corporate transactions, we may not be able to successfully address any integration challenges in a timely manner, or at all. Failing to successfully integrate or realign our business to take advantage of efficiencies or reduce redundancies of an acquisition may result in not realizing all or any of the anticipated benefits of the acquisition. In addition, failing to achieve the financial model projections for an acquisition may result in the incurrence of impairment charges and other expenses, both of which could adversely impact our results of operations or financial condition. Furthermore, we may agree to provide continuing service obligations or enter into other agreements in order to obtain certain regulatory approvals of our corporate transactions, and failure to satisfy these additional obligations could result in our failing to obtain regulatory approvals or the imposition of additional obligations on us, any of which could adversely affect our business, financial condition and results of operations.

Please also see the section above titled “Risks Related to Our Planned Acquisition of SanDisk, the Planned Investment by Unis and Integration of Our HGST Acquisition.”

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

We have entered into strategic relationships with various partners to reduce the risk associated with relying on external suppliers for technologies, components, equipment and materials for use in our product design and manufacturing. Please see the risk factor entitled “Because we are dependent on a limited number of qualified suppliers for components, sub-assemblies, equipment, consumables, raw materials, and logistics, a supplier’s inability, unwillingness, or failure to support us in a timely manner with goods or services at a quality level and cost acceptable to us can adversely affect our margins, revenues and operating results,” for a further description of the risks associated with our reliance on external suppliers. We have also entered into a strategic relationship with Unis to accelerate sales growth of our data center storage systems in China. These strategic relationships are subject to various risks that could adversely affect the value of our investments and our results of operations. These risks include the following:

- our interests could diverge from our partners’ interests or we may not be able to agree with co-venturers on ongoing activities, or on the amount, timing or nature of further investments in the relationship;
- we may experience difficulties and delays in ramping production at, and transferring technology to, such ventures;
- our control over the operations of our ventures is limited;
- due to financial constraints, our co-venturers may be unable to meet their commitments to us or may pose credit risks for our transactions with them;
- due to differing business models or long-term business goals, our partners may decide not to join us in funding capital investment by our ventures, which may result in higher levels of cash expenditures by us;

- we may lose the rights to technology or products being developed by the strategic relationship, including if our partner is acquired by another company, files for bankruptcy or experiences financial or other losses;
- we may experience difficulties or delays in collecting amounts due to us from our co-venturers;
- the terms of our arrangements may turn out to be unfavorable; and
- changes in tax, legal or regulatory requirements may necessitate changes in the agreements with our co-venturers.

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

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

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

The nature of our industry and its reliance on intellectual property and other proprietary information subjects us and our suppliers and customers 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. Intellectual property risks increase when we enter into new markets where we have little or no intellectual property protection as a defense against 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 in Part I, Item 1, Note 5 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, in relation to our litigation matter with Seagate, on October 8, 2014, the Minnesota Supreme Court affirmed the decision of the Minnesota Court of Appeals, and as a result on October 14, 2014, we paid Seagate $773.4 million to satisfy the full amount of the final arbitration award plus interest accrued through October 13, 2014.

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. In addition, our suppliers and customers are subject to similar risks of litigation, and a material, adverse ruling against a supplier or customer could negatively impact our business.

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 could harm our operating results.

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

We are subject to, and may become subject to additional, state, federal and international laws and regulations governing our environmental, labor, trade, health, safety, anti-corruption and tax practices. These laws and regulations, particularly those applicable to our international operations, are or may be complex, extensive and subject to change. We will need to ensure that we and our suppliers and partners timely comply with such laws and regulations, which may result in an increase in our operating costs. Legislation has been, and may in the future be, enacted in locations where we manufacture or sell our products. In addition, climate change and financial reform legislation is a significant topic of discussion and has generated and may continue to generate federal, international or other regulatory responses in the near future. If we or our suppliers or partners fail to timely comply with applicable legislation, our customers may refuse to purchase our products or we may face increased operating costs as a result of taxes, fines or penalties, or legal liability and reputational damage, which would have a materially adverse effect on our business, financial condition and operating results.

In connection with our compliance with environmental laws and regulations, as well as our compliance with industry and coalition environmental initiatives, such as those established by the Electronics Industry Citizenship Coalition, 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.

