WESTERN DIGITAL CORP
Form 10-Q
November 08, 2016

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 September 30, 2016
Or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 1-8703

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

Delaware	33-0956711
(State or other jurisdiction of incorporation or organization)	(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 o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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 September 30, 2016, 285,473,906 shares of common stock, par value $0.01 per share, were outstanding.

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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.

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

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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 the anticipated benefits of our acquisition of SanDisk Corporation;
- expectations regarding the integration of our HGST and WD subsidiaries following the decision by the Ministry of Commerce of the People’s Republic of China in October 2015;
- expectations regarding the growth of digital data and demand for digital storage;
- expectations regarding our business strategy, our ability to execute that strategy and its intended benefits;
- expectations with respect to relationships with our customers, employees, suppliers and strategic partners;
- our plans to develop and invest in new products and expand into new storage markets and into emerging economic markets;
- expectations regarding the personal computer market and the emergence of new storage markets for our products;
- expectations regarding the amount and timing of charges and cash expenditures associated with our restructuring activities;
- 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;
- expectations regarding capital investments and sources of funding for those investments;
- our beliefs regarding the sufficiency of our available liquidity to meet our working capital, debt, dividend and capital expenditure needs; and
- 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 II, Item 1A of this Quarterly Report on Form 10-Q, and any of those made in our other reports filed with the Securities and Exchange Commission. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. We do not intend, and undertake no obligation, to publish revised forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)

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

	September 30, 2016	July 1, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,077	$8,151
Short-term investments	248	227
Accounts receivable, net	2,023	1,461
Inventories	2,109	2,129
Other current assets	666	616
Total current assets	9,123	12,584
Property, plant and equipment, net	3,359	3,503
Notes receivable and investments in Flash Ventures	1,217	1,171
Goodwill	9,967	9,951
Other intangible assets, net	4,791	5,034
Other non-current assets	553	619
Total assets	$ 29,010	$32,862
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,946	$1,888
Accounts payable to related parties	190	168
Accrued expenses	983	995
Accrued compensation	552	392
Accrued warranty	170	172
Bridge loan	—	2,995
Current portion of long-term debt	78	339
Total current liabilities	3,919	6,949
Long-term debt	13,055	13,660
Other liabilities	1,261	1,108
Total liabilities	18,235	21,717
Commitments and contingencies (Notes 4, 5, 6 and 8)		
Stockholders' equity:		
Preferred stock, $0.01 par value; authorized — 5 shares; issued and outstanding — none	—	—
Common stock, $0.01 par value; authorized — 450 shares; issued — 312 shares; outstanding — 285 shares	3	3
Additional paid-in capital	4,492	4,429
Accumulated other comprehensive income	115	103
Retained earnings	8,329	8,848
Treasury stock — common shares at cost; 27 shares and 28 shares, respectively	(2,164)	(2,238)
Total stockholders' equity	10,775	11,145
Total liabilities and stockholders' equity	$ 29,010	$32,862

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

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WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share amounts)
(Unaudited)

	Three Months Ended	
	September 30, 2016	October 2, 2015
Revenue, net	$4,714	$ 3,360
Cost of revenue	3,379	2,405
Gross profit	1,335	955
Operating expenses:		
Research and development	639	385
Selling, general and administrative	396	192
Employee termination, asset impairment and other charges	68	56
Total operating expenses	1,103	633
Operating income	232	322
Interest and other income (expense):		
Interest income	5	5
Interest expense	(236)	(13)
Other income (expense), net	(272)	—
Total interest and other income (expense), net	(503)	(8)
Income (loss) before taxes	(271)	314
Income tax expense	95	31
Net income (loss)	$(366)	$ 283
Income (loss) per common share		
Basic	$(1.28)	$ 1.23
Diluted	$(1.28)	$ 1.21
Weighted average shares outstanding:		
Basic	285	231
Diluted	285	234
Cash dividends declared per share	$0.50	$ 0.50

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 (LOSS)
(in millions)
(Unaudited)

	Three Months Ended	
	September 30, 2016	October 2, 2015
Net income (loss)	$(366)	$ 283
Other comprehensive income (loss), before tax:		
Actuarial pension gain	5	—
Foreign currency translation adjustment	17	—
Net unrealized loss on foreign exchange contracts	(4)	(25)
Net unrealized gain on available-for-sale securities	—	1
Total other comprehensive income (loss), before tax	18	(24)
Income tax expense related to items of other comprehensive income (loss)	(6)	—
Other comprehensive income (loss), net of tax	12	(24)
Total comprehensive income (loss)	$(354)	$ 259

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

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WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(Unaudited)

	Three Months Ended	
	September 30, 2016	October 2, 2015
Cash flows from operating activities		
Net income (loss)	$(366)	$ 283
Adjustments to reconcile net income (loss) to net cash provided by operations:		
Depreciation and amortization	508	236
Stock-based compensation	99	42
Deferred income taxes	147	(7)
Loss on disposal of assets	4	—
Write-off of issuance costs and amortization of debt discounts	247	1
Loss on settlement of convertible debt	5	—
Non-cash portion of employee termination, asset impairment and other charges	—	18
Other non-cash operating activities, net	1	—
Changes in:		
Accounts receivable, net	(562)	(84)
Inventories	28	105
Accounts payable	99	(71)
Accounts payable to related parties	21	—
Accrued expenses	128	18
Accrued compensation	160	6
Other assets and liabilities, net	(79)	(2)
Net cash provided by operations	440	545
Cash flows from investing activities		
Purchases of property, plant and equipment	(184)	(151)
Proceeds from the sale of equipment	1	—
Purchases of investments	(84)	(236)
Proceeds from sale of investments	39	38
Proceeds from maturities of investments	54	86
Investments in Flash Ventures	(20)	—
Notes receivable issuances to Flash Ventures	(127)	—
Notes receivable proceeds from Flash Ventures	120	—
Strategic investments and other, net	(1)	(10)
Net cash used in investing activities	(202)	(273)
Cash flows from financing activities		
Issuance of stock under employee stock plans	24	15
Taxes paid on vested stock awards under employee stock plans	(26)	(43)
Excess tax benefits from employee stock plans	28	19
Proceeds from acquired call option	61	—
Repurchases of common stock	—	(60)
Dividends paid to shareholders	(142)	(115)
Repayment of debt	(8,242)	(31)
Proceeds from debt	3,992	—
Debt issuance costs	(7)	—

Net cash used in financing activities	(4,312)	(215)
Net increase (decrease) in cash and cash equivalents	(4,074)	57
Cash and cash equivalents, beginning of year	8,151	5,024
Cash and cash equivalents, end of period	$4,077	$ 5,081
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$18	$ 8
Cash paid for interest	$93	$ 11
Supplemental disclosure of non-cash investing and financing activities:		
Accrual of cash dividend declared	$143	$ 116

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)

Note 1. Basis of Presentation

Western Digital Corporation (the "Company" or "Western Digital") is a leading developer, manufacturer and provider of data storage devices and solutions that address the needs of the information technology industry and the infrastructure that enables the storage of data. The Company also generates license and royalty revenue related to its intellectual property.

The accounting policies followed by the Company are set forth in Part II, Item 8, Note 1 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended July 1, 2016.

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 fiscal year ended July 1, 2016. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

Fiscal Year

The Company's fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Fiscal year 2017, which ends on June 30, 2017, and fiscal year 2016, which ended on July 1, 2016, are both comprised of 52 weeks, with all quarters presented consisting of 13 weeks.

Reclassifications

Certain prior year amounts have been reclassified in the condensed consolidated statement of cash flows to conform to the current year presentation.

Use of Estimates

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

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

Note 2. Accounting Changes and Recent Accounting Pronouncements

Recently Adopted

In April 2015, the Financial Accounting Standard Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-05, "Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40)" ("ASU 2015-05"), which provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The Company's adoption of ASU 2015-05 at the beginning of the current year did not have a material impact on its condensed consolidated financial statements.

Recently Issued

In October 2016, the FASB issued ASU No. 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"). The new standard removes the prohibition in ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The ASU is intended to reduce the complexity of U.S. GAAP and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving intellectual property. The new standard is effective for fiscal years beginning after December 15, 2017, which for the Company is the first quarter of 2019. Early adoption is permitted. The Company is currently evaluating the impact ASU 2016-16 will have on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230)" ("ASU 2016-15"). The new standard addresses certain cash flows issues regarding the classification of certain cash receipts and cash payments, which among others, includes the Company's disclosure requirement related to debt prepayment or extinguishment costs and distributions received from equity method investees. The new standard is effective for fiscal years beginning after December 15, 2017, which for the Company is the first quarter of 2019. Early adoption is permitted. The Company expects to adopt this standard in the first quarter of 2019. The Company is currently evaluating the impact ASU 2016-15 will have on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). The new standard simplifies several aspects of the accounting for share-based payment transactions and states that, among other things, all excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit in the income statement and an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. The new standard is effective for fiscal years beginning after December 15, 2016, and interim periods within those years, which for the Company is the first quarter of 2018. Early adoption is permitted. The Company expects to adopt this standard in the first quarter of 2018. The Company is currently evaluating the impact ASU 2016-09 will have on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). The new standard, among other things, requires lessees to recognize a right-of-use asset and a lease liability for leases. The new standard is effective for fiscal years beginning after December 15, 2018, which for the Company is the first quarter of 2020. Early adoption is permitted. The Company expects to adopt this standard in the first quarter of 2020. The Company is currently evaluating the impact ASU 2016-02 will have on its consolidated financial statements and related disclosures.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments — Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"), which provides guidance related to accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. ASU 2016-01 is

effective for fiscal years beginning after December 15, 2017, which for the Company is the first quarter of 2019. Early adoption is not permitted. The Company is currently evaluating the impact ASU 2016-01 will have on its consolidated financial statements.

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

In May 2014, the FASB issued ASU No. 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. The Company does not expect the proposed standard to materially change the timing of revenue recognition for product revenue; however, the proposed standard may accelerate the timing of revenue recognition for the Company’s license and royalty contracts. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2015-14 by one year. The new standard allows for either a full retrospective or a modified retrospective transition method. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, which for the Company is the first quarter of 2018. The Company has not yet selected a transition method and currently expects to adopt this standard in the first quarter of 2019.

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

Note 3. Supplemental Financial Statement Data

Accounts receivables

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. During the three months ended September 30, 2016, the Company did not sell any trade accounts receivables. During the three months ended October 2, 2015, the Company sold trade accounts receivable and received cash proceeds of $200 million. The discounts on the trade accounts receivables sold during the three months ended October 2, 2015 were not material and were recorded within Other income (expense), net in the condensed consolidated statements of operations.

Inventories

	September 30, 2016	July 1, 2016
	(in millions)	
Inventories:		
Raw materials and component parts	$610	$569
Work-in-process	680	589
Finished goods	819	971
Total inventories	$2,109	$2,129

Property, Plant and Equipment

	September 30, 2016	July 1, 2016
	(in millions)	
Property, plant and equipment:		
Land and buildings	$1,920	$1,900
Machinery and equipment	7,155	7,070
Furniture and fixtures	50	110
Leasehold improvements	313	307
Construction-in-process	149	245
Property, plant and equipment, gross	$9,587	$9,632
Accumulated depreciation	(6,228)	(6,129)
Property, plant and equipment, net	$3,359	$3,503

Goodwill

	Carrying Amount (in millions)
Balance at July 1, 2016	$ 9,951
Purchase price adjustments to goodwill	15
Foreign currency translation adjustment	1
Balance at September 30, 2016	$ 9,967

The purchase price adjustments resulted from adjustments to the assessment of fair value for certain acquired inventory and property and equipment and a portion of the deferred tax liability related to the acquisition of SanDisk Corporation (“SanDisk”). See Note 14 to the condensed consolidated financial statements for additional disclosures related to these adjustments.

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

Intangible Assets

	September 30, 2016	July 1, 2016
	(in millions)	
Finite-lived intangible assets	$3,539	$3,539
In-process research and development	2,435	2,435
Accumulated amortization	(1,183)	(940)
Intangible assets, net	$4,791	$5,034

Product Warranty Liability

Changes in the warranty accrual were as follows:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
Warranty accrual, beginning of period	$279	$ 221
Charges to operations	47	45
Utilization	(45)	(54)
Changes in estimate related to pre-existing warranties	(4)	6
Warranty accrual, end of period	$277	$ 218

The long-term portion of the warranty accrual classified in other liabilities was $107 million at September 30, 2016 and July 1, 2016.

Accumulated Other Comprehensive Income (Loss)

Other comprehensive income (loss), net of tax refers to expenses, gains and losses that are recorded as an element of stockholders' equity but are excluded from net income. The following table illustrates the changes in the balances of each component of accumulated other comprehensive income (loss):

	Actuarial Pension Gains (Losses)	Foreign Currency Translation Gains (Losses)	Unrealized Gains (Losses) on Foreign Exchange Contracts	Total Accumulated Other Comprehensive Income (Loss)
	(in millions)			
Balance at July 1, 2016	$(45)	$ 74	$ 74	$ 103
Other comprehensive income before reclassifications	5	17	22	44
Amounts reclassified from accumulated other comprehensive income	—	—	(26)	(26)
Income tax expense related to items of other comprehensive income	(1)	(5)	—	(6)
Net current-period other comprehensive income (loss)	4	12	(4)	12
Balance at September 30, 2016	$(41)	$ 86	$ 70	$ 115

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

The following table illustrates the significant amounts reclassified out of each component of accumulated comprehensive income (loss) ("AOCI"):

AOCI Component	Three Months Ended		Statement of Operations Line Item
	September 30, 2016	October 2, 2015	
	(in millions)		
Unrealized holding gain (loss) on cash flow hedging activities:			
Foreign exchange contracts	$ 24	$ (28)	Cost of revenue
Foreign exchange contracts	2	—	Research and development
Unrealized holding gain (loss) on cash flow hedging activities	$ 26	$ (28)	

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

Note 4. Debt

Debt consisted of the following as of September 30, 2016 and July 1, 2016:

	September 30, 2016	July 1, 2016
	(in millions)	
Variable interest rate Term Loan A maturing 2021	$4,125	$4,125
Variable interest rate U.S. Term Loan B maturing 2023	—	3,750
Variable interest rate U.S. Term Loan B-1 maturing 2023	2,993	—
Variable interest rate Euro Term Loan B maturing 2023[1]	—	987
Variable interest rate Euro Term Loan B-1 maturing 2023[1]	990	—
7.375% senior secured notes due 2023	1,875	1,875
10.500% senior unsecured notes due 2024	3,350	3,350
Convertible senior notes	37	439
Bridge loans	—	3,000
Total debt	13,370	17,526
Issuance costs and debt discounts	(237)	(532)
Subtotal	13,133	16,994
Less bridge loans and current portion of long-term debt	(78)	(3,334)
Long-term debt	$13,055	$13,660

(1) Euro Term Loan B and Euro Term Loan B-1 outstanding principal amounts as of September 30, 2016 and July 1, 2016 were based upon the Euro to U.S. dollar exchange rate as of those respective dates.

Term Loans

In the first quarter ended September 30, 2016, the Company settled in full the principal amounts of the $3.75 billion U.S. Term Loan B and the €885 million Euro Term Loan B, plus accrued interest. In connection with the settlement of the U.S. Term Loan B and Euro Term Loan B, the Company recognized a loss on debt extinguishment of $227 million consisting of unamortized issuance costs and debt discount fees.

On August 17, 2016, the Company borrowed $3.0 billion under a new U.S. dollar-denominated term loan ("U.S. Term Loan B-1") under the Credit Agreement (as defined below) and used the proceeds of this new loan and cash of $750 million to prepay in full the U.S. Term Loan B previously outstanding under the Credit Agreement. The U.S. Term Loan B-1 has an interest rate equal to, at the Company's option, either an adjusted LIBOR rate, subject to a 0.75% floor, plus 3.75% or a base rate plus 2.75% (4.50% at September 30, 2016). Principal payments on U.S. Term Loan B-1 of 0.25% are due quarterly and began on September 30, 2016 with the balance due on April 29, 2023. The U.S. Term Loan B-1 issuance costs of $5 million are amortized to interest expense over the term of the loan. As of September 30, 2016, issuance costs of $5 million remain unamortized.

On September 22, 2016, the Company borrowed €885 million under a new Euro-denominated term loan ("Euro Term Loan B-1") under the Credit Agreement and used the proceeds of this new loan to prepay in full the Euro Term Loan B previously outstanding under the Credit Agreement. The Euro Term Loan B-1 has an interest rate equal to an adjusted EURIBOR rate, subject to a 0.75% floor, plus 3.25% (4.00% at September 30, 2016). Principal payments on Euro Term Loan B-1 of 0.25% are due quarterly and began on September 30, 2016 with the balance due on April 29, 2023. The Euro Term Loan B-1 issuance costs of $2 million are amortized to interest expense over the term of the loan. As of September 30, 2016, issuance costs of $2 million remain unamortized.

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

Credit Agreement

On April 29, 2016, the Company entered into a new credit agreement (the "Credit Agreement") that provided for a $4.125 billion Term Loan A, a $3.750 billion U.S. Term Loan B, a €885 million Euro Term Loan B and a $1.0 billion revolving credit facility. As described above, during the first quarter ended September 30, 2016, the U.S. Term Loan B and Euro Term Loan B were settled and replaced with the $3.0 billion U.S. Term Loan B-1 and the €885 million Euro Term Loan B-1, respectively.

The revolving credit facility includes a $200 million sublimit for letters of credit. As of September 30, 2016, the revolving credit facility was not drawn upon, and there was no outstanding balance. Beginning in September 2017, we are required to make quarterly principal payments on Term Loan A totaling $206 million in 2018, $309 million in 2019, $413 million in 2020 and the remaining balance of $3.197 billion due in 2021. As of September 30, 2016, Term Loan A had an outstanding balance of $4.125 billion with a variable interest rate of 2.526%.

The obligations under the Credit Agreement are guaranteed by HGST, Inc., WD Media, LLC, Western Digital (Fremont), LLC and Western Digital Technologies, Inc. ("WDT") (together referred to as the "WD Guarantors"), and are secured on a first-priority basis by a lien on substantially all the assets and properties of the Company and the WD Guarantors, including all of the capital stock held by these entities (subject to a 65% limitation on pledges of capital stock of foreign subsidiaries and domestic holding companies of foreign subsidiaries), subject to certain exceptions.

The term loans and the revolving credit loans under the Credit Agreement may be prepaid in whole or in part at any time without premium or penalty, subject to certain conditions, except that the U.S. Term Loan B-1 and the Euro Term Loan B-1 require us to pay a 1.0% prepayment fee if the loans thereunder are repaid in connection with certain "repricing" transactions on or before February 17, 2017, with respect to U.S. Term Loan B-1, and March 22, 2017, with respect to Euro Term Loan B-1.

Covenants

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

Additional Bridge Facility

On May 12, 2016, WDT entered into a short-term senior secured bridge credit agreement providing for $3.0 billion in aggregate principal amount of senior secured bridge loans. On July 21, 2016, the Company repaid in full the $3.0 billion aggregate principal amount outstanding, together with accrued interest.

Senior Notes

On April 13, 2016, the Company completed an offering of its $1.875 billion aggregate principal amount of 7.375% senior secured notes due 2023 (the "Secured Notes") and $3.350 billion aggregate principal amount of 10.500% senior unsecured notes due 2024 (the "Unsecured Notes" and, together with the Secured Notes, the "Notes"). The Company is not required to make principal payments on the Notes prior to their respective maturity dates, except that the Company may be required to offer to purchase the Notes upon the occurrence of a change of control (as defined in the indentures governing the Notes) or with the proceeds of certain non-ordinary course asset sales. Interest payments on the Notes are due semi-annually in arrears.

The Notes are guaranteed by the WD Guarantors, and the Secured Notes and related guarantees are secured on an equal and ratable basis by liens on the same assets that secure indebtedness under the Credit Agreement.

Convertible Notes, Exchange Options and Call Options

As of July 1, 2016, the Company had outstanding, through the acquisition of SanDisk, $129 million aggregate principal amount of its 1.5% Convertible Senior Notes due 2017 (the "2017 Notes") and $310 million aggregate principal amount of its 0.5% Convertible Senior Notes due 2020 (the "2020 Notes" and, together with the 2017 Notes, the "Convertible Notes"). The 2017 Notes mature on August 15, 2017 and the 2020 Notes mature on November 15,

2020.

During the three months ended September 30, 2016, the Company paid to the holders of the Convertible Notes for conversion and repurchase, $490 million of cash and 0.3 million shares of the Company's common stock with an aggregate value of $16 million.

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As of September 30, 2016, $37 million principal amount of the 2020 Notes and less than $1 million principal amount of the 2017 Notes were outstanding. For the 2020 Notes that remain outstanding, the conversion rate is 10.9006 units of reference property per $1,000 principal amount of the 2020 Notes, corresponding to 2.6020 shares of the Company's common stock and $735.79 of cash, subject to adjustments under the indenture. The 2020 Notes are not currently exchangeable into reference property.

The Convertible Notes were bifurcated into a debt host and exchange option for accounting purposes. The exchange options are accounted for as a derivative liability because they are predominantly settled in cash. Changes in the fair value of the exchange options are reported in Other income (expense), net in the condensed consolidated statements of operations until the Company extinguishes the related debt. The exchange options are measured and reported at fair value on a recurring basis, within Level 3 of the fair value hierarchy. The fair value of the unredeemed and unsettled exchange options was reported in accrued expenses and other liabilities in the condensed consolidated balance sheets. See Note 10 to the condensed consolidated financial statements for additional disclosures related to the fair values of the exchange options. For the three months ended September 30, 2016, the change in the fair value of the outstanding exchange options related to the Convertible Notes resulted in an immaterial gain.

In connection with the SanDisk acquisition, the Company assumed the outstanding call options entered into by SanDisk at the inception of the respective Convertible Notes, which were structured to reduce the potential economic dilution associated with the conversion of Convertible Notes. The call options are derivative instruments classified as an asset that result in the Company receiving cash and shares that partially offset the Company's obligation upon conversion of the Convertible Notes. The fair value of the unredeemed and unsettled call options was reported in other current assets and other non-current assets in the condensed consolidated balance sheets. During the three months ended September 30, 2016, under the call options, the Company received $61 million of cash and 0.1 million shares of the Company's common stock which had an aggregate value of $11 million. During the three months ended September 30, 2016, the Company recognized an immaterial non-cash loss related to the change in value in the outstanding call options. The value of the call options at September 30, 2016 was immaterial.

The exchange and repurchase of the Convertible Notes and related settlement of the call options during the three months ended September 30, 2016 resulted in a net loss of $5 million.

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Note 5. Commitments, Contingencies and Related Parties

Flash Ventures

The Company's business ventures with Toshiba Corporation ("Toshiba") consist of three separate legal entities: Flash Partners Ltd. ("Flash Partners"), Flash Alliance Ltd. ("Flash Alliance") and Flash Forward Ltd ("Flash Forward" and together with Flash Partners and Flash Alliance, "Flash Ventures"). The Company has a 49.9% ownership interest and Toshiba has a 50.1% ownership interest in each of these entities. Through these ventures, the Company and Toshiba collaborate in the development and manufacture of NAND flash memory products, which are manufactured by Toshiba at its wafer fabrication facilities located in Yokkaichi, Japan, using semiconductor manufacturing equipment individually owned or leased by each Flash Ventures entity. The entities within Flash Ventures purchase wafers from Toshiba at cost and then resell those wafers to the Company and Toshiba at cost plus a markup.

The Company accounts for its ownership position of each entity with Flash Ventures under the equity method of accounting. The financial and other support provided by the Company in all periods presented was either contractually required or the result of a joint decision to expand wafer capacity, transition to new technologies or refinance existing equipment lease commitments. Entities within Flash Ventures are variable interest entities ("VIEs"). The Company evaluated whether it is the primary beneficiary of any of the entities within Flash Ventures for all periods presented and determined that it is not the primary beneficiary of any of the entities within Flash Ventures because it does not have a controlling financial interest in any of those entities. In determining whether the Company is the primary beneficiary, the Company analyzed the primary purpose and design of Flash Ventures, the activities that most significantly impact Flash Ventures' economic performance, and whether the Company had the power to direct those activities. The Company concluded, based upon its 49.9% ownership, the voting structure and the manner in which the day-to-day operations are conducted for each entity within Flash Ventures, that the Company lacked the power to direct most of the activities that most significantly impact the economic performance of each entity within Flash Ventures.

During the three months ended September 30, 2016, the Company purchased NAND flash memory wafers from Flash Ventures and made loans to, and investments in, Flash Ventures totaling $127 million and $20 million, respectively, and received loan repayments from Flash Ventures of $120 million. At September 30, 2016 and July 1, 2016, the Company had accounts payable balances due to Flash Ventures of $190 million and $168 million, respectively.

The Company's maximum reasonably estimable loss exposure (excluding lost profits) as a result of its involvement with Flash Ventures, based upon the Japanese yen to U.S. dollar exchange rate at September 30, 2016, is presented below. Flash Ventures' investments are denominated in Japanese yen and the maximum possible loss exposure excludes any cumulative translation adjustment due to revaluation from the Japanese yen to the U.S. dollar.

	September 30, 2016	July 1, 2016
	(in millions)	
Notes receivable	$580	$563
Equity investments	637	608
Operating lease guarantees	1,235	1,151
Prepayments	30	34
Maximum estimable loss exposure	$2,482	$2,356

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

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The following table presents, as of September 30, 2016, the notes receivable from and equity investments in Flash Ventures:

	September 30, 2016	July 1, 2016
	(in millions)	
Notes receivable, Flash Partners	$63	$65
Notes receivable, Flash Alliance	196	235
Notes receivable, Flash Forward	321	263
Investment in Flash Partners	205	202
Investment in Flash Alliance	310	306
Investment in Flash Forward	122	100
Total notes receivable and investments in Flash Ventures	$1,217	$1,171

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

The Company assesses financing receivable credit quality through financial and operational reviews of the borrower and creditworthiness, including credit rating agency ratings, of significant investors of the borrower, where material or known. Impairments, when required for credit worthiness, are recorded in Other income (expense), net in the condensed consolidated statements of operations.

Off-Balance Sheet Liabilities

Flash Ventures sells and leases back from a consortium of financial institutions a portion of its tools and has entered into equipment lease agreements of which the Company guarantees half of the total outstanding obligations. The lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the lease agreements contain acceleration clauses for certain events of default related to the guarantors, including the Company. The following table presents the Company's portion of the remaining guarantee obligations under the Flash Ventures' lease facilities in both Japanese yen and U.S. dollar-equivalent based upon the Japanese yen to U.S. dollar exchange rate at September 30, 2016.

	Lease Amounts (Japanese yen, in billions)	(U.S. dollar, in millions)
Total guarantee obligations	¥125	$ 1,235

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The following table details the breakdown of the Company's remaining guarantee obligations between the principal amortization and the purchase option exercise price at the end of the term of the lease agreements, in annual installments as of September 30, 2016 in U.S. dollars based upon the Japanese yen to U.S. dollar exchange rate at September 30, 2016:

Annual Installments	Payment of Principal Amortization	Purchase Option Exercise Price at Final Lease Terms	Guarantee Amount
	(in millions)		
Year 1	$298	$ 71	$ 369
Year 2	247	11	258
Year 3	203	59	262
Year 4	125	73	198
Year 5	39	109	148
Total guarantee obligations	$912	$ 323	$ 1,235

The Company and Toshiba have agreed to mutually contribute to, and indemnify each other and Flash Ventures for, environmental remediation costs or liability resulting from Flash Ventures' manufacturing operations in certain circumstances. The Company has not made any indemnification payments, nor recorded any indemnification receivables, under any such agreements. As of September 30, 2016, no amounts have been accrued in the consolidated financial statements with respect to these indemnification guarantees.

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Note 6. Legal Proceedings

Unless otherwise stated below, for each of the matters described below, the Company has either recorded an accrual for losses that are probable and reasonably estimable or has determined that, while a loss is reasonably possible (including potential losses in excess of the amounts accrued by the Company), a reasonable estimate of the amount of loss or range of possible losses with respect to the claim or in excess of amounts already accrued by the Company cannot be made. The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates. Solely for purposes of this note, "WD" refers to Western Digital Corporation or one or more of its subsidiaries excluding HGST prior to the closing of the Company's acquisition of HGST on March 8, 2012 (the "HGST Closing Date") and SanDisk prior to May 12, 2016 (the "SanDisk Closing Date"). HGST refers to Hitachi Global Storage Technologies Holdings Pte. Ltd. or one or more of its subsidiaries as of the HGST Closing Date, and SanDisk refers to SanDisk Corporation or one or more of its subsidiaries as of the SanDisk Closing Date and "the Company" refers to Western Digital Corporation and all of its subsidiaries on a consolidated basis including HGST and SanDisk.

Intellectual Property Litigation

In June 2008, Convolve, Inc. ("Convolve") filed a complaint 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.

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

Antitrust

On June 25, 2010, Ritz Camera & Image, LLC ("Ritz") filed a complaint captioned Ritz Camera & Image, LLC v. SanDisk Corporation, Inc. and Eliyahou Harari in the U.S. District Court for the Northern District of California, alleging that SanDisk violated federal antitrust laws by conspiring to monopolize and monopolizing the market for flash memory products. The lawsuit purports to be on behalf of direct purchasers of flash memory products sold by SanDisk and SanDisk-controlled joint ventures from June 25, 2006 through the present. The complaint alleged that SanDisk created and maintained a monopoly by fraudulently obtaining patents and using them to restrain competition and by allegedly converting other patents for its competitive use. The complaint sought damages, injunctive relief, and fees and costs. On February 24, 2011, the District Court granted in part SanDisk's motion to dismiss, which resulted in Dr. Harari being dismissed as a defendant. Between 2013 and 2014, the District Court granted Ritz's motion to substitute in as named plaintiff Albert Giuliano, the Chapter 7 Trustee of the Ritz bankruptcy estate, and the Trustee's motions to add as named plaintiffs CPM Electronics Inc., E.S.E. Electronics, Inc. and Mflash, Inc. On May 14, 2015, the District Court granted in part plaintiffs' motion for class certification. On April 29, 2016, the court granted SanDisk's motion for summary judgment and entered judgment in SanDisk's favor as to all of the plaintiffs' claims. On May 31, 2016, the plaintiffs filed a notice of appeal to the U.S. Court of Appeals for the Federal Circuit. The appeal is currently pending.

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On July 15, 2010, Samsung Electronics Co., Ltd. (“Samsung”) filed an action against Panasonic and SD-3C LLC (“SD-3C”) in the U.S. District Court for the Northern District of California, alleging that defendants violated federal antitrust laws and California antitrust and unfair competition laws relating to the licensing practices and operations of SD-3C. The complaint seeks damages, restitution, injunctive and declaratory relief, and fees and costs. SanDisk is not a defendant in this case, but it established SD-3C along with Panasonic and Toshiba, and the complaint includes various factual allegations concerning SanDisk. As a member of SD-3C, SanDisk could be responsible for a portion of any monetary award. Other requested relief, if granted, could result in a loss of revenue to SanDisk. On August 25, 2011, the District Court granted the defendants’ motion to dismiss, dismissing Samsung’s patent misuse claim with prejudice and all other claims with leave to amend. Samsung filed an amended complaint on September 16, 2011. On January 3, 2012, the District Court granted the defendants’ motion to dismiss Samsung’s amended complaint without leave to amend. Samsung appealed. On April 4, 2014, the U.S. Court of Appeals for the Ninth Circuit reversed the District Court’s dismissal and remanded the case to the District Court for further proceedings. Samsung filed a third amended complaint on January 20, 2015. On September 30, 2015, the District Court granted in part the defendants’ motion to dismiss with leave to amend. On October 21, 2015, Samsung filed a fourth amended complaint. On November 4, 2015, the defendants filed a motion to dismiss. On September 26, 2016, the District Court stayed the litigation pending the outcome of an ongoing arbitration between Samsung and Toshiba. The District Court denied the motion to dismiss without prejudice to refiling after the stay is lifted.

On March 15, 2011, a complaint was filed against SanDisk, SD-3C, Panasonic Corporation, Panasonic Corporation of North America, Toshiba and Toshiba America Electronic Components, Inc. in the U.S. District Court for the Northern District of California. The lawsuit purports to be on behalf of a nationwide class of indirect purchasers of Secure Digital (“SD”) cards. The complaint asserts claims under federal antitrust laws and California antitrust and unfair competition laws, as well as common law claims. The complaint seeks damages, restitution, injunctive relief, and fees and costs. The plaintiffs allege that the defendants conspired to artificially inflate the royalty costs associated with manufacturing SD™ cards, which in turn allegedly caused the plaintiffs to pay higher prices for SD cards. The allegations are similar to and incorporate allegations in Samsung Electronics Co., Ltd. v. Panasonic Corp., et al., described above. On May 21, 2012, the District Court granted the defendants’ motion to dismiss the complaint with prejudice. The plaintiffs appealed. On May 14, 2014, the U.S. Court of Appeals for the Ninth Circuit reversed the District Court’s dismissal and remanded the case to the District Court for further proceedings. On February 3, 2015, the plaintiffs filed a second amended complaint in the District Court. On September 30, 2015, the District Court granted the defendants’ motion to dismiss with leave to amend. On November 4, 2015, the plaintiffs filed a third amended complaint. On November 25, 2015, the defendants filed a motion to dismiss the plaintiffs’ federal law claims. On October 3, 2016, the District Court granted the defendants’ motion with leave to amend. On October 21, 2016, the defendants filed a motion to dismiss the plaintiffs’ remaining claims. Discovery is presently stayed until after completion of the pleading stage. The Company intends to defend itself vigorously in this matter.

Securities

Beginning on March 30, 2015, SanDisk and two officers, Sanjay Mehrotra and Judy Bruner, were named in three putative class action lawsuits filed in the United States District Court for the Northern District of California. Two complaints are allegedly brought on behalf of a class of purchasers of SanDisk’s securities between October 16, 2014 and March 25, 2015, and one is brought on behalf of a purported class of purchasers of SanDisk’s securities between April 16, 2014 and April 15, 2015. The complaints generally allege violations of federal securities laws arising out of alleged misstatements or omissions by the defendants during the alleged class periods. The complaints seek, among other things, damages and fees and costs. On July 9, 2015, the Court consolidated the cases and appointed Union Asset Management Holding AG and KBC Asset Management NV as lead plaintiffs. The lead plaintiffs filed an amended complaint in August 2015. On January 22, 2016, the court granted the defendants’ motion to dismiss and dismissed the amended complaint with leave to amend. On February 22, 2016, the court issued an order appointing as new lead plaintiffs Bristol Pension Fund; City of Milford, Connecticut Pension & Retirement Board; Pavers and Road

Builders Pension, Annuity and Welfare Funds; the Newport News Employees' Retirement Fund; and Massachusetts Laborers' Pension Fund (collectively, the "Institutional Investor Group"). On March 23, 2016, the Institutional Investor Group filed an amended complaint. The defendants filed a motion to dismiss on April 29, 2016. On June 24, 2016, the court granted the motion and dismissed the amended complaint with leave to amend. On July 15, 2016, the Institutional Investor Group filed a further amended complaint. The Company filed a motion to dismiss on August 19, 2016. The Company intends to defend itself vigorously in this matter.

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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 WD's German subsidiary ("WD Germany") before the Copyright Arbitration Board ("CAB") claiming copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce in Germany by WD Germany from January 2008 through December 2010. In February 2013, WD Germany filed a declaratory relief action against ZPÜ in the Higher Regional Court of Munich (the "Higher Court"), seeking an order from the 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 products which it sold in Germany between January 2008 and December 2010. The judgment specifies levy amounts on certain products sold from January 2008 through December 2010 and directs WD Germany to provide applicable sales data to 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. The Company intends to defend itself vigorously in this matter.

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

The Company has recorded an accrual for German copyright levies in an amount that is not material to the Company's financial position, results of operations or cash flows. It is reasonably possible that the Company may incur losses totaling up to $133 million, including the amounts accrued.

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.

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Note 7. Shareholders' Equity

Stock-based Compensation Expense

The following tables present the Company's stock-based compensation for equity-settled awards and related tax benefit by type and financial statement line included in the Company's condensed consolidated statements of operations:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
Options	$ 12	$ 14
Employee Stock Purchase Plan	8	5
Restricted Stock Units[1]	79	23
Subtotal	99	42
Tax benefit	(25)	(10)
Total	$ 74	$ 32

[1] Restricted stock units ("RSUs") include performance stock units ("PSUs")

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
Cost of Revenue	$ 13	$ 5
Research and Development	44	15
Selling, General and Administrative	42	22
Subtotal	99	42
Tax benefit	(25)	(10)
Total	$ 74	$ 32

As of September 30, 2016, total compensation cost related to unvested stock options was $97 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.9 years. As of September 30, 2016, total compensation cost related to the Company's Employee Stock Purchase Plan ("ESPP") rights issued to employees but not yet recognized was $46 million and will be amortized on a straight-line basis over a weighted average service period of approximately 1.7 years.

As of September 30, 2016, the aggregate unamortized fair value of all unvested RSUs and PSUs was $685 million, which will be recognized on a straight-line basis over a weighted average vesting period of approximately 2.8 years, assuming the performance metrics are met for the PSUs.

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

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
	(in millions)		(in years)	(in millions)
Options outstanding at July 1, 2016	9.0	$ 55.74	3.9	$ 60
Granted	2.8			
Exercised	(0.8)			
Canceled or expired	(0.3)			
Options outstanding at September 30, 2016	10.7	54.30	4.6	140
Exercisable at September 30, 2016	5.0	51.79	3.0	79
Vested and expected to vest after September 30, 2016	10.3	54.38	4.5	136

As of September 30, 2016, the Company had options outstanding to purchase an aggregate of 7.3 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 $140 million at that date.

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

	Number of Shares	Weighted Average Grant Date Fair Value
	(in millions)	
RSUs and PSUs outstanding at July 1, 2016	15.7	$ 41.92
Granted	5.1	44.98
Vested	(1.6)	72.36
Forfeited	(0.5)	46.47
RSUs and PSUs outstanding at September 30, 2016	18.7	42.64
Expected to vest after September 30, 2016	17.4	42.64

RSUs and PSUs are generally settled in an equal number of shares of the Company's common stock at the time of vesting of the units. The aggregate value of RSUs and PSUs that became fully-vested during the three months ended September 30, 2016 was $76 million, determined as of the vest date.

SARs Activity

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
SAR expense (benefit)	$ 5	$ (1)
Tax expense (benefit)	(1)	—
Total SAR expense (benefit)	$ 4	$ (1)

As of September 30, 2016, all outstanding stock appreciation rights ("SARs") issued to employees were fully vested, and the fair values are solely subject to market price fluctuations. As of September 30, 2016, 0.5 million SARs were outstanding with a weighted average exercise price of $6.17.

The Company's SARs will be settled in cash upon exercise. The Company had a total liability of $24 million and $20 million related to SARs included in accrued expenses in the Company's condensed consolidated balance sheet as of September 30, 2016 and July 1, 2016, respectively.

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Stock Repurchase Program

The Company's Board of Directors (the "Board") has authorized $5.0 billion for the repurchase of the Company's common stock. The stock repurchase program is effective until February 3, 2020. The Company did not repurchase any shares during the three months ended September 30, 2016. The remaining amount available to be purchased under the Company's stock repurchase program as of September 30, 2016 was $2.1 billion.

Dividends to Shareholders

On September 13, 2012, the Company announced that the Board had authorized the adoption of a quarterly cash dividend policy. Under the cash dividend policy, holders of the Company's common stock receive dividends when and as declared by the Board. The Company paid $142 million in cash of dividends on July 15, 2016 relating to dividends declared on May 3, 2016.

On August 3, 2016, the Company's Board of Directors declared a cash dividend for the quarter ended September 30, 2016 of $0.50 per share of the Company's common stock, $0.01 par value per share. The cash dividend of $143 million was paid on October 17, 2016 to the Company's stockholders of record as of September 30, 2016.

On November 3, 2016, the Company's Board of Directors declared a cash dividend for the quarter ended December 30, 2016 of $0.50 per share of the Company's common stock, $0.01 par value per share. The cash dividend will be paid on January 17, 2017 to shareholders of record as of December 30, 2016.

The Company may modify, suspend or cancel its cash dividend policy in any manner and at any time.

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Note 8. Income Tax Expense

The following table presents the income tax expense and the effective tax rate:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
Income tax expense	$95	$ 31
Effective tax rate	(35)%	10 %

Income tax expense of $95 million for the three months ended September 30, 2016 is attributable to discrete effects consisting of income tax expense from the integration of SanDisk of $90 million and a valuation allowance on acquired tax attributes of $109 million, partially offset by income tax benefit from deductible debt issuance costs, debt discounts and prepayment fees from the debt refinancing of $96 million and from decreases in the Company's liability for unrecognized tax benefits due to lapses in the statute of limitations of $8 million. These discrete items are the primary drivers of the negative effective tax rate for the three months ended September 30, 2016.

The primary drivers for the difference between the effective tax rate for the three months ended September 30, 2016 and the U.S. Federal statutory rate of 35% are the discrete items described above, the current year generation of tax credits and tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2029. For the three months ended October 2, 2015, the difference between the effective tax rate and the U.S. Federal statutory rate of 35% is primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2029.

In the three months ended September 30, 2016, the Company recorded a net decrease of $6 million in its liability for unrecognized tax benefits. As of September 30, 2016, the Company's liability for unrecognized tax benefits was approximately $485 million. Accrued interest and penalties related to unrecognized tax benefits as of September 30, 2016 was $78 million.

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

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax examinations cannot be predicted with certainty. If any issues addressed in the Company's tax examinations are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of September 30, 2016, 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.

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Note 9. Net Income (Loss) Per Common Share
The following table presents the computation of basic and diluted income (loss) per common share:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions, except per share data)	
Net income (loss)	$(366)	$ 283
Weighted average shares outstanding:		
Basic	285	231
Employee stock options, RSUs, PSUs, ESPP	—	3
Diluted	285	234
Income (loss) per common share		
Basic	$(1.28)	$ 1.23
Diluted	$(1.28)	$ 1.21
Anti-dilutive potential common shares excluded[(1)]	5	4

(1) 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.

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 ESPP, awards of RSUs and exchange options related to the Company's Convertible Notes.

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Note 10. Fair Value Measurements

Financial Instruments Carried at Fair Value

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

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

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

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

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 September 30, 2016 and July 1, 2016, and indicate the fair value hierarchy of the valuation techniques utilized to determine such values:

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Assets:				
Cash equivalents:				
Money market funds	$1,355	$ —	$ —	$1,355
Certificates of deposit	—	6	—	6
Total cash equivalents	1,355	6	—	1,361
Short-term investments:				
Certificates of deposit	—	222	—	222
Corporate notes and bonds	—	12	—	12
Asset-backed securities	—	7	—	7
Municipal notes and bonds	—	7	—	7
Total short-term investments	—	248	—	248
Long-term investments:				
U.S. Government agency securities	—	4	—	4
International government securities	—	1	—	1
Corporate notes and bonds	—	64	—	64
Asset-backed securities	—	12	—	12
Municipal notes and bonds	—	6	—	6
Total long-term investments	—	87	—	87
Foreign exchange contracts	—	76	—	76
Total assets at fair value	$1,355	$ 417	$ —	$1,772
Liabilities:				
Foreign exchange contracts	$—	$ 22	$ —	$22
Exchange option	—	—	1	1
Total liabilities at fair value	$—	$ 22	$ 1	$23

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	July 1, 2016			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Assets:				
Cash equivalents:				
Money market funds	$2,199	$ —	$ —	$2,199
Certificates of deposit	—	1	—	1
Total cash equivalents	2,199	1	—	2,200
Short-term investments:				
Certificates of deposit	—	202	—	202
Corporate notes and bonds	—	8	—	8
Asset-backed securities	—	11	—	11
Municipal notes and bonds	—	6	—	6
Total short-term investments	—	227	—	227
Long-term investments:				
U.S. Treasury securities	2	—	—	2
U.S. Government agency securities	—	10	—	10
International government securities	—	1	—	1
Corporate notes and bonds	—	89	—	89
Asset-backed securities	—	11	—	11
Municipal notes and bonds	—	6	—	6
Total long-term investments	2	117	—	119
Foreign exchange contracts	—	126	—	126
Call options	—	—	71	71
Total assets at fair value	$2,201	$ 471	$ 71	$2,743
Liabilities:				
Foreign exchange contracts	$—	$ 23	$ —	$23
Exchange option	—	—	155	155
Total liabilities at fair value	$—	$ 23	$ 155	$178

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.

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. and International Government Agency Securities. The Company’s U.S. and International Government agency securities are investments in fixed income securities sponsored by the U.S. and International Government and are held in custody by a third party. U.S. and International Government agency securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

Asset-Backed Securities, and Corporate and Municipal Notes and Bonds. The Company’s asset-backed securities, and Corporate and Municipal notes and bonds securities are investments issued by corporations and U.S. state municipalities which are held in custody by a third party. Asset-backed securities, and Corporate and Municipal notes and bonds 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.

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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 condensed consolidated balance sheets. Foreign exchange contracts are valued using an income approach that is based on a present value of future cash flows model. The market-based observable inputs for the model include forward rates and credit default swap rates. For more information on the Company's foreign exchange contracts, see Note 12 to the condensed consolidated financial statements.

During the three months ended September 30, 2016 and October 2, 2015, the Company had no transfers of financial assets and liabilities between Level 1 and Level 2.

Assets and Liabilities Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

The fair value measurement of the call options and exchange options arising from the assumed Convertible Notes which are not actively traded, is determined using unobservable inputs (Level 3). These inputs include (i) the estimated amount and timing of settlement of the underlying debt; (ii) the probability of the achievement of the factor(s) on which the settlement is based; (iii) the risk-adjusted discount rate based on the expected term to maturity of the debt; and (iv) economic incentive for holders to exercise their exchange options. Significant increases or decreases in any of those inputs in isolation could result in a significantly lower or higher fair value measurement.

There were no transfers of call options or exchange options out of Level 3 for three months ended September 30, 2016.

The following is a reconciliation of the call options reported in other current assets and other non-current assets in the Company's condensed consolidated balance sheets as of September 30, 2016.

	2017 Call Options	2020 Call Options	Total
	(in millions)		
Fair value at July 1, 2016	$70	$ 1	$71
Net realized gain	—	(1)	(1)
Redemptions	(70)	—	(70)
Fair value at September 30, 2016	$—	$ —	$—

The following is a reconciliation of the exchange options reported in accrued expenses and other liabilities in the Company's condensed consolidated balance sheets as of September 30, 2016.

	2017 Exchange Options	2020 Exchange Options	Total
	(in millions)		
Fair value at July 1, 2016	$87	$ 68	$155
Net realized gain	(3)	(31)	(34)
Redemptions	(83)	(46)	(129)
Net unrealized loss	—	9	9
Fair value at September 30, 2016	$1	$ —	$1

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Financial Instruments Not Carried at Fair Value

For those financial instruments where the carrying amounts differ from fair value, the following table represents the related carrying values and fair values, which are based on quoted market prices. Each of the debt instruments presented below was categorized as Level 2 for all periods presented, based on the frequency of trading immediately prior to the end of the first quarter of 2017 and the fourth quarter of 2016, respectively.

	September 30, 2016		July 1, 2016	
	Aggregated Principal	Aggregated Fair Value	Aggregated Principal	Aggregated Fair Value
	(in millions)			
Secured Notes	$1,875	$ 2,044	$1,875	$ 2,044
Unsecured Notes	3,350	3,891	3,350	3,575
Term Loan A	4,125	4,084	4,125	4,161
U.S. Term Loan B	—	—	3,750	3,773
U.S. Term Loan B-1	2,993	3,029	—	—
Euro Term Loan B	—	—	987	981
Euro Term Loan B-1	990	1,006	—	—
Bridge Loan	—	—	3,000	3,000
Total	$13,333	$ 14,054	$17,087	$ 17,534

Cost Method Investments

From time to time, the Company enters into certain strategic investments for the promotion of business and strategic objectives. As of September 30, 2016 and July 1, 2016, the Company had aggregate net investments under the cost method of accounting of $129 million and $135 million, respectively, and these investments consisted of privately-held equity securities without a readily determinable fair value. The Company has determined that it is not practicable to estimate the fair value of these investments. These privately-held equity investments are reported under other non-current assets in the condensed consolidated balance sheets.

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Note 11. Investments
The following tables summarize, by major type, the fair value and cost basis of the Company's investments classified as available-for-sale:

	September 30, 2016		
	Cost Basis	Unrealized Gains (Losses)	Fair Value
	(in millions)		
Available-for-sale securities:			
U.S. Government agency securities	$4	$ —	$ 4
Certificates of deposit	222	—	222
International government securities	1	—	1
Corporate notes and bonds	76	—	76
Asset-backed securities	19	—	19
Municipal notes and bonds	13	—	13
Total	$335	$ —	$ 335

	July 1, 2016		
	Cost Basis	Unrealized Gains (Losses)	Fair Value
	(in millions)		
Available-for-sale securities:			
U.S. Treasury securities	$2	$ —	$ 2
U.S. Government agency securities	10	—	10
Certificates of deposit	202	—	202
International government securities	1	—	1
Corporate notes and bonds	96	1	97
Asset-backed securities	22	—	22
Municipal notes and bonds	12	—	12
Total	$345	$ 1	$ 346

The fair value of the Company's investments classified as available-for-sale securities at September 30, 2016, by remaining contractual maturity, were as follows:

	Cost Basis	Fair Value
	(in millions)	
Due in less than one year (short-term investments)	$248	$ 248
Due in one to five years (included in other non-current assets)	87	87
Total	$335	$ 335

The Company determined no available-for-sale securities were other-than-temporarily impaired in three months ended September 30, 2016.

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Note 12. Derivatives

The majority of the Company's transactions are in U.S. dollars; however, 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 September 30, 2016, 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 accumulated 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 September 30, 2016 and October 2, 2015.

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 September 30, 2016 and July 1, 2016. The changes in fair value on these contracts were immaterial to the condensed consolidated financial statements during the three months ended September 30, 2016 and October 2, 2015.

As of September 30, 2016, the net amount of unrealized gains with respect to the Company's foreign exchange contracts that is expected to be reclassified into earnings within the next 12 months was $70 million. In addition, as of September 30, 2016, the Company did not have any foreign exchange contracts with credit-risk-related contingent features.

See Note 10 to the condensed consolidated financial statements for additional disclosures related to the Company's foreign exchange contracts.

Derivative Instruments

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

	Derivative Assets Reported in			
	Other Current Assets		Other Non-current Assets	
	September 30, 2016	July 1, 2016	September 30, 2016	July 1, 2016
	(in millions)			
Foreign exchange forward contracts designated	$65	$ 114	$ —	$ —
Foreign exchange forward contracts not designated	11	12	—	—
Call options	—	70	—	1
Total derivatives	$76	$ 196	$ —	$ 1

	Derivative Liabilities Reported in			

	Accrued Expenses		Other Liabilities	
	September 30, 2016	July 1, 2016	September 30, 2016	July 1, 2016
	(in millions)			
Foreign exchange forward contracts designated	$22	$ 23	$ —	$ —
Exchange option	1	141	—	14
Total derivatives	$23	$ 164	$ —	$ 14

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Netting Arrangements
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 September 30, 2016:

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	Gross Amounts Not Offset in the Balance Sheet		Net Amount
				Financial Instruments	Cash Collateral Received or Pledged	
	(in millions)					
Foreign exchange contracts						
Financial assets	$70	$ (5)	$ 65	$ —	$ —	$ 65
Financial liabilities	(27)	5	(22)	—	—	(22)
Total derivative instruments	$43	$ —	$ 43	$ —	$ —	$ 43

The Company had a gross and net liability of $91 million related to its derivative instruments outstanding at July 1, 2016. There were no amounts offset due to master netting arrangements in place at July 1, 2016.

Effect of Foreign Exchange Contracts on the Condensed Consolidated Statements of Operations
The impact of foreign exchange contracts on the consolidated financial statements was as follows:

Derivatives in Cash Flow Hedging Relationships	Three Months Ended			
	Amount of Gain (Loss) Recognized in Accumulated Other Comprehensive Income on Derivatives		Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Income into Income	
	September 30, 2016	October 2, 2015	September 30, 2016	October 2, 2015
	(in millions)			
Foreign exchange contracts	$22	$ (53)	$ 26	$ (28)

The total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements for the three months ended September 30, 2016 and October 2, 2015.

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Note 13. Pension and Other Post-Retirement Benefit Plans

The Company has pension and other post-retirement benefit plans in various countries. The Company's principal plans are in Japan. All pension and other post-retirement benefit plans outside of the Company's Japanese plans are immaterial to the Company's condensed consolidated financial statements. The expected long-term rate of return on the Japanese plan assets is 2.5%.

Obligations and Funded Status

The following table presents the unfunded status of the benefit obligations for the Japanese defined benefit pension plans were as follows:

	September 30, 2016	July 1, 2016
	(in millions)	
Benefit obligations	$ 324	$ 326
Fair value of plan assets	217	212
Unfunded status	$ 107	$ 114

The following table presents the unfunded amounts related to the Japanese defined pension plans as recognized on the Company's condensed consolidated balance sheets:

	September 30, 2016	July 1, 2016
	(in millions)	
Non-current liabilities	$ 107	$ 114
Net amount recognized	$ 107	$ 114

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Note 14. Acquisitions

Fiscal 2016 Acquisition

In May 2016, we acquired SanDisk, a global leader in NAND flash storage solutions primarily 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.

Assets Acquired and Liabilities Assumed at Fair Value

During the period, the Company adjusted the assessment of fair value for certain acquired inventory and property and equipment and a portion of the deferred tax liability. Management is continuing to assess the values assigned to the remaining assets acquired and liabilities assumed and may make further adjustments during the measurement period (through May 11, 2017) as further information becomes available. Any changes in the fair values of the assets acquired and liabilities assumed during the measurement period may result in adjustments to goodwill.

Pro Forma Financial Information

The financial information in the table below summarizes the combined results of operations for the Company and SanDisk, on a pro forma basis, as though the combination had occurred as of the beginning of 2016. The pro forma financial information for the period presented includes the effects of adjustments related to amortization charges from acquired intangible assets, depreciation charges from acquired fixed assets, interest expenses from financing the acquisition, stock-based compensation expenses from the conversion of unvested equity awards and the elimination of certain expenses directly related to the transaction. The pro forma financial information as presented below is for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of 2016.

	Three Months Ended October 2, 2015 (in millions, except per share amounts)
Revenue, net	$ 4,812
Net income	98
Basic income per common share	$ 0.35
Diluted income per common share	$ 0.35

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Note 15. Employee Termination, Asset Impairment and Other Charges
The Company recorded the following charges related to employee terminations benefits, asset impairment and other charges:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
Employee termination and other charges:		
Restructuring Plan 2016	$ 27	$ —
Closure of Foreign Manufacturing Facility	4	—
Business Realignment	37	48
Total employee termination and other charges	68	48
Stock-based compensation accelerations and adjustments		
Restructuring Plan 2016	(1)	—
Business Realignment	1	—
Total stock-based compensation accelerations and adjustments	—	—
Asset impairment:		
Business Realignment	—	8
Total asset impairment	—	8
Total employee termination and other charges, stock-based compensation adjustments and asset impairments	$ 68	$ 56

Restructuring Plan 2016
In 2016, the Company initiated a set of actions relating to the restructuring plan associated with the integration of substantial portions of its HGST and WD subsidiaries (the “Restructuring Plan 2016”). Restructuring Plan 2016 consists of asset and footprint reduction, product road map consolidation and organization rationalization. The following table presents an analysis of the components of the activity against the reserve during the three months ended September 30, 2016:

	Employee Termination Benefits	Contract Termination and Other	Total
	(in millions)		
Accrual balance at July 1, 2016	$26	$ —	$26
Charges	8	19	27
Cash payments	(21)	(19)	(40)
Non-cash items and other	1	—	1
Accrual balance at September 30, 2016	$14	$ —	$14

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Closure of Foreign Manufacturing Facility

In January 2016, the Company announced the closing of its head component front end wafer manufacturing facility in Odawara, Japan, in order to reduce manufacturing costs. As of September 30, 2016, the Company substantially completed all activities related to the closure of the facility. The following table presents an analysis of the components of the activity against the reserve during the three months ended September 30, 2016:

	Employee Termination Benefits	Contract Termination and Other	Total
	(in millions)		
Accrual balance at July 1, 2016	$14	$ —	$14
Charges	2	2	4
Cash payments	(9)	(5)	(14)
Non-cash items and other	—	3	3
Accrual balance at September 30, 2016	$7	$ —	$7

Business Realignment

The Company periodically incurs charges to realign its operations with anticipated market demand. The following table presents an analysis of the components of the activity against the reserve during the three months ended September 30, 2016:

	Employee Termination Benefits	Contract Termination and Other	Total
	(in millions)		
Accrual balance at July 1, 2016	$11	$ 3	$14
Charges	37	—	37
Cash payments	(22)	—	(22)
Non-cash items and other	6	—	6
Accrual balance at September 30, 2016	$32	$ 3	$35

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

The following discussion and analysis contains forward-looking statements within the meaning of the federal securities laws, and should be read in conjunction with the disclosures we make concerning risks and other factors that may affect our business and operating results. You should read this information in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Part II, Item 7, contained in our Annual Report on Form 10-K for the fiscal year ended July 1, 2016.

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

Our Company

We are a leading developer, manufacturer and provider of data storage devices and solutions that address the evolving needs of the information technology ("IT") industry and the infrastructure that enables the proliferation of data in virtually every industry. Our broad portfolio of offerings addresses three categories: Data Center Devices and Solutions (capacity and performance enterprise hard disk drives ("HDD"), enterprise solid-state drives ("SSD"), data center software and system solutions); Client Devices (mobile, desktop, gaming and digital video hard drives, client SSDs, embedded products and wafers); and Client Solutions (removable products, hard drive content solutions and flash content solutions). We also generate license and royalty revenue related to our intellectual property which is included in each of the three categories.

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Fiscal years 2017, which ends on June 30, 2017, and 2016, which ended July 1, 2016, are both comprised of 52 weeks, with all quarters presented consisting of 13 weeks.

Recent Developments

Debt Facilities

During the first quarter of 2017, we settled certain debt facilities and entered into new debt facilities at more favorable rates. The financing arrangement activities during the quarter were:

- We paid in full, with accrued interest, our $3.0 billion short-term senior secured bridge credit agreement.
- We settled our $3.750 billion U.S. Term Loan B tranche with a new issuance of a $3.0 billion seven-year U.S. dollar-denominated term loan ("U.S. Term Loan B-1") at an interest rate lower than our U.S. Term Loan B tranche. Proceeds from this new loan and a voluntary cash prepayment of $750 million were used to settle our U.S. Term Loan B tranche.
- We settled our €885 million Euro Term Loan B tranche with a new issuance of a €885 million seven-year Euro-denominated term loan ("Euro Term Loan B-1") at an interest rate lower than our Euro Term Loan B tranche. Proceeds from this new loan were used to settle our Euro Term Loan B tranche.
- We paid to the holders of our Convertible Notes (as defined below), for conversion and repurchase, $490 million of cash and 0.3 million shares of our common stock with an aggregate value of $16 million. In conjunction with the settlements, we received from the exercise of the related call options, $61 million of cash and 0.1 million shares of our common stock which had an aggregate value of $11 million.

For additional information regarding our debt facilities, see Part I, Item 1, Note 4, in this Quarterly Report on Form 10-Q.

Unis Joint Venture

In November 2015, we entered into an agreement to form a joint venture with Unisplendour Corporation Limited ("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 became operational during the first quarter of 2017. The joint venture is 49% owned by us and 51% owned by Unis and its subsidiary, Unissoft (Wuxi) Group Co. Ltd. The financial results of this joint venture did not have a material impact on our condensed consolidated financial statements for the first quarter of 2017.

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Results of Operations

First Quarter Overview

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

	Three Months Ended					
	September 30, 2016		October 2, 2015		% Change	
	(in millions, except percentages)					
Revenue, net	$4,714	100.0 %	$3,360	100.0%	40	%
Gross profit	1,335	28.3	955	28.4	40	
Total operating expenses	1,103	23.4	633	18.8	74	
Operating income	232	4.9	322	9.6	(28	)
Net income (loss)	(366	) (7.8)	283	8.4	(229	)

The following is a summary of our financial performance for the first quarter of 2017 compared to the first quarter of 2016:

- Net revenue increased by 40.3% to $4.7 billion on higher revenues related to our NAND-flash memory products due primarily to our acquisition of SanDisk Corporation ("SanDisk"), partially offset by lower HDD unit shipments, as compared to net revenue of $3.4 billion in the prior year.
- Gross profit as a percentage of net revenue was 28.3%, as compared to 28.4% in the prior year.
- Operating income decreased to $232 million, as compared to $322 million in the prior year. Operating income in the first quarter of 2017 included $263 million of amortization of intangible assets and $68 million of employee termination, contract terminations and other charges, as compared to $23 million and $56 million in the first quarter of 2016, respectively.
- The first quarter of 2017 reflected a net loss of $366 million, or a loss of $1.28 per diluted share, as compared to net income of $283 million, or income of $1.21 per diluted share, in the prior year.

The following table sets forth, for the periods presented, summary information regarding unit shipments, average selling prices ("ASPs") and net revenues by geography and channel:

	Three Months Ended			
	September 30, 2016		October 2, 2015	
	(in millions, except percentages and ASPs)			
Revenue, net	$4,714		$3,360	
HDD ASPs (per unit)	$61		$60	
Revenues by Geography (%)				
Americas	40	%	30	%
Europe, Middle East and Africa	16		21	
Asia	44		49	
Revenues by Channel (%)				
Original Equipment Manufacturers	64	%	67	%
Distributors	17		21	
Retailers	19		12	
HDD Unit Shipments				
PC	24		28	
Non-PC	24		24	
Total units shipped	48		52	

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Net Revenue

Net revenue for the three months ended September 30, 2016 increased $1.35 billion, or 40%, from the prior year, which reflects an increase from NAND-flash products from our acquisition of SanDisk, partially offset by lower HDD unit shipments. Total HDD shipments for the three months ended September 30, 2016 decreased to 48 million units, as compared to 52 million units in the prior year, primarily due to lower HDD shipments for personal computer ("PC") and performance enterprise. This was partially offset by an increase in HDD ASP per unit of $1 from the prior year, primarily due to a change in product mix driven by increased capacity enterprise shipments.

For the three months ended September 30, 2016, no customer accounted for 10% or more of our net revenue. For the three months ended October 2, 2015, one customer, Hewlett-Packard Company, accounted for 13% of our net revenue. For the three months ended September 30, 2016 and October 2, 2015, our top 10 customers accounted for 43% and 44%, respectively, of our net revenue.

Consistent with standard industry practice, we have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. For each of the three months ended September 30, 2016 and October 2, 2015, these programs represented 8% and 11% of gross revenues, respectively. These amounts generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of products. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue.

Net Revenue by Geography

Changes in the mix of net revenue by geography for the three months ended September 30, 2016, compared to the prior year, reflect the additional revenues from NAND-flash products from our acquisition of SanDisk which have a larger market in the Americas.

Net Revenue by Channel

Changes in the mix of net revenue by channel for the three months ended September 30, 2016, compared to the prior year, also reflect the increase in revenues from NAND-flash products from our acquisition of SanDisk which has a higher market presence in retail.

Gross Profit and Gross Margin

Gross profit for the three months ended September 30, 2016 was $1.3 billion, an increase of $380 million from the prior year driven by the increased revenues from NAND-flash products from our acquisition of SanDisk. Gross profit as a percentage of net revenue was 28.3% in the three months ended September 30, 2016, as compared to 28.4% in the prior year. Gross profit in the current year was negatively impacted by amortization expense on acquired intangible assets, acquisition related charges, and charges related to the implementation of cost-saving initiatives, which aggregated $249 million or 5.3% of revenue, compared to $17 million or 0.5% in the prior year. The current year costs were largely offset by higher margins on NAND-flash memory products, increased HDD ASPs, and cost improvements resulting from increased volumes and integration activities.

Operating Expenses

	Three Months Ended					
	September 30, 2016		October 2, 2015			
	Amount	% of Rev	Amount	% of Rev	% Change	
	(in millions, except percentages)					
Research and development	$639	13.6%	$385	11.5%	66	%
Selling, general and administrative	396	8.4	192	5.7	106	
Employee termination, asset impairment and other charges	68	1.4	56	1.7	21	
Total operating expenses	$1,103	23.4	$633	18.8	74	

The increase in research and development ("R&D") expense in the three months ended September 30, 2016, compared to the prior year, was primarily related to our acquisition of SanDisk and continued development of NAND technology to complement our existing product offerings. These costs were partially offset by cost savings from our integration activities.

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The increase in selling, general and administrative ("SG&A") expense in the three months ended September 30, 2016, compared to the prior year, was primarily related to our acquisition of SanDisk. The current year also included an aggregate of $77 million in charges related to amortization expense on acquired intangible assets, acquisition related charges, and charges related to the implementation of cost-saving initiatives, compared to $9 million of such charges in the prior year. These costs were partially offset by cost savings from our integration activities.

Employee termination and other charges were $68 million in the three months ended September 30, 2016, an increase of $12 million from the prior year. The charges of $68 million for the three months ended September 30, 2016 consisted of $47 million of employee termination costs and $21 million of contract termination and other charges. The charges of $56 million for the three months ended October 2, 2015, consisted of $38 million of employee termination, $8 million of asset impairment and $10 million of contract termination and other charges. For additional information regarding employee termination, asset impairment and other charges, see Part I, Item 1, Note 15 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Interest and Other Income (Expense)

	Three Months Ended				
	September 30, 2016		October 2, 2015		
	Amount	% of Rev	Amount	% of Rev	% Change
	(in millions, except percentages)				
Interest income	$5	0.1 %	$5	0.1 %	—%
Interest expense	(236)	(5.0)	(13)	(0.4)	**
Other income (expense), net	(272)	(5.8)	—	—	**
Total interest and other income (expense), net	$(503)	(10.7)	$(8)	(0.2)	**

** Amount not meaningful.

Interest expense increased for the three months ended September 30, 2016, compared to the same period in 2016, primarily due to the additional debt issued in connection with the acquisition of SanDisk.

Other income (expense), net for the three months ended September 30, 2016 was primarily comprised of the write-off of debt issuance costs on the settlement of the original U.S. Term Loan B and Euro Term Loan B, and loss on the settlement of our convertible debt instruments.

Income Tax Expense

	Three Months Ended				
	September 30, 2016		October 2, 2015		
	Amount	% of Rev	Amount	% of Rev	% Change
	(in millions, except percentages)				
Income tax expense	$95	2.0%	$31	0.9%	206 %
Effective tax rate	(35)%		10 %		

Income tax expense of $95 million for the three months ended September 30, 2016 is attributable to discrete effects consisting of income tax expense from the integration of SanDisk of $90 million and a valuation allowance on acquired tax attributes of $109 million, partially offset by income tax benefit from deductible debt issuance costs, debt discounts and prepayment fees from the debt refinancing of $96 million and from decreases in our liability for unrecognized tax benefits due to lapses in the statute of limitations of $8 million. These discrete items are the primary drivers of the negative effective tax rate for the three months ended September 30, 2016.

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The primary drivers for the difference between the effective tax rate for the three months ended September 30, 2016 and the U.S. Federal statutory rate of 35% are the discrete items described above, the current year generation of tax credits and tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2029. For the three months ended October 2, 2015, the difference between the effective tax rate and the U.S. Federal statutory rate of 35% is primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2029.

We recognized a net decrease of $6 million in our liability for unrecognized tax benefits during the three months ended September 30, 2016. As of September 30, 2016, we had a liability recorded for unrecognized tax benefits of $485 million. Accrued interest and penalties related to unrecognized tax benefits as of September 30, 2016 was $78 million.

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

We believe 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 our tax examinations are resolved in a manner not consistent with management’s expectations, we could be required to adjust our provision for income taxes in the period such resolution occurs. As of September 30, 2016, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of our liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of our tax returns.

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Liquidity and Capital Resources

The following table summarizes our statements of cash flows for the three months ended September 30, 2016 and October 2, 2015:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in millions)	
Net cash flow provided by (used in):		
Operating activities	$440	$ 545
Investing activities	(202)	(273)
Financing activities	(4,312)	(215)
Net increase (decrease) in cash and cash equivalents	$(4,074)	$ 57

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 in this Quarterly Report on Form 10-Q.

The cash on hand and indebtedness used to finance our acquisition of SanDisk 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, capital expenditure needs, dividends, or to pursue other potential strategic plans.

During 2017, we expect cash used for purchases of property, plant and equipment, and net activity in Flash Ventures notes receivable and equity investments to be approximately $0.6 billion to $1.0 billion of our cash.

A total of $2.8 billion and $6.9 billion of our cash and cash equivalents was held outside of the U.S. as of September 30, 2016 and July 1, 2016, respectively. 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 U.S., any repatriation could result in the accrual and payment of additional U.S. income tax.

Operating Activities

Cash flow from operating activities consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash used for working capital changes was $205 million for the first quarter of 2017, as compared to $28 million used for working capital changes in the first quarter of 2016.

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 for the three months ended September 30, 2016 and October 2, 2015 were as follows:

	Three Months Ended	
	September 30, 2016	October 2, 2015
	(in days)	
Days sales outstanding	39	44
Days in inventory	57	48
Days payables outstanding	(58)	(68)
Cash conversion cycle	38	24

For the three months ended September 30, 2016, our days sales outstanding (“DSOs”) decreased by 5 days, days in inventory (“DIOs”) increased by 9 days and days payables outstanding (“DPOs”) decreased by 10 days, as compared to the prior year. Changes in DSOs are generally due to the linearity of shipments. 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.

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Investing Activities

Net cash used in investing activities in three months ended September 30, 2016 was $202 million, as compared to $273 million in the three months ended October 2, 2015. During the three months ended September 30, 2016, net cash used in investing activities primarily consisted of $184 million of capital expenditures and a net $27 million increase in notes receivable to and investments in Flash Ventures, partially offset by a net $9 million decrease in our investments in marketable securities. During the three months ended October 2, 2015, net cash used in investing activities primarily consisted of $151 million of capital expenditures and a net $112 million increase in investments in marketable securities.

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

Financing Activities

Net cash used in financing activities was $4.3 billion in three months ended September 30, 2016, as compared to net cash used of $215 million in the three months ended October 2, 2015. During the three months ended September 30, 2016, net cash used in financing activities consisted of $8.2 billion to repay debt and $142 million to pay dividends on our common stock, partially offset by $4.0 billion of proceeds from debt, net of issuance costs, $61 million of proceeds from call options and a net $26 million provided by employee stock plans. During the three months ended October 2, 2015, net cash used in financing activities primarily consisted of $115 million to pay dividends on our common stock, $60 million to repurchase shares of our common stock and $31 million to repay debt.

Off-Balance Sheet Arrangements

Other than the commitments related to Flash Ventures, facility lease commitments incurred in the normal course of business and certain indemnification provisions (see “Contractual Obligations and Commitments” below), we do not have any other material off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any other obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in the condensed consolidated financial statements. Additionally, we do not have an interest in, or relationships with, any special-purpose entities. For additional information regarding our off-balance sheet arrangements, see Part I, Item 1, Note 5 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Short and Long-term Liquidity

Contractual Obligations and Commitments

The following is a summary of our known contractual cash obligations and commercial commitments as of September 30, 2016:

	Total	1 Year (Remaining 9 months of 2017)	2-3 Years (2018-2019)	4-5 Years (2020-2021)	More than 5 Years (Beyond 2021)
	(in millions)				
Long-term debt, including current portion	$13,370	$ 30	$ 597	$ 3,727	$9,016
Interest on debt	5,280	689	1,567	1,535	1,489
Flash Ventures and other related commitments[1]	5,174	1,431	2,231	1,135	377
Operating leases	304	77	142	48	37
Purchase obligations	457	448	9	—	—
Total	$24,585	$ 2,675	$ 4,546	$ 6,445	$10,919

(1)

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

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Term Loans

In the first quarter ended September 30, 2016, we settled in full, $4.815 billion of term loans, which was composed of principal amounts of the $3.75 billion U.S. Term Loan B and the €885 million Euro Term Loan B, plus accrued interest. In connection with the settlement of the U.S. Term Loan B and Euro Term Loan B, we recognized $227 million in unamortized issuance cost and debt discount fees.

On August 17, 2016, we borrowed $3.0 billion under a new U.S. dollar-denominated term loan ("U.S. Term Loan B-1") under the Credit Agreement (as defined blow) and used the proceeds of this new loan and cash of $750 million to prepay in full the U.S. Term Loan B previously outstanding under the Credit Agreement. The U.S. Term Loan B-1 has an interest rate equal to, at our option, either an adjusted LIBOR rate, subject to a 0.75% floor, plus 3.75% or a base rate plus 2.75% (4.50% at September 30, 2016). Principal payments of 0.25% are due quarterly and began on September 30, 2016 with the balance due on April 29, 2023.

On September 22, 2016, we borrowed €885 million under a new Euro-denominated term loan ("Euro Term Loan B-1") under the Credit Agreement and used the proceeds of this new loan to prepay in full the Euro Term Loan B previously outstanding under the Credit Agreement. The Euro Term Loan B-1 has an interest rate equal to an adjusted EURIBOR rate, subject to a 0.75% floor, plus 3.25% (4.00% at September 30, 2016). Principal payments of Euro Term Loan B-1 of 0.25% are due quarterly and began on September 30, 2016 with the balance due on April 29, 2023.

Term Loan A and the revolving credit facility have a term of five years. Beginning in September 2017, we are required to make quarterly principal payments on Term Loan A totaling $206 million in 2018, $309 million in 2019, $413 million in 2020 and the remaining balance of $3.197 billion due in 2021. As of September 30, 2016, Term Loan A had an outstanding balance of $4.125 billion with a variable interest rate of 2.526%.

The term loans and the revolving credit loans under the Credit Agreement may be prepaid in whole or in part at any time without premium or penalty, subject to certain conditions, except that the term loans B-1 require us to pay a 1.0% prepayment fee if the loans thereunder are repaid in connection with certain "repricing" transactions on or before February 17, 2017, with respect to U.S. Term Loan B-1, and March 22, 2017, with respect to Euro Term Loan B-1.

Credit Agreement

On April 29, 2016, we entered into a new credit agreement (the "Credit Agreement") that provided for a $4.125 billion Term Loan A, a $3.750 billion U.S. Term Loan B, a €885 million Euro Term Loan B and a $1.0 billion revolving credit facility.

The revolving credit facility includes a $200 million sublimit for letters of credit. As of September 30, 2016, the revolving credit facility was not drawn upon, and there was no outstanding balance.

The obligations under the Credit Agreement are guaranteed by HGST, Inc., WD Media, LLC, Western Digital (Fremont), LLC and Western Digital Technologies, Inc. ("WDT") (together referred to as the "WD Guarantors"), and are secured on a first-priority basis by a lien on substantially all the assets and properties of the Company and the WD Guarantors, including all of the capital stock held by these entities (subject to a 65% limitation on pledges of capital stock of foreign subsidiaries and domestic holding companies of foreign subsidiaries), subject to certain exceptions.

Covenants

The Credit Agreement requires us to comply with certain financial covenants, such as a leverage ratio and an interest coverage ratio. In addition, the documents governing substantially all of our outstanding debt, including the Credit Agreement, require us to comply with customary covenants that limit or restrict our and our subsidiaries' ability to incur liens and indebtedness; make certain restricted payments, acquisitions, investments, loans and guarantees; and enter into certain transactions with affiliates, mergers and consolidations. As of September 30, 2016, we were in compliance with these covenants.

Senior Notes

On April 13, 2016, we completed an offering of $1.875 billion aggregate principal amount of 7.375% senior secured notes due 2023 (the "Secured Notes") and $3.350 billion aggregate principal amount of 10.500% senior unsecured notes due 2024 (the "Unsecured Notes" and, together with the Secured Notes, the "Notes"). We are not required to make principal payments on the Notes prior to their respective maturity dates, except that we may be required to offer to purchase the Notes upon the occurrence of a change of control (as defined in the indentures governing the Notes) or with the proceeds of certain non-ordinary course asset sales. Interest payments on the Notes are due semi-annually in

arrears.

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The obligations under the Notes are guaranteed by WD Guarantors, and the Secured Notes and related guarantees are secured on an equal and ratable basis by liens on the same assets that secure indebtedness under the Credit Agreement.

Convertible Notes

As of September 30, 2016, $37 million principal amount of the 0.5% Convertible Senior Notes due 2020 (“2020 Notes”) and less than of $1 million of principal amount the 1.5% Convertible Senior Notes due 2017 (“2017 Notes”) were outstanding. For the 2020 Notes that remain outstanding, the conversion rate is 10.9006 units of reference property per $1,000 principal amount of the 2020 Notes, corresponding to 2.6020 shares of our common stock and $735.79 in cash, subject to adjustments under the indenture. The 2020 Notes are not currently exchangeable into reference property.

Non-Guarantors

As of September 30, 2016, excluding intercompany transactions, our non-guarantor subsidiaries had $3 billion of aggregate total liabilities, all of which were structurally senior to the Notes and the related guarantees, and approximately $24 billion of consolidated assets. For the three months ended September 30, 2016, our non-guarantor subsidiaries accounted for $1.6 billion of net sales and less than $0.1 billion of operating income.

Flash Ventures

We are a 49.9% owner of each entity within Flash Ventures (Flash Partners, Ltd., Flash Alliance, Ltd., and Flash Forward, Ltd.), our business ventures with Toshiba Corporation (“Toshiba”) to develop and manufacture NAND flash memory products. These NAND flash memory products are manufactured by Toshiba at Toshiba’s Yokkaichi, Japan operations using the semiconductor manufacturing equipment owned or leased by Flash Ventures. This equipment is funded, or will be funded, by investments in, or loans to, Flash Ventures from us and Toshiba as well as through operating leases received by Flash Ventures from third-party banks and guaranteed by us and Toshiba. The entities within Flash Ventures purchase wafers from Toshiba at cost and then resell those wafers to us and Toshiba at cost plus a markup. We are contractually obligated to purchase half of Flash Ventures’ NAND wafer supply or pay for 50% of the fixed costs of Flash Ventures. We are not able to estimate our total wafer purchase obligations beyond our rolling three month purchase commitment because the price is determined by reference to the future cost to produce the semiconductor wafers. We are also committed to fund 49.9% to 50% of Flash Ventures’ investments to the extent that Flash Ventures’ operating cash flow is insufficient to fund these investments.

For semiconductor manufacturing equipment that is leased by Flash Ventures, we and Toshiba each guarantee, on an unsecured and several basis, 50% of the outstanding Flash Ventures’ lease obligations under lease agreements entered into by Flash Ventures. These lease obligations are denominated in Japanese yen and are noncancelable. Our lease obligation guarantees as of September 30, 2016, which reflects future payments and any lease adjustments, totaled $1.24 billion, based upon the Japanese yen to U.S. dollar exchange rate at September 30, 2016. The lease agreements contain certain covenants and cancellation events that are customary for Japanese lease facilities and that relate to Flash Ventures and each of the guarantors. The breach of a covenant or the occurrence of another cancellation event could result in an acceleration of Flash Ventures’ lease obligations. As of September 30, 2016, we were in compliance with all covenants under these Japanese lease facilities.

For additional information regarding Flash Ventures, see Part I, Item 1, Note 5 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Foreign Exchange Contracts

We purchase foreign exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. For a description of our current foreign exchange contract commitments, see Part I, Item 3, under the heading “Disclosure About Foreign Currency Risk,” and Part I, Item 1, Note 12 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, environmental compliance 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.

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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 September 30, 2016, the amount of unrecognized tax benefits, including related accrued interest and penalties, was $563 million, of which $420 million could result in potential cash payments. We are not able to provide a reasonable estimate of the timing of future tax payments related to these obligations. For additional information regarding our total tax liability for unrecognized tax benefits, see Part I, Item 1, Note 8 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Cash Dividend

Since the first quarter of 2014, we have issued a quarterly cash dividend. On August 3, 2016, we declared a cash dividend of $0.50 per share of our common stock to our stockholders of record as of September 30, 2016. The cash dividend of $143 million was paid on October 17, 2016. On November 3, 2016, we declared a cash dividend of $0.50 per share of our common stock to our stockholders of record as of December 30, 2016. The cash dividend will be paid on January 17, 2017. We may modify, suspend, or cancel our cash dividend policy in any manner and at any time.

Critical Accounting Policies and Estimates

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States. 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 since our fiscal year ended July 1, 2016. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended July 1, 2016 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, see Part I, Item 1, Note 2 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.

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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, see Part I, Item 1, Notes 10 and 12 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

As of September 30, 2016, we had outstanding the foreign exchange contracts presented in the following table. The changes in fair values of these foreign exchange contracts would be largely offset in other income (expense) by corresponding changes in the fair values of the foreign currency denominated monetary assets and liabilities.

	Contract Amount	Weighted Average Contract Rate[1]	Unrealized Gain (Loss)
	(in millions, except weighted average contract rate)		
Foreign exchange contracts:			
Cash flow hedges:			
Japanese Yen	$697	109.34	$ 65
Malaysian Ringgit	151	4.12	(1)
Philippine Peso	44	47.40	(1)
Singapore Dollar	32	1.38	—
Thailand Baht	554	35.16	7
Fair value hedges:			
British Pound Sterling	$11	0.76	$ —
Euro	9	0.86	—
Japanese Yen	299	104.53	—
Malaysian Ringgit	15	4.08	—
Philippine Peso	24	48.33	—
Singapore Dollar	12	1.36	—
Thailand Baht	191	34.57	—

[1] Expressed in units of foreign currency per U.S. dollar.

During the three months ended September 30, 2016 and October 2, 2015, total net realized transaction and foreign exchange contract currency gains and losses were not material to our condensed consolidated financial statements. Notwithstanding our efforts to mitigate some foreign exchange risks, we do not hedge all of our foreign currency exposures, and there can be no assurance that our mitigating activities related to the exposures that we hedge will adequately protect us against risks associated with foreign currency fluctuations.

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Disclosure About Other Market Risks

Variable Interest Rate Risk

Borrowings under our Term Loan A and our revolving credit facility bear interest at a rate per annum, at our option, of either an adjusted LIBOR rate (subject to a 0.0% floor) plus an applicable margin of 2.0% or at a base rate plus an applicable margin of 1.0%. The applicable margin for the borrowings under our Term Loan A Facility and our revolving credit facility will range, depending on our leverage, from 1.50% to 2.25% for LIBOR loans and from 0.50% to 1.25% for base rate loans.

Borrowings under the U.S. Term Loan B-1 tranche bear interest at a rate per annum, at our option, of an adjusted LIBOR rate, subject to a 0.75% floor, plus 3.75% or a base rate plus 2.75% (4.50% at September 30, 2016).

Borrowings under the Euro Term Loan B-1 tranche bear interest at a rate per annum, at our option, equal to an adjusted EURIBOR rate, subject to a 0.75% floor, plus 3.25% (4.00% at September 30, 2016).

As of September 30, 2016, we had $8.1 billion of long-term variable rate debt outstanding, and a one percent increase in the variable rate of interest, subject to each loan specific floor, would have increased annual interest expense by $66 million.

For additional information regarding our term loans, see Part I, Item 1, Note 4 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and Part II, Item 8, Note 3 of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended July 1, 2016.

Item 4. Controls and Procedures

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

There has been no change in our internal control over financial reporting during the first quarter ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a description of our legal proceedings, see Part I, Item 1, Note 6 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 the 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 the 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.

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

Adverse global economic conditions and uncertain conditions in the credit market have had, and in the future could have, a significant adverse effect on our company and on the storage industry as a whole. Several factors contribute to these conditions and this uncertainty, including, but not limited to, volatility in the equity, credit and other financial markets and real estate markets, slower growth in certain geographic regions, lower levels of consumer liquidity, risk of default on sovereign debt, higher interest rates, materials and component cost increases, political uncertainty and other macroeconomic factors, such as the June 23, 2016 referendum by British voters to exit the European Union, commonly referred to as "Brexit". Some of the risks and uncertainties we face as a result of these conditions include the following:

- Volatile Demand and Supplier Risk. Our direct and indirect customers may delay or reduce their purchases of our products and systems containing our products. In addition, many of our customers rely on credit financing to purchase our products. If negative conditions in the global credit markets prevent our customers' access to credit, product orders may decrease, which could result in lower revenue. Likewise, if our suppliers, sub-suppliers and sub-contractors (collectively referred to as "suppliers"), or partners face challenges in obtaining credit, in selling their products or otherwise in operating their businesses, they may be unable to offer the materials we use to manufacture our products. These actions could result in reductions in our revenue and increased operating costs, which could adversely affect our business, results of operations and financial condition.
- Restructuring Activities. If demand for our products slows as a result of a deterioration in economic conditions, we may undertake restructuring activities to realign our cost structure with softening demand. The occurrence of restructuring activities could result in impairment charges and other expenses, which could adversely impact our results of operations and financial condition.

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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 to pay us on their accounts receivable balances. Additionally, negative or uncertain global economic conditions increase the risk that if a customer we have insured fails to pay us on their accounts receivable, the financial condition of the insurance carrier for such customer account may have also deteriorated such that it cannot cover our loss. A significant loss of accounts receivable that we cannot recover through credit insurance would have a negative impact on our financial condition.

Impairment Charges. We test goodwill for impairment annually as of the first day of our fourth quarter and at other times if events have occurred or circumstances exist that indicate the carrying value of goodwill may no longer be recoverable. Negative or uncertain global economic conditions could result in circumstances, such as a sustained decline in our stock price and market capitalization or a decrease in our forecasted cash flows, indicating that the carrying value of our long-lived assets or goodwill may be impaired. If we are required to record a significant charge to earnings in our consolidated financial statements because of an impairment of our long-lived assets or goodwill, our results of operations will be adversely affected. For example, given the recent volatility of our market capitalization, it is possible that our goodwill could become impaired in the near term which could result in a material charge and adversely affect our results of operations and financial condition.

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

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

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

- difficulties entering new markets or manufacturing in new geographies where we have no or limited direct prior experience;
- successfully managing relationships with our strategic partners, and our combined supplier and customer base;
- coordinating and integrating independent research and development ("R&D") and engineering teams across technologies and product platforms to enhance product development while reducing costs;
- increased levels of investment in R&D, manufacturing capability and technology enhancement relating to SanDisk's business;
- successfully transitioning to 3-dimensional ("3D") NAND and alternative technologies;
- coordinating sales and marketing efforts to effectively position the combined company's capabilities and the direction of product development;
- difficulties in integrating the systems and processes of two companies with complex operations and multiple manufacturing sites;
- the increased scale and complexity of our operations resulting from the Merger;
- retaining key employees;

- obligations that we will have to counterparties of SanDisk that arise as a result of the change in control of SanDisk; and
- the diversion of management attention from other important business objectives.

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

The incurrence of substantial indebtedness in connection with the financing of the Merger 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.

In connection with the Merger, we substantially increased our indebtedness, which could adversely affect our ability to fulfill our obligations and have a negative impact on our financing options and liquidity position. As of September 30, 2016, our total indebtedness was $13.4 billion, and we had $1.0 billion of additional borrowing availability under our revolving credit facility.

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

- limiting our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or other general corporate purposes;
- requiring a substantial portion of our cash flows to be dedicated to debt service payments instead of other purposes, thereby reducing the amount of cash flows available for working capital, capital expenditures, acquisitions, R&D and other general corporate purposes;
- limiting our ability to refinance our indebtedness on terms acceptable to us or at all;
- imposing restrictive covenants on our operations;
- if we breach the covenants under our debt agreements, causing an event of default under the applicable indebtedness, which, if not cured or waived, could result in us having to repay our indebtedness before their due dates or result in cross defaults;
- placing us at a competitive disadvantage to competitors carrying less debt; and
- making us more vulnerable to economic downturns and limiting our ability to withstand competitive pressures.

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

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

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 the Ministry of Commerce of the People's Republic of China ("MOFCOM"), including adopting measures to keep HGST as an independent competitor until MOFCOM agreed otherwise. 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 that will separately offer products under the WD and HGST brands for two years from the date of the decision.

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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, R&D, recording heads and magnetic media operations, engineering and manufacturing). We expect this integration to continue through the end of calendar year 2017. Our integration efforts during this time may involve significant management time and create uncertainty for employees and customers. Any delays in the integration 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 Western Digital Technologies, Inc. ("WDT") 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, along with any delay in the integration process or 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 WDT subsidiaries. Any failure to achieve the full operating expense synergies that we expect from this integration could harm our business and financial condition. Achieving these synergies is also subject to significant business, operational, economic and competitive uncertainties and contingencies, and we cannot assure you that any or all of these synergies will be achieved in the anticipated amounts or within the anticipated time frames or cost expectations or at all.

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

Demand for our devices, software and solutions that we offer to our customers, which we refer to in this Item 1A as our "products", depends in large part on the demand for systems (including personal computers ("PCs") and mobile devices) manufactured by our customers and on storage upgrades to existing systems. The demand for systems has been volatile in the past and often has had an exaggerated effect on the demand for our products in any given period. The price of NAND flash memory is also influenced by, among other factors, the balance between supply and demand, including the effects of new fab capacity in the industry, macroeconomic factors, business conditions, technology transitions, conversion of industry DRAM capacity to NAND, conversion of 2-dimensional ("2D") NAND capacity to 3D NAND or other actions taken by us or our competitors. The storage market has experienced periods of excess capacity, which can lead to liquidation of excess inventories and 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. Rapid technological changes often reduce the volume and profitability of sales of existing products and increase the risk of inventory obsolescence. These factors, along with others, may also result in significant shifts in market share among the industry's major participants, including a substantial decrease in our market share, all of which could adversely impact our operating results and financial condition.

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

The data storage industry faces difficulties in accurately forecasting market and customer demand for its products. The variety and volume of products we manufacture are based in part on these forecasts. Accurately forecasting demand has become increasingly difficult for us, our customers and our suppliers in light of the volatility in global economic conditions and industry consolidation, resulting in less availability of historical market data for certain product segments. Further, for many of our original equipment manufacturers ("OEMs") utilizing just-in-time inventory, we do

not generally require firm order commitments and instead receive a periodic forecast of requirements, which may prove to be inaccurate. In addition, because our products are designed to be largely interchangeable with competitors' products, our demand forecasts may be impacted significantly by the strategic actions of our competitors. As forecasting demand becomes more difficult, the risk that our forecasts are not in line with demand increases. If our forecasts exceed actual market demand, then we could experience periods of product oversupply, excess inventory and price decreases, which could impact our financial performance. If market demand increases significantly beyond our forecasts or beyond our ability to add manufacturing capacity, then we may not be able to satisfy customer product needs, possibly resulting in a loss of market share if our competitors are able to meet customer demands. In addition, some of our components have long lead-times, requiring us to place orders several months in advance of anticipated demand. Such long lead-times increase the risk of excess inventory or loss of sales in the event our forecasts vary substantially from actual demand.

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We experience significant sales seasonality and cyclicality, which could cause our operating results to fluctuate.
Sales of computer systems, mobile devices, storage subsystems, gaming consoles and consumer electronics ("CE") tend to be seasonal and cyclical, and therefore we expect to continue to experience seasonality and 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 systems and enterprise markets, which have accounted for and may continue accounting for an increasing percentage of our overall revenue, may grow at a slower rate than current estimates or not at all, which could materially adversely impact our operating results and financial condition.
The secular growth of digital data has resulted in a more diversified mix of revenue from the CE, cloud computing, NAS, surveillance systems and enterprise markets. As sales into these markets have become a more significant portion of our revenue, events or circumstances that adversely impact demand in these markets, or our inability to address that demand successfully, could materially adversely impact our operating results. For example, demand in, or our sales to, these markets may be adversely affected by the following:

- Mobile Devices. There has been and continues to be a rapid growth in devices that do not contain a hard drive such as tablet computers and smart phones. As tablet computers and smart phones provide many of the same capabilities as PCs, they have displaced or materially affected, and we expect will continue to displace or materially affect, the demand for PCs. If we are not successful in adapting our product offerings to include disk drives or alternative storage solutions that address these devices, even after our acquisition of SanDisk, demand for our products in these markets may decrease and our financial results could be materially adversely affected. In addition, global slowdown in the growth rate of mobile devices will also negatively impact our financial results.
- Enterprise. The enterprise storage space is comprised of customers with long design, qualification and test cycles prior to sales. We spend substantial time and resources in our sales process without any assurance that our efforts will produce any customer orders on the timelines or in the quantities we expect. These lengthy and uncertain processes also make it difficult for us to forecast demand and timing of customer orders. Due to longer customer product cycles, we may not be able to transition customers to our leading edge products, which would prevent us from benefitting from the technology transitions that enable cost reductions, which may harm our gross margin. Demand for our enterprise solutions from our hyperscale customers is correlated to large projects and expansions which can be sporadic, resulting in demand that is lumpy and less consistent than the consumer-driven demand for many of our solutions. Hyperscale customers may place orders for significant volumes with short lead times that may be difficult for us to fulfill, and sales to hyperscale customers may negatively impact gross margins due to product mix and pricing, each of which could adversely affect our business. In addition, hyperscale companies may internally develop enterprise storage solutions that reduce the demand for our solutions.
- Cloud Computing. Consumers traditionally have stored their data on their PC, often supplemented with personal external storage devices. Most businesses also include similar local storage as a primary or secondary storage location. This storage is typically provided by hard disk drives ("HDDs") and increasingly solid-state drives ("SSDs"). With cloud computing, applications and data are hosted, accessed and processed through a third-party provider over a broadband Internet connection, potentially reducing or eliminating the need for, among other things, significant storage inside the accessing electronic device. Even if we are successful at increasing revenues from sales to cloud computing customers, if we are not successful in manufacturing compelling products to address the cloud computing opportunity, demand for our products in these other markets may decrease and our financial results could be materially adversely affected. Demand for cloud computing solutions themselves may be volatile due to differing patterns of technology adoption and innovation, improved data storage efficiency by cloud computing service providers, and concerns about data protection by end users.

- Obsolete Inventory. In some cases, products we manufacture for these markets are uniquely configured for a single customer's application, creating a risk of obsolete inventory if anticipated demand is not actually realized. In addition, rapid technological change in our industry increases the risk of inventory obsolescence.
- Macroeconomic Conditions. Consumer spending has been, and may continue to be, adversely affected in many regions due to negative macroeconomic conditions and high unemployment levels. Please see the risk factor entitled "Adverse global economic conditions and credit market uncertainty could harm our business, results of operations and financial condition" for additional risks and uncertainties relating to macroeconomic conditions.

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

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

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

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

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

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

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

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

During the three months ended September 30, 2016, 43% of our revenue came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, often resulting in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results and financial condition would likely be harmed.

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

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

Our vertical integration of recording head and magnetic media manufacturing makes us dependent on our ability to timely and cost-effectively develop recording 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 recording 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 recording head and magnetic media technologies developed by other manufacturers. Technology transition for recording heads and magnetic media designs is critical to increasing our volume production of recording heads and magnetic media. We may be unsuccessful in timely and cost-effectively developing and manufacturing recording heads or magnetic media for products using future technologies. We also may not effectively transition our recording 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 recording heads or magnetic media we manufacture. If we are unable to timely and cost-effectively develop recording 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 recording heads 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 recording 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 recording 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.

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

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

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

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

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

The data storage industry as a whole has experienced consolidation over the past several years through acquisitions, mergers and decisions by industry players to exit the industry. 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.

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

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

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

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

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

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

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.

We rely substantially on our business ventures and strategic partnerships with Toshiba for the supply of NAND flash memory, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results.

We are dependent on Flash Ventures and other strategic relationships with Toshiba for our NAND flash memory supply, and therefore our business, financial condition and operating results, and our ability to realize the anticipated benefits from the Merger, will be dependent on the success of Flash Ventures and other strategic relationships with Toshiba.

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

In addition, we partner with Toshiba on the development of NAND flash technology. SanDisk has entered into strategic partnerships with Toshiba relating to R&D for the next technology transitions of NAND flash and alternative technologies beyond NAND flash technologies.

These ventures and strategic partnerships are subject to various risks that could harm the value of our investments, our revenue and costs, our future rate of spending, our technology plans and our future growth opportunities. Under the terms of SanDisk's venture agreements with Toshiba, which govern the operations of Flash Ventures, we have limited power to unilaterally direct most of the activities that most significantly impact Flash Ventures' performance. Although SanDisk and Toshiba have a long history of aligning on important manufacturing and technology development decisions, the integration of SanDisk into our organization could complicate the process of reaching agreement with Toshiba in a timely and favorable manner. We may not always agree with Toshiba on the NAND R&D roadmap, the technology path beyond NAND flash memory, or expansions or conversions of production capacity. A change in the management or control of Toshiba's storage business could lead to delays in decision-making or changes in strategic direction that could also adversely impact Flash Ventures. In addition, Toshiba's financial position or shift in strategic priorities could adversely impact our business.

Flash Ventures requires significant investments by both Toshiba and us for technology transitions, including the transition to 3D NAND, and capacity expansions. In March 2016, Toshiba announced plans to construct a new wafer fab in Yokkaichi, Japan, to provide additional cleanroom space for expanded 3D NAND production. Although we intend to extend the joint venture partnership with Toshiba to the new wafer fab, there is no certainty as to when, and on what terms, we will participate with Toshiba in any investment in, or use of, the new wafer fab, if at all. Failure to extend the joint venture partnership or failure to continue to secure and invest in additional cleanroom space to support the continued 3D NAND transition could adversely impact our supply of captive NAND flash memory and financial results. If Toshiba does not or we do not provide sufficient resources or have adequate access to credit, these investments could be delayed or reduced. In addition, in the event that lease financings for Flash Ventures are not available on favorable terms or at all, more cash would be required to fund these investments.

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

We have entered into strategic relationships with various partners for future product development, sales growth and the supply of technologies, components, equipment and materials for use in our product design and manufacturing, including our relationships with Toshiba for NAND flash memory supply. In addition, in the first quarter of 2017, our joint venture with Unisplendour Corporation Limited ("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 became operational; the joint venture is 49% owned by us and 51% owned by Unis and its subsidiary, Unissoft (Wuxi) Group Co. Ltd. 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. These strategic relationships are subject to various risks that could adversely affect the value of our investments and our results of operations and financial condition. These risks include, but are not limited to, the following:

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

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

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

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

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

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

A majority of our flash memory is currently supplied by Flash Ventures and, to a much lesser extent, by third-party silicon suppliers. Any disruption or shortage in supply of flash memory from our captive or non-captive sources would harm our operating results and financial condition. Many of the risks that affect us also affect our supply base and Flash Ventures, including, but not limited to, having single site manufacturing locations and other facilities based in high risk regions of the world (for example, Flash Ventures is located in Yokkaichi, Japan), natural disasters, power shortages, macro and local economic conditions, shortages of commodity materials, proper management of technology transitions, geo-political risks, employee strikes and other labor actions, compliance with legal requirements, financial instability and exposure to intellectual property ("IP") and other litigation, including an injunction or other action that could delay shipping. If any of these risks were to affect our suppliers or Flash Ventures, we could also be adversely affected, especially in the case of products, components or services that are single-sourced. For example, if suppliers are facing increased costs due to the above risks, they may require us to enter into long-term volume agreements to shift the burden of fixed costs to us. Further, we work closely with many of our suppliers and strategic partners to develop new technologies and, as a result, we may become subject to litigation from our suppliers, strategic partners or third parties.

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

In addition to an external supply base, we also rely on an internal supply chain of heads, media and media substrate, and we rely on our business ventures with Toshiba for the supply of NAND flash memory. Please see the risk factors entitled, "A fundamental change in storage technologies and standards could result in significant increases in our costs and could put us at a competitive disadvantage," "If we do not properly manage technology transitions, our competitiveness and operating results may be negatively affected," and "We rely substantially on our business ventures and strategic partnerships with Toshiba for the supply of NAND flash memory, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results" for a review of some of the risks related to these supplies.

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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 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.

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

The storage markets in which we offer our products continuously undergo technology transitions that we must anticipate and adapt our products to address in a timely manner. If we fail to implement new technologies successfully, or if we are slower than our competitors at implementing new technologies, we may not be able to competitively offer products that our customers desire or keep pace with ASP reduction, which could harm our operating results. In addition, if our customers choose to delay transition to new technologies, if demand for the products that we develop is lower than expected or if the supporting technologies to implement these new technologies are not available, we may be unable to achieve the cost structure required to support our profit objectives or may be unable to grow or maintain our market position.

Our successful development of 3D NAND and alternative technologies, such as 3D resistive random-access memory ("ReRAM"), and transitioning our customers to these technologies in a timely and effective manner are crucial to continuing the cost reductions necessary to maintain adequate gross margin. In transitioning our 2D NAND manufacturing capacity to 3D NAND technology, we could experience delays or other challenges in the production ramp, qualification of wafers, shipment of samples to customers or customer approval process. 3D NAND and any new manufacturing node may be more susceptible to manufacturing yield issues. Manufacturing yield issues may not be identified during the development or production process or solved until an actual product is manufactured and tested, further increasing our costs. If our technology transitions, including the production ramp of 3D NAND technology, take longer, are more costly to complete than anticipated, or do not improve manufacturing yield or other manufacturing efficiencies, our flash memory costs may not remain competitive with other NAND flash memory

producers or may not fall commensurate with declines in the price of NAND flash memory, which would harm revenues, our gross margin and operating results.

Many companies, including some of our competitors, have developed or are attempting to develop alternative non-volatile technologies. Successful broad-based commercialization of one or more competing technologies, as well as differing strategies and timing with respect to the transition from 2D NAND to 3D NAND, could reduce the competitiveness and future revenue and profitability of our 2D NAND and 3D NAND flash technologies, and the potential 3D ReRAM technology that we are developing with our partners. In addition, we generate license and royalty revenue from NAND flash technology, and if NAND flash technology is replaced by a technology where our IP is less relevant, our license and royalty revenue would decrease. Also, we may not have access to alternative technologies that we do not develop internally and we may have to pay royalties in order to access such technologies.

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

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

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

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

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

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

If our existing licensees do not renew their licenses upon expiration, renew or sign new agreements on less favorable terms, exercise their option to terminate the license or fail to exercise their option to extend the licenses, or we are not successful in signing new licensees in the future, our license revenue, profitability and cash provided by operating activities would be harmed and we may incur significant patent litigation costs to enforce our patents against these licensees. As our older patents expire, and the coverage of our newer patents may be different, it may be more difficult to negotiate or renew favorable license agreement terms or a license agreement at all. Our 2009 license agreement with Samsung expired on August 14, 2016. If we are unable to negotiate a new agreement or if we negotiate a new agreement on less favorable terms such as a lower effective royalty rate compared to the expired license agreement, we will experience a decrease in license and royalty revenue. Our agreements may require us in certain instances to recognize license revenue related to a particular licensee all in one period instead of over time, which could create additional volatility in our licensing revenue. A portion of our license and royalty revenue is based on sales of product categories as well as the underlying technology, and fluctuations in the sales of those products or technology adoption rates would also result in fluctuations in the license and royalty revenue due to us under our agreements. If our licensees or we fail to perform on contractual obligations, we may incur costs to enforce or defend the terms of our licenses and there can be no assurance that our enforcement, defense or collection efforts will be effective. If we license new IP from third parties or existing licensees, we may be required to pay license fees, royalty payments or offset existing license revenue. We may enter into agreements with customers, suppliers or partners that could limit our ability to monetize our IP or could result in us being required to provide IP indemnification to our customers, suppliers or partners. In addition, we may be subject to disputes, claims or other disagreements on the timing, amount or collection of royalties or license payments under our license agreements.

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

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

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

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

In particular, as part of our growth strategy, we have made significant investments in active archive systems, which are designed to enable organizations to rapidly access massive long-term data stores. For example, our acquisition of Amplidata NV 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.

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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.

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

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

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

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

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

- obtaining requisite governmental permits and approvals, compliance with foreign laws and regulations, changes in foreign laws and regulations;
- the need to comply with regulations on international business, including the Foreign Corrupt Practices Act, the United Kingdom Bribery Act 2010, the anti-bribery laws of other countries and rules regarding conflict minerals;
- currency exchange rate fluctuations or restrictions;
- political and economic instability, civil unrest and natural disasters;
- 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 and fees, import and export restriction including on encryption technology, and complex customs regulations;
- copyright levies or similar fees or taxes imposed in European and other countries;

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- exchange, currency and tax controls and reallocations;
- increasing labor and overhead costs;
- weaker protection of IP rights;
- difficulties in managing international operations, including appropriate internal controls; and
- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

As a result of these risks, our business, results of operations or financial condition could be adversely affected.

Terrorist attacks may adversely affect our business and operating results.

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

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

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

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

We experience cyber attacks of varying degrees on our technology infrastructure and systems and, as a result, unauthorized parties have obtained in the past, and may in the future obtain, access to our computer systems and networks. The technology infrastructure and systems of our suppliers, vendors and partners may also experience such attacks. Cyber attacks can include computer viruses, computer denial-of-service attacks, worms, and other malicious software programs or other attacks, covert introduction of malware to computers and networks, impersonation of authorized users, and efforts to discover and exploit any 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. We have agreed with certain customers and strategic partners, including Toshiba, to undertake certain commitments to promote information security, and we may be liable to Toshiba or such other parties if we fail to meet our cyber security commitments.

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

If efforts to breach our infrastructure, systems or products are successful or we are unable to protect against these risks, we could suffer interruptions, delays, or cessation of operations of our systems, and loss or misuse of proprietary or confidential information, IP, or sensitive or personal information. Breaches of our infrastructure, systems or

products could also cause our customers and other affected third parties to suffer loss or misuse of proprietary or confidential information, IP, or sensitive or personal information, and could harm our relationships with customers and other third parties. As a result, we could experience additional costs, indemnification claims, litigation, and damage to our brand and reputation. All of these consequences could harm our reputation and our business and materially and adversely affect our operating results and financial condition.

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

We seek to be an industry-leading developer, manufacturer and provider of innovative storage solutions, balancing our core hard drive and flash memory business with growing investments in newer areas that we believe will provide us with higher growth opportunities. Acquisitions of, investment opportunities in, or other significant transactions with companies that are complementary to our business are a key part of our overall business strategy. For example, we have completed the acquisitions of SanDisk (in May 2016), Amplidata NV (in March 2015), Virident Systems, Inc. (in October 2013) and sTec, Inc. (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. We are also subject to certain covenants in our debt agreements which place limits on our ability to complete acquisitions and investments. Even if we identify and complete suitable corporate transactions, we may not be able to successfully address any integration challenges in a timely manner, or at all. Failing to successfully integrate or realign our business to take advantage of efficiencies or reduce redundancies of an acquisition may result in not realizing all or any of the anticipated benefits of the acquisition. In addition, failing to achieve the financial model projections for an acquisition may result in the incurrence of impairment charges and other expenses, both of which could adversely impact our results of operations or financial condition. Acquisitions and investments may also result in the issuance of equity securities that may be dilutive to our stockholders and the issuance of additional indebtedness which would put additional pressure on liquidity. Furthermore, we may agree to provide continuing service obligations or enter into other agreements in order to obtain certain regulatory approvals of our corporate transactions, and failure to satisfy these additional obligations could result in our failing to obtain regulatory approvals or the imposition of additional obligations on us, any of which could adversely affect our business, financial condition and results of operations.

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

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

We and certain of our officers are at times involved in litigation, including IP, antitrust and securities litigation, which may be costly, may divert the efforts of our key personnel and could result in adverse court rulings, which could materially harm our business.

We are involved in litigation, including cases involving our IP rights and those of others, antitrust and commercial matters, putative securities class action suits and other actions. We are the plaintiff in some of these actions and the defendant in others. Some of the actions seek injunctive relief, including injunctions against the sale of our products and substantial monetary damages, which if granted or awarded, could materially harm our business, financial condition and operating results.

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

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

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

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

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

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

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

Moreover, from time to time, we agree to indemnify certain of our suppliers and customers for alleged IP infringement. The scope of such indemnity varies but may include indemnification for direct and consequential damages and expenses, including attorneys' fees. We may be engaged in litigation as a result of these indemnification

obligations. Third party claims for patent infringement are excluded from coverage under our insurance policies. A future obligation to indemnify our customers or suppliers may harm our business, financial condition and operating results.

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

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

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

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

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

In connection with our compliance with environmental laws and regulations, as well as our compliance with industry and coalition environmental initiatives, such as those established by the 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 and operating results to suffer.

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

We are subject to the SEC's diligence and disclosure requirements regarding the use and source of gold, tantalum, tin and tungsten, commonly referred to as 3TG or conflict minerals, which are necessary to the functionality or production of products manufactured or contracted to be manufactured by public companies. 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, and some of our customers have notified us that they require, that our products contain only conflict free 3TG, and our revenues and margins may be harmed if we are unable to meet this requirement at a reasonable price, or at all, or are unable to pass through any increased costs associated with meeting this requirement. Additionally, we may suffer reputational harm with our customers and other stakeholders and challenges from government regulators if our products are not conflict free or if we are unable to sufficiently verify the origins of the 3TG contained in our products through the due diligence procedures that we implement. We could incur significant costs to the extent that we are required to make changes to products, processes, or sources of supply due to the foregoing requirements or pressures. To the extent that conflict minerals legislation is adopted by the European Commission, Canada or any other jurisdiction, these risks could increase.

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

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

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

Because of high debt levels, we may not be able to service our debt obligations in accordance with their terms.

As of September 30, 2016, our total indebtedness was $13.4 billion, and we had $1.0 billion of additional borrowing availability under our revolving credit facility. Our ability to meet our expense and debt service obligations contained in our debt agreements will depend on our available cash and our future performance, which will be affected by financial, business, economic and other factors, including potential changes in laws or regulations, industry conditions, industry supply and demand balance, customer preferences, the success of our products and pressure from competitors. If we are unable to meet our debt service obligations or should we fail to comply with our financial and other restrictive covenants contained in the agreements governing our indebtedness, 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 are able to raise additional funds through the issuance of equity securities, such issuance would also result in dilution to our shareholders. Our inability to service our debt obligations or refinance our debt could have a material adverse effect on our business, operating results and financial condition. In addition, our debt obligations may limit our ability to make required investments in capacity, technology or other areas of our business, which could have a material adverse effect on our business, operating results and financial condition. Further, if we are unable to repay, refinance or restructure our secured indebtedness, the holder of such debt could proceed against the collateral securing that indebtedness.

The terms of the agreements governing our indebtedness may restrict our current and future operations, particularly our ability to respond to changes or to pursue our business strategies, and could adversely affect our capital resources, financial condition and liquidity.

The agreements that govern our indebtedness contain a number of restrictive covenants that impose significant operating and financial restrictions on us and may limit our ability to engage in acts that may be in our long-term best interests, including, among other things, restrictions on our ability to:

- incur, assume or guarantee additional indebtedness;

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- declare or pay dividends or make other distributions with respect to, or purchase or otherwise acquire or retire for value, equity interests;
- make principal payments on, or redeem or repurchase, subordinated debt;
- make loans, advances or other investments;
- incur liens;
- sell or otherwise dispose of assets, including capital stock of subsidiaries;
- purchase assets, make investments, complete acquisitions, consolidate or merge with or into, or sell all or substantially all of our assets to, another person; and
- enter into transactions with affiliates.

Due to these restrictions, we may be unable to raise additional debt or equity financing to operate our business during general economic or business downturns, and we may be unable to compete effectively or take advantage of new opportunities to grow our business. In addition, our credit facilities require us to comply with certain financial maintenance covenants. Our ability to satisfy these financial maintenance covenants can be affected by events beyond our control, and we cannot assure you that we will meet them. The indebtedness and these restrictive covenants may have the effect, among other things, of limiting our flexibility in the conduct of our business and making us more vulnerable to economic downturns and adverse competitive and industry conditions.

A breach of the covenants under these agreements could result in an event of default under the applicable indebtedness, which, if not cured or waived, could result in us having to repay our borrowings or repay our notes before their due dates. Such default may allow the debt holders to accelerate the related debt and may result in the acceleration of any other debt, leases, or other obligations to which a cross-acceleration or cross-default provision applies. If we are forced to refinance these borrowings or our notes on less favorable terms or if we were to experience difficulty in refinancing the debt prior to maturity, our results of operations and financial condition could be materially affected. In addition, an event of default under our credit facilities may permit the lenders under our credit facilities to terminate all commitments to extend further credit under such credit facilities. If we are unable to repay the amounts due and payable under our credit facilities and our senior secured notes, those lenders may be able to proceed against the collateral granted to them to secure that indebtedness. In the event our lenders or holders of notes accelerate the repayment of such borrowings, we cannot assure you that we will have sufficient assets to repay such indebtedness. Any of the foregoing would have a material adverse effect on our business, results of operations and financial condition.

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

Flash Ventures sells and leases back from a consortium of financial institutions ("lessors") a portion of its equipment and Flash Ventures has entered into equipment lease agreements, of which we and Toshiba each guarantee half of the total outstanding obligations. As of September 30, 2016, the portion of outstanding Flash Ventures' lease obligations covered by our guarantees totaled approximately $1.2 billion, based upon the Japanese yen to U.S. dollar exchange rate at September 30, 2016. The equipment lease agreements contain covenants and cancellation events that are customary for Japanese lease facilities and that relate to Flash Ventures and each of the guarantors. Cancellation events relating to the guarantors include, among other things, an assignment of all or a substantial part of a guarantor's business and acceleration of other monetary debts of a guarantor above a specified threshold.

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

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

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

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

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

Prices for our products are substantially U.S. dollar denominated, even when sold to customers that are located outside the U.S. Therefore, as a substantial portion of our sales are from countries outside the U.S., fluctuations in currency exchanges rates, most notably the strengthening of the U.S. dollar against other foreign currencies, contribute to variations in sales of products in impacted jurisdictions and could adversely impact demand and revenue growth. In addition, currency variations can adversely affect margins on sales of our products in countries outside the 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. Thus, our decisions and hedging strategy with respect to currency risks may not be successful and harm our operating results. Further, the ability to enter into foreign exchange contracts with financial institutions is based upon our available credit from such institutions and compliance with covenants and other restrictions. Operating losses, third party downgrades of our credit rating or instability in the worldwide financial markets could impact our ability to effectively manage our foreign currency exchange rate risk. Hedging also exposes us to the credit risk of our counterparty financial institutions.

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

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

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

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

- weakness in demand for one or more product categories;
- the timing of orders from and shipment of products to major customers, loss of major customers;
- our product mix;
- reductions in the ASPs of our products and lower margins;

- excess output, capacity or inventory, resulting in lower ASPs, financial charges or impairments, or insufficient output, capacity or inventory, resulting in lost revenue opportunities;
- inability to successfully transition to 3D NAND or other technology developments, or other failure to reduce product costs to keep pace with reduction in ASPs;
- manufacturing delays or interruptions;

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- delays in design wins or customer qualifications, acceptance by customers of competing products in lieu of our products;
- success of our partnerships and joint ventures, in particular the volume, timing and cost of wafer production at Flash Ventures, and our success in managing the relationships with our strategic partners;
- inability to realize the potential benefits of our acquisitions and the success of our integration efforts;
- ability to penetrate new markets for our storage solutions;
- variations in the cost of and lead times for components for our products, disruptions of our supply chain;
- limited availability of components that we obtain from a single or a limited number of suppliers;
- seasonal and other fluctuations in demand often due to technological advances;
- increase in costs due to warranty claims;
- higher costs as a result of currency exchange rate fluctuations; and
- availability and rates of transportation.

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

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

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

- price protection adjustments and other sales promotions and allowances on products sold to retailers, resellers and distributors;
- inventory adjustments for write-down of inventories to lower of cost or market value (net realizable value);
- testing of goodwill and other long-lived assets for impairment;
- 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.

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

The market price of our common stock is volatile.

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

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

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- periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures or industry consolidation;
- developments with respect to patents or proprietary rights, and any litigation;
- proposed or adopted regulatory changes or developments or anticipated or pending investigations, proceedings or litigation that involve or affect us or our competitors;
- conditions and trends in the hard drive, solid state storage, flash memory, computer, mobile, data and content management, storage and communication industries;
- contraction in our operating results or growth rates that are lower than our previous high growth-rate periods;
- failure to meet analysts' revenue or earnings estimates or changes in financial estimates or publication of research reports and recommendations by financial analysts relating specifically to us or the storage industry in general;
- announcements relating to dividends and share repurchases; and
- macroeconomic conditions that affect the market generally and, in particular, developments related to market conditions for our industry.

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

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 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 repay our indebtedness, fund acquisitions, pay dividends, or repurchase shares of our common stock, we may choose or be required to increase our borrowings, if available, or to repatriate funds to the 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 September 30, 2016, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal control over financial reporting was effective. If our internal control over financial reporting is found to be ineffective or if we identify a material weakness in our financial reporting in future periods, investors may lose confidence in the reliability of our financial statements, we may be required to restate our financial results, our access to capital markets may be limited, and we may be subject to sanctions from

regulatory agencies and The NASDAQ Global Select Market, each of which may adversely affect our stock price.

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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 a Revenue Agent's Report seeking certain adjustments to income as disclosed in Part I, Item 1, Note 8 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. Although we believe our tax positions are properly supported, the final timing and resolution of any tax examinations are subject to significant uncertainty and could result in our having to pay amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations or cash flows.

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

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

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

Tax laws are dynamic and subject to change as new laws and regulations are passed and new interpretations of the laws are issued or applied. The current U.S. administration and key members of Congress have made public statements indicating that tax reform is a priority, and certain changes to the U.S. tax laws and regulations have been proposed. In addition, many countries in the European Union, as well as a number of other countries and organizations such as the Organization for Economic Cooperation and Development, are actively considering changes to existing tax laws that, if enacted, could increase our tax obligations in many countries where we do business. Due to the large scale of our U.S. and international business activities, many of these proposed changes to the taxation of our activities, if enacted, could increase our worldwide effective tax rate and harm our financial position and results of operations.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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

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SIGNATURES

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

WESTERN DIGITAL CORPORATION

By: /s/ MARK P. LONG
Mark P. Long
President WD Capital, Chief Strategy Officer and Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

Dated: November 8, 2016

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EXHIBIT INDEX

Exhibit Number	Description
2.1	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 By-Laws 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	Separation and General Release Agreement, dated August 3, 2016, between Western Digital Technologies, Inc. and Olivier C. Leonetti (Filed as Exhibit 10.8 to the Company's Annual Report on Form 10-K (File No. 1-08703) with the Securities and Exchange Commission on August 29, 2016)*
10.2	Amendment No. 1, dated as of August 17, 2016, to the Loan Agreement dated as of April 29, 2016, by and among Western Digital Corporation, JPMorgan Chase Bank, N.A., as administrative agent and collateral agent, the lenders party thereto and the other loan parties thereto (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on August 18, 2016)
10.3	Amendment No. 2, dated as of September 22, 2016, to the Loan Agreement dated as of April 29, 2016, as amended by Amendment No. 1, dated as of August 17, 2016, by and among Western Digital Corporation, JPMorgan Chase Bank, N.A., as administrative agent and collateral agent, the lenders party thereto and the other loan parties thereto (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on September 22, 2016)
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.

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

** Furnished with this report.

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