

WESTERN DIGITAL CORP

Form 10-Q

January 31, 2014

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 27, 2013

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-8703

WESTERN DIGITAL CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or other jurisdiction of incorporation or organization)

33-0956711

(I.R.S. Employer Identification No.)

3355 Michelson Drive, Suite 100

Irvine, California

(Address of principal executive offices)

92612

(Zip Code)

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

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

As of the close of business on January 22, 2014, 236,261,586 shares of common stock, par value \$.01 per share, were outstanding.



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Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Our fiscal second quarters ended December 27, 2013 and December 28, 2012 both consisted of 13 weeks. Fiscal year 2013 was comprised of 52 weeks and ended on June 28, 2013. Fiscal year 2014 will be comprised of 52 weeks and will end on June 27, 2014. Fiscal year 2015 will be comprised of 53 weeks, with the first quarter consisting of 14 weeks and the second, third and fourth quarters consisting of 13 weeks each. 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 storage business, which operates under two independent subsidiaries – HGST and WD. Our principal executive offices are located at 3355 Michelson Drive, Suite 100, Irvine, California 92612. Our telephone number is (949) 672-7000 and our Web site is [www.westerndigital.com](http://www.westerndigital.com). The information on our Web site is not incorporated in this Quarterly Report on Form 10-Q.

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

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## PART I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## WESTERN DIGITAL CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except par values; unaudited)

	December 27, 2013	June 28, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$4,655	\$4,309
Accounts receivable, net	1,959	1,793
Inventories	1,293	1,188
Other current assets	381	308
Total current assets	8,288	7,598
Property, plant and equipment, net	3,509	3,700
Goodwill	2,555	1,954
Other intangible assets, net	607	605
Other non-current assets	323	179
Total assets	\$15,282	\$14,036
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$2,106	\$1,990
Accrued arbitration award	732	706
Accrued expenses	479	480
Accrued compensation	456	453
Accrued warranty	117	114
Short-term debt	500	—
Current portion of long-term debt	230	230
Total current liabilities	4,620	3,973
Long-term debt	1,610	1,725
Other liabilities	473	445
Total liabilities	6,703	6,143
Commitments and contingencies (Notes 4 and 5)		
Shareholders' equity:		
Preferred stock, \$.01 par value; authorized — 5 shares; issued and outstanding — none	—	—
Common stock, \$.01 par value; authorized — 450 shares; issued — 261 shares; outstanding — 237 shares	3	3
Additional paid-in capital	2,262	2,188
Accumulated other comprehensive loss	(49	) (35 )
Retained earnings	7,541	6,749
Treasury stock — common shares at cost; 24 shares	(1,178	) (1,012 )
Total shareholders' equity	8,579	7,893
Total liabilities and shareholders' equity	\$15,282	\$14,036
The accompanying notes are an integral part of these condensed consolidated financial statements.		

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WESTERN DIGITAL CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 (in millions, except per share amounts; unaudited)

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Revenue, net	\$3,972	\$3,824	\$7,776	\$7,859
Cost of revenue	2,831	2,765	5,547	5,607
Gross profit	1,141	1,059	2,229	2,252
Operating expenses:				
Research and development	421	378	822	774
Selling, general and administrative	229	162	361	341
Charges related to arbitration award	13	—	26	—
Employee termination benefits and other charges	—	41	—	67
Total operating expenses	663	581	1,209	1,182
Operating income	478	478	1,020	1,070
Other income (expense):				
Interest income	3	3	6	5
Interest and other expense	(14	) (13	) (27	) (29
Total other expense, net	(11	) (10	) (21	) (24
Income before income taxes	467	468	999	1,046
Income tax provision	37	133	74	192
Net income	\$430	\$335	\$925	\$854
Income per common share:				
Basic	\$1.82	\$1.38	\$3.92	\$3.50
Diluted	\$1.77	\$1.36	\$3.81	\$3.43
Weighted average shares outstanding:				
Basic	236	242	236	244
Diluted	243	246	243	249