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

In August 2012, the SEC adopted rules establishing diligence and disclosure requirements regarding the use and source of gold, tantalum, tin and tungsten, commonly referred to as 3TG or conflict minerals, that are necessary to the functionality or production of products manufactured or contracted to be manufactured by public companies. These rules require us to determine and report annually whether such 3TG originated from the Democratic Republic of the Congo or an adjoining country. These rules could affect our ability to source components that contain 3TG, or 3TG generally, at acceptable prices and could impact the availability of such components or 3TG, since there may be only a limited number of suppliers of “conflict free” 3TG. Our customers, including our OEM customers, may require that our products contain only conflict free 3TG, and our revenues and margins may be harmed if we are unable to meet this requirement at a reasonable price, or at all, or are unable to pass through any increased costs associated with meeting this requirement. Additionally, we may suffer reputational harm with our customers and other stakeholders if our products are not conflict free or if we are unable to sufficiently verify the origins of the 3TG contained in our products through the due diligence procedures that we implement. We could incur significant costs to the extent that we are required to make changes to products, processes, or sources of supply due to the foregoing requirements or pressures. To the extent that proposed conflict minerals legislation is adopted by the European Commission or Canada, these risks could increase.

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

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

- interrupting or otherwise disrupting the shipment of our product components;
- damaging our reputation;

- forcing us to find alternate component sources;
- reducing demand for our products (for example, through a consumer boycott); or
- exposing us to potential liability for our suppliers' or customers' wrongdoings.

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

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

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

Because we manufacture and sell our products abroad, our revenue, margins, operating costs and cash flows are impacted by fluctuations in foreign currency exchange rates. If the U.S. dollar exhibits sustained weakness against most foreign currencies, the U.S. dollar equivalents of unhedged manufacturing costs could increase because a significant portion of our production costs are foreign-currency denominated. Conversely, there would not be an offsetting impact to revenues since revenues are substantially U.S. dollar denominated. Additionally, we negotiate and procure some of our component requirements in U.S. dollars from non-U.S. based vendors. If the U.S. dollar weakens against other foreign currencies, some of our component suppliers may increase the price they charge for their components in order to maintain an equivalent profit margin. 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 attempt to manage the impact of foreign currency exchange rate changes by, among other things, entering into short-term, foreign exchange contracts. However, these contracts do not cover our full exposure and can be canceled by the counterparty if currency controls are put in place.

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

Some of our OEM customers have adopted a subcontractor model that requires us to contract directly with companies, such as ODMs, that provide manufacturing and fulfillment services to our OEM customers. Because these subcontractors are generally not as well capitalized as our direct OEM customers, this subcontractor model exposes us to increased credit risks. Our agreements with our OEM customers may not permit us to increase our product prices to alleviate this increased credit risk. Additionally, as we attempt to expand our OEM and distribution channel sales into emerging economies such as Brazil, Russia, India and China, the customers with the most success in these regions may have relatively short operating histories, making it more difficult for us to accurately assess the associated credit risks. Our acquisition of HGST has also resulted in an increase to our customer credit risk given that we service many of the same customers. Any credit losses we may suffer as a result of these increased risks, or as a result of credit losses from any significant customer, especially in situations where there are term extensions under existing contracts with such customers, would increase our operating costs, which may negatively impact our operating results.

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

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

- the timing of orders from and shipment of products to major customers;
- our product mix;
- changes in the ASPs 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;

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- seasonal and other fluctuations in demand for systems that use storage devices 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);
- testing of goodwill and other long-lived assets for impairment;
- 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, 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;
- strategic actions by us or competitors, such as acquisitions and restructurings;

- periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures or industry consolidation;
- developments with respect to patents or proprietary rights;
- proposed or adopted regulatory changes or developments or anticipated or pending investigations, proceedings or litigation that involve or affect us or our competitors;

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- conditions and trends in the hard drive, solid state storage, 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;
- failure to meet analysts' revenue or earnings estimates or changes in financial estimates or publication of research reports and recommendations by financial analysts relating specifically to us or the storage industry in general; and
- macroeconomic conditions that affect the market generally and, in particular, developments related to market conditions for our industry.

In addition, the stock market is subject to fluctuations in the stock prices and trading volumes that affect the market prices of the stock of public companies, including us. These broad market fluctuations have adversely affected and may continue to adversely affect the market price of shares of our common stock. For example, expectations concerning general economic conditions may cause the stock market to experience extreme price and volume fluctuations from time to time that particularly affect the stock prices of many high technology companies. These fluctuations 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.

The resale of shares of common stock issued to Hitachi, Ltd. ("Hitachi") in connection with our acquisition of HGST could adversely affect the market price of our common stock.

On March 8, 2012, as partial consideration for our acquisition of HGST, we issued 25 million shares of our common stock to Hitachi. On each of November 6, 2013 and November 13, 2014, Hitachi completed a secondary offering of 12.5 million and 6.25 million, respectively, of these shares. Future sales of the remaining 6.25 million shares of our common stock held by Hitachi could adversely affect the market price of our common stock.

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

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

In addition, if we are unable to generate sufficient cash flows from operations to fund acquisitions, pay dividends, or repurchase shares of our common stock, we may choose or be required to increase our borrowings, if available, or to repatriate funds to the United States at a substantial tax cost.

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

Our most recent evaluation resulted in our conclusion that as of July 3, 2015, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal control over financial reporting was effective. If our internal control over financial reporting is found to be ineffective or if we identify a material weakness in our financial reporting in future periods, investors may lose confidence in the reliability of our financial statements, which may adversely affect our stock price.

Restrictive covenants in our credit agreement could restrict current and future operations or limit our flexibility to take certain actions.

Our credit agreement includes covenants relating to our financial performance and financial position. In addition, our credit agreement restricts our ability to take other actions with respect to our current and future operations, including our ability to

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incur certain additional indebtedness or consolidate, merge or sell assets. Our ability to meet these restrictive covenants may be affected by events that could be beyond our control, and a breach of these restrictive covenants could result in an event of default under the credit agreement, which, if not cured or waived, could result in the indebtedness becoming immediately due and payable and could result in material adverse consequences that negatively impact our business.

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

We are subject to income taxes in the 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 Notice of Proposed Adjustments seeking certain adjustments to income as disclosed in Part I, Item 1, Note 6 to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. Although we believe our tax positions are properly supported, the final timing and resolution of any tax examinations are subject to significant uncertainty and could result in our having to pay amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations or cash flows.

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

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

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Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities during the period covered by this report, other than as reported in our Current Report on Form 8-K filed with the SEC on September 30, 2015 about the Unis Investment.

Issuer Purchases of Equity Securities

The following table provides information about repurchases by us of shares of our common stock during the quarter ended October 2, 2015:

(in millions, except average price paid per share)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased As Part of Publicly Announced Program(1)	Maximum Value of Shares that May Yet be Purchased Under the Program(1)
Jul. 4, 2015—Jul. 31, 2015	0.2	$78.77	0.2	$ 2,184
Aug. 1, 2015—Aug. 28, 2015	0.5	$85.30	0.5	$ 2,164
Aug. 29, 2015—Oct. 2, 2015	—	$—	—	$ 2,124
Total	0.7		0.7	$ 2,124

(1) Our Board of Directors previously authorized $5.0 billion for the repurchase of our common stock and approved the extension of our stock repurchase program to February 3, 2020. Repurchases under our stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan. Effective October 21, 2015, in connection with our planned acquisition of SanDisk, the stock repurchase program has been suspended.

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Item 6. EXHIBITS

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

Exhibit Number	Description
2.1	Stock Purchase Agreement, dated as of September 29, 2015, by and among Unis Union Information System Ltd., Unisplendour Corporation Limited and Western Digital Corporation†
2.2	Agreement and Plan of Merger, dated as of October 21, 2015, among Western Digital Corporation, Schrader Acquisition Corporation and SanDisk Corporation (Filed as Exhibit 2.1 to the Company’s Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on October 26, 2015)±
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Filed as Exhibit 3.1 to the Company’s Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on February 8, 2006)
3.2	Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 14, 2013 (Filed as Exhibit 3.1 to the Company’s Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on November 14, 2013)
10.1	Western Digital Corporation Incentive Compensation Plan, as Amended and Restated August 5, 2015 (Filed as Exhibit 10.1.8 to the Company’s Annual Report on Form 10-K (File No. 1-08703) with the Securities and Exchange Commission on August 21, 2015)*
10.2	Form of Notice of Grant of Performance Stock Units and Performance Stock Unit Award Agreement for Mark Long, dated September 17, 2015, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan†*
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002††
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002††
101.INS	XBRL Instance Document†
101.SCH	XBRL Taxonomy Extension Schema Document†
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document†
101.LAB	XBRL Taxonomy Extension Label Linkbase Document†
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document†
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document†

† Filed with this report.

† † Furnished with this report.

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

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

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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/ OLIVIER C. LEONETTI
Olivier C. Leonetti
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

Date: November 9, 2015