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

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

	Three Months Ended		Six Months Ended		
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012	
Net income	\$430	\$335	\$925	\$854	
Other comprehensive income (loss), net of tax:					
Net unrealized gain (loss) on foreign exchange contracts	(30	) (2	) (14	) 26	
Net actuarial pension gain	—	—	—	1	
Translation loss	—	(4	) —	(4	)
Other comprehensive income (loss)	(30	) (6	) (14	) 23	
Total comprehensive income	\$400	\$329	\$911	\$877	

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)

	Six Months Ended	
	December 27, 2013	December 28, 2012
Cash flows from operating activities		
Net income	\$925	\$854
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	629	622
Stock-based compensation	84	71
Deferred income taxes	(39)	) 68
Gain from insurance recovery	(65)	) —
Loss on disposal of assets	29	—
Non-cash portion of employee termination benefits and other charges	—	15
Changes in:		
Accounts receivable, net	(145)	) 633
Inventories	(66)	) 7
Accounts payable	93	(352)
Accrued arbitration award	26	—
Accrued expenses	(36)	) (185)
Accrued compensation	3	16
Other assets and liabilities	(32)	) (41)
Net cash provided by operating activities	1,406	1,708
Cash flows from investing activities		
Purchases of property, plant and equipment	(306)	) (628)
Acquisitions, net of cash acquired	(823)	) (27)
Other investing activities, net	4	(15)
Net cash used in investing activities	(1,125)	) (670)
Cash flows from financing activities		
Issuance of stock under employee stock plans	97	86
Taxes paid on vested stock awards under employee stock plans	(24)	) (8)
Excess tax benefits from employee stock plans	25	35
Repurchases of common stock	(300)	) (364)
Dividends paid to shareholders	(118)	) (121)
Proceeds from revolving credit facility	500	—
Repayment of long-term debt	(115)	) (58)
Net cash provided by (used in) financing activities	65	(430)
Net increase in cash and cash equivalents	346	608
Cash and cash equivalents, beginning of period	4,309	3,208
Cash and cash equivalents, end of period	\$4,655	\$3,816
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$122	\$95
Cash paid for interest	\$24	\$21
Supplemental disclosure of non-cash financing activities:		
Accrual of cash dividend declared	\$71	\$—

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





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

## 1. Basis of Presentation

The accounting policies followed by Western Digital Corporation (the "Company") are set forth in Part II, Item 8, Note 1 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended June 28, 2013. In the opinion of management, all adjustments necessary to fairly state the unaudited condensed consolidated financial statements have been made. All such adjustments are of a normal, recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended June 28, 2013. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year. The Company acquired Virident Systems, Inc. ("Virident") on October 17, 2013, sTec, Inc. ("sTec") on September 12, 2013, and VeloBit, Inc. ("VeloBit") on July 10, 2013. These acquisitions are further described in Note 11 below. In connection with the acquisitions, Virident, sTec and VeloBit became indirect wholly-owned subsidiaries of the Company. Virident, sTec and VeloBit's results of operations since the dates of acquisition are included in the condensed consolidated financial statements.

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

## 2. Supplemental Financial Statement Data

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

	December 27, 2013	June 28, 2013	
	(in millions)		
Inventories:			
Raw materials and component parts	\$201	\$167	
Work-in-process	581	575	
Finished goods	511	446	
Total inventories	\$1,293	\$1,188	
Property, plant and equipment:			
Property, plant and equipment	\$7,879	\$7,616	
Accumulated depreciation	(4,370)	(3,916)	)
Property, plant and equipment, net	\$3,509	\$3,700	
Other intangible assets:			
Other intangible assets	\$1,060	\$948	
Accumulated amortization	(453)	(343)	)
Other intangible assets, net	\$607	\$605	

## Warranty

The Company records an accrual for estimated warranty costs when revenue is recognized. The Company generally warrants its products for a period of one to five years. The warranty provision considers estimated product failure rates and trends, estimated replacement costs, estimated repair costs which include scrap costs, and estimated costs for customer compensatory claims related to product quality issues, if any. A statistical warranty tracking model is used to help prepare estimates and assist the Company in exercising judgment in determining the underlying estimates. The statistical tracking model captures specific detail on hard drive reliability, such as factory test data, historical field

return rates, and costs to repair by product type. Management's judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base warranty estimates. Management reviews the warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross profit and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. If actual product return trends, costs to repair

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returned products or costs of customer compensatory claims differ significantly from estimates, future results of operations could be materially affected. Changes in the warranty accrual were as follows (in millions):

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Warranty accrual, beginning of period	\$195	\$230	\$187	\$260
Warranty liability assumed as a result of acquisition (see Note 11)	1	—	4	—
Charges to operations	44	44	84	90
Utilization	(57	) (51	) (106	) (111
Changes in estimate related to pre-existing warranties	7	(12	) 21	(28
Warranty accrual, end of period	\$190	\$211	\$190	\$211

The long-term portion of the warranty accrual classified in other liabilities was \$73 million at both December 27, 2013 and June 28, 2013.

**Other Comprehensive Income (Loss)**

Other comprehensive income (loss) refers to revenue, expenses, gains and losses that are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income (loss) is comprised of unrealized gains and losses on foreign exchange contracts and actuarial gains and losses related to pensions. The income tax impact on components of other comprehensive income is immaterial for all periods presented.

The following table illustrates the changes in the balances of each component of accumulated other comprehensive income for the six months ended December 27, 2013 (in millions):

	Actuarial Pension Gain (Loss)	Foreign Currency Translation Gain (Loss)	Unrealized Gain (Loss) on Foreign Exchange Contracts	Accumulated Other Comprehensive Income (Loss)
Balance at June 28, 2013	\$11	\$—	\$(46	) \$(35
Other comprehensive income before reclassifications	—	—	(11	) (11
Amounts reclassified from accumulated other comprehensive income	—	—	(3	) (3
Net current-period other comprehensive income	—	—	(14	) (14
Balance at December 27, 2013	\$11	\$—	\$(60	) \$(49

The following table illustrates the changes in the balances of each component of accumulated other comprehensive income for the six months ended December 28, 2012 (in millions):

	Actuarial Pension Gain (Loss)	Foreign Currency Translation Gain (Loss)	Unrealized Gain (Loss) on Foreign Exchange Contracts	Accumulated Other Comprehensive Income (Loss)
Balance at June 29, 2012	\$(3	) \$4	\$(16	) \$(15
Other comprehensive income before reclassifications	1	—	45	46
Amounts reclassified from accumulated other comprehensive income	—	(4	) (19	) (23
Net current-period other comprehensive income	1	(4	) 26	23

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Balance at December 28, 2012	\$ (2	) \$—	\$10	\$8
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## 3. Income per Common Share

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

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

	Three Months		Six Months	
	Ended		Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Net income	\$430	\$335	\$925	\$854
Weighted average shares outstanding:				
Basic	236	242	236	244
Employee stock options and other	7	4	7	5
Diluted	243	246	243	249
Income per common share:				
Basic	\$1.82	\$1.38	\$3.92	\$3.50
Diluted	\$1.77	\$1.36	\$3.81	\$3.43
Anti-dilutive potential common shares excluded*	2	7	1	6

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

## 4. Debt

On March 8, 2012 (the "HGST Closing Date"), the Company, in its capacity as the parent entity and guarantor, Western Digital Technologies, Inc. ("WDT"), a wholly owned subsidiary of the Company, and Western Digital Ireland, Ltd. ("WDI"), an indirect wholly owned subsidiary of the Company, entered into a five-year credit agreement (the "Credit Facility") with Bank of America, N.A., as administrative agent, swing line lender and letter of credit issuer, and certain other participating lenders. The Credit Facility provided for \$2.8 billion of unsecured loan facilities consisting of a \$2.3 billion term loan facility and a \$500 million revolving credit facility. The only borrower under the term loan facility was WDI and the revolving credit facility was available to both WDI and WDT. As of December 27, 2013, the outstanding balance was \$1.8 billion for the term loan facility and \$500 million for the revolving credit facility, totaling \$2.3 billion. As of December 27, 2013, the term loan facility and revolving credit facility had a variable interest rate of 2.16% and the Company was in compliance with all covenants. On January 9, 2014, the outstanding balance on the existing Credit Facility was repaid, the Credit Facility was terminated, and a new credit agreement was entered into. For more information on the credit agreement subsequent event, see Note 14.

## 5. Legal Proceedings

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

potential losses in excess of the amounts accrued by the Company), a reasonable estimate of the amount of loss or range of possible losses with respect to the claim or in excess of amounts already accrued by the Company cannot be made. The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

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Solely for purposes of this footnote, “WD” refers to Western Digital Corporation or one or more of its subsidiaries excluding HGST prior to the HGST Closing Date. HGST refers to Hitachi Global Storage Technologies Holdings Pte. Ltd. or one or more of its subsidiaries as of the HGST Closing Date, and “the Company” refers to Western Digital Corporation and all of its subsidiaries on a consolidated basis including HGST.

Intellectual Property Litigation

On June 20, 2008, plaintiff Convole, Inc. (“Convole”) filed a complaint in the Eastern District of Texas against WD, HGST, and one other company alleging infringement of U.S. Patent Nos. 6,314,473 and 4,916,635. The complaint sought unspecified monetary damages and injunctive relief. On October 10, 2008, Convole amended its complaint to allege infringement of only the ‘473 patent. The ‘473 patent allegedly relates to interface technology to select between certain modes of a disk drive’s operations relating to speed and noise. A trial in the matter began on July 18, 2011 and concluded on July 26, 2011 with a verdict against WD and HGST in an amount that is not material to the Company’s financial position, results of operations or cash flows. WD and HGST have filed post-trial motions challenging the verdict and will evaluate their options for appeal after the Court rules on the post-trial motions.

On December 7, 2009, plaintiff Nazomi Communications (“Nazomi”) filed a complaint in the Eastern District of Texas against WD and seven other companies alleging infringement of U.S. Patent Nos. 7,080,362 and 7,225,436. Nazomi dismissed the Eastern District of Texas suit after filing a similar complaint in the Central District of California on February 8, 2010. The case was subsequently transferred to the Northern District of California on October 14, 2010. The complaint seeks injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to processor cores capable of Java hardware acceleration. In August 2012, the Court dismissed WD on summary judgment for non-infringement. Nazomi filed a notice of appeal on January 16, 2013. The Federal Circuit heard oral argument on the appeal on November 4, 2013 and affirmed the Court's grant of summary judgment of non-infringement on January 10, 2014. WD intends to continue to defend itself vigorously in this matter.

On August 1, 2011, plaintiff Guzik Technical Enterprises (“Guzik”) filed a complaint in the Northern District of California against WD and various of its subsidiaries alleging infringement of U.S. Patent Nos. 6,023,145 and 6,785,085, breach of contract and misappropriation of trade secrets. The complaint seeks injunctive relief and unspecified monetary damages, fees and costs. The patents asserted by Guzik allegedly relate to devices used to test hard disk drive heads and media. On November 30, 2013, WD entered into a settlement agreement for an amount that is not material to the Company’s financial position, results of operations or cash flows, for which the Company recorded an accrual in the three months ended December 27, 2013. Guzik is disputing the enforceability of the agreement and on December 27, 2013, WD filed a motion to enforce the agreement. WD intends to defend itself vigorously in this matter.

On July 9, 2012, Siemens Aktiengesellschaft (“Siemens”) filed a complaint in German court against WD, Western Digital GmbH, and Digital River International, S.a.r.l. alleging patent infringement of European patent no. EP 674769, which claims an artificial antiferromagnetic (AAF) (aka, synthetic antiferromagnetic) structure for giant magneto-resistive (GMR) sensors. On March 14-15, 2013, Western Digital GmbH filed a response of non-infringement and also filed a separate nullity action. Siemens separately served WD on July 15, 2013. WD responded on September 6, 2013. Siemens' response is due on March 28, 2014. Western Digital GmbH's and WD’s rejoinder will then be due on September 26, 2014. The oral hearing is scheduled for October 28, 2014. WD and Western Digital GmbH intend to defend themselves vigorously in this matter.

On April 29, 2013, plaintiffs Charles C. Freeney III et al. filed a complaint in the Eastern District of Texas against WD alleging infringement of U.S. Patent No. 7,110,744. The complaint seeks injunctive relief and unspecified monetary damages, fees and costs. The patent allegedly relates to WD’s AC router products. On November 14, 2013, WD and Mr. Freeney III et al. reached a settlement in this matter for an amount that was not material to the Company’s financial position, results of operations or cash flows. On December 11, 2013, the United States District Court for the Eastern District of Texas ordered that all claims against WD are dismissed with prejudice.

On September 5, 2013, plaintiff Lake Cherokee Hard Drive Technologies, LLC (“Lake Cherokee”) filed a complaint in the Eastern District of Texas against: Marvell Asia PTE, Ltd., Samsung Semiconductor, Inc., Seagate Tech. LLC, Seagate Tech. Int’l., Toshiba Corp., Toshiba Am. Elec. Components, Toshiba Am. Inf. Sys., Inc., Toshiba Am. Inf. Equip. (Philippines), Inc., and WDT alleging infringement of US Patent Nos. 5,844,738 and 5,978,162. Lake



Cherokee alleges that WDT's hard disk drive products that contain Marvell read channel systems-on-a-chip (SOCs) infringe its '738 and '162 patents. The complaint seeks unspecified monetary damages, fees and costs. WDT intends to defend itself vigorously in this matter.

On September 25, 2013, plaintiff Lake Cherokee filed a complaint in the Eastern District of Texas against: Marvell Semiconductor, Inc., Marvell Asia PTE, Ltd., Dell Inc., and WDT alleging infringement of US Patent No. 5,583,706. Lake

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Cherokee alleges that WDT's hard disk drive products that contain Marvell read channel systems-on-a-chip (SOCs) infringe its '706 patent. The complaint seeks an injunction, unspecified monetary damages, fees and costs. WDT intends to defend itself vigorously in this matter.

On September 9, 2013, plaintiff Garnet Digital, LLC ("Garnet Digital") filed a complaint in the Eastern District of Texas against WDT, alleging infringement of US Patent No. 5,379,421. Garnet Digital alleges that the WD TV Live product infringes the '421 patent. The complaint seeks unspecified monetary damages, fees and costs. On January 21, 2014, WDT and Garnet Digital reached a settlement in this matter for an amount that was not material to the Company's financial position, results of operations or cash flows.

Seagate Matter

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

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

On October 12, 2012, the District Court of Hennepin County, Minnesota vacated, in full, the \$630.4 million final arbitration award. Specifically, the Court confirmed the arbitration award with respect to each of the five trade secret claims that WD and the former employee had won at the arbitration and vacated the arbitration award with respect to the three trade secret claims that WD and the former employee had lost at the arbitration. The Court ordered that a rehearing be held concerning those three alleged trade secret claims before a new arbitrator.

On October 30, 2012, Seagate initiated an appeal of the Court's decision with the Minnesota Court of Appeals. On July 22, 2013, the Minnesota Court of Appeals reversed the District Court's decision and remanded for entry of an order and judgment confirming the arbitration award. The Company strongly disagrees with the decision of the Court of Appeals and believes that the District Court's decision was correct. On August 20, 2013, the Company filed a petition for review with the Minnesota Supreme Court and, on October 15, 2013, the Company was informed that the Minnesota Supreme Court granted the Company's petition. The appeal before the Minnesota Supreme Court has been fully briefed, and oral argument is scheduled for February 5, 2014. The Company will continue to vigorously defend itself in this matter. In light of uncertainties with respect to this matter, the Company recorded an accrual of \$681 million for this matter in its financial statements in the fourth quarter of fiscal 2013 and recorded additional interest totaling \$13 million and \$26 million in the three and six months ended December 27, 2013, respectively, which is included within charges related to arbitration award in the condensed consolidated statements of income. This amount is in addition to the \$25 million previously accrued in the fourth quarter of fiscal 2011. The total amount accrued of \$732 million represents the amount of the final arbitration award, plus interest accrued on the initial arbitration award

at the statutory rate of 10% from January 24, 2012 through December 27, 2013.

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### Other Matters

In the normal course of business, the Company is subject to other legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of probable monetary liability or financial impact with respect to these other matters is subject to many uncertainties and is therefore not predictable with assurance, management believes that any monetary liability or financial impact to the Company from these other matters, individually and in the aggregate, would not be material to the Company's financial condition, results of operations or cash flows. However, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these other matters could differ materially from those projected.

### 6. Income Taxes

The Company's income tax provision for the three and six months ended December 27, 2013 was \$37 million and \$74 million, respectively, as compared to \$133 million and \$192 million in the respective prior-year periods. The Company recorded an \$88 million charge to reduce its previously recognized California deferred tax assets in the six months ended December 28, 2012 as a result of the enactment of California Proposition 39. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2014 through 2025 and the current year generation of income tax credits.

In the three months ended December 27, 2013, the Company recorded a net increase of \$10 million in its liability for unrecognized tax benefits. In the six months ended December 27, 2013, the Company recorded a net increase of \$23 million in its liability for unrecognized tax benefits. In addition, the Company recorded a \$3 million increase related to the Virident and sTec acquisitions in the six months ended December 27, 2013. As of December 27, 2013, the Company had a recorded liability for unrecognized tax benefits of approximately \$263 million. Interest and penalties recognized on such amounts were not material to the condensed consolidated financial statements during the three and six months ended December 27, 2013.

The Internal Revenue Service ("IRS") previously completed its field examination of the Company's federal income tax returns for fiscal years 2006 and 2007 and issued Revenue Agent Reports that proposed adjustments to income before income taxes of approximately \$970 million primarily related to transfer pricing and intercompany payable balances. The Company disagreed with the proposed adjustments and filed a protest with the IRS Appeals Office. In June 2013, the Company reached an agreement with the IRS to resolve the transfer pricing issue. This agreement resulted in a decrease in the amount of net operating loss and tax credits realized, but did not have an impact on the Company's consolidated statements of income. The proposed adjustment relating to intercompany payable balances for fiscal years 2006 and 2007 will be addressed in conjunction with the IRS's examination of the Company's fiscal years 2008 and 2009, which commenced in January 2012. In addition, in January 2012, the IRS commenced an examination of the 2007 fiscal period ended September 5, 2007 of Komag, Incorporated, which was acquired by the Company on September 5, 2007. In February 2013, the IRS commenced an examination of calendar years 2010 and 2011 of HGST, which was acquired by the Company on March 8, 2012.

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of December 27, 2013, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company's liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company's tax returns.

### 7. Fair Value Measurements

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

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

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

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

The following table presents information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of December 27, 2013, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

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	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	\$ 1,739	\$—	\$—	\$ 1,739
Auction-rate securities	—	—	14	14
Total assets at fair value	\$ 1,739	\$—	\$ 14	\$ 1,753
Liabilities:				
Foreign exchange contracts	\$—	\$ 73	\$—	\$ 73
Total liabilities at fair value	\$—	\$ 73	\$—	\$ 73

The following table presents information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of June 28, 2013, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	\$ 1,227	\$—	\$—	\$ 1,227
Auction-rate securities	—	—	14	14
Total assets at fair value	\$ 1,227	\$—	\$ 14	\$ 1,241
Liabilities:				
Foreign exchange contracts	\$—	\$ 57	\$—	\$ 57
Total liabilities at fair value	\$—	\$ 57	\$—	\$ 57

Money Market Funds. The Company's money market funds are funds that invest in U.S. Treasury and U.S.

Government Agency securities and are recorded within cash and cash equivalents in the condensed consolidated balance sheets. Money market funds are valued based on quoted market prices.

Auction-Rate Securities. The Company's auction-rate securities have maturity dates through 2050, are primarily backed by insurance products and are accounted for as available-for-sale securities. These investments are classified as long-term investments and recorded within other non-current assets in the condensed consolidated balance sheets.

Auction-rate securities are valued by a third party using trade information related to the secondary market.

Foreign Exchange Contracts. The Company's foreign exchange contracts are short-term contracts to hedge the Company's foreign currency risk. Foreign exchange contracts are classified within other current assets and liabilities in the condensed consolidated balance sheets. 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. For more information on the Company's foreign exchange contracts, see Note 8 below. Foreign exchange contracts are valued using an income approach that is based on a present value of future cash flows model. The market-based observable inputs for the model include forward rates and credit default swap rates.

In the three and six months ended December 27, 2013, there were no transfers between levels and no changes in Level 3 financial assets measured on a recurring basis.

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

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## 8. Foreign Exchange Contracts

Although the majority of the Company's transactions are in U.S. dollars, some transactions are based in various foreign currencies. The Company purchases short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedging transactions is to minimize the impact of foreign currency fluctuations on the Company's results of operations. These contract maturity dates do not exceed 12 months. All foreign exchange contracts are for risk management purposes only. The Company does not purchase foreign exchange contracts for trading purposes. As of December 27, 2013, the Company had outstanding foreign exchange contracts with commercial banks for British Pound Sterling, Euro, Japanese Yen, Malaysian Ringgit, Philippine Peso, Singapore Dollar and Thai Baht, which were designated as either cash flow or fair value hedges.

If the derivative is designated as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially deferred in other comprehensive income (loss), net of tax and presented within cash flow from operations. These amounts are subsequently recognized into earnings when the underlying cash flow being hedged is recognized into earnings. Recognized gains and losses on foreign exchange contracts entered into for manufacturing-related activities are reported in cost of revenue. Hedge effectiveness is measured by comparing the hedging instrument's cumulative change in fair value from inception to maturity to the underlying exposure's terminal value. The Company determined the ineffectiveness associated with its cash flow hedges to be immaterial to the condensed consolidated financial statements for the three and six months ended December 27, 2013 and December 28, 2012.

A change in the fair value of fair value hedges is recognized in earnings in the period incurred and is reported as a component of operating expenses. All fair value hedges were determined to be effective. The fair value and the changes in fair value on these contracts were immaterial to the condensed consolidated financial statements during the three and six months ended December 27, 2013 and December 28, 2012.

As of December 27, 2013, the net amount of unrealized losses with respect to the Company's foreign exchange contracts that is expected to be reclassified into earnings within the next 12 months was \$60 million. In addition, as of December 27, 2013, the Company did not have any foreign exchange contracts with credit-risk-related contingent features. The Company opened \$1.7 billion and \$2.7 billion and closed \$1.3 billion and \$2.7 billion, in foreign exchange contracts in the three and six months ended December 27, 2013, respectively. The Company opened \$647 million and \$1.4 billion and closed \$923 million and \$2.0 billion, in foreign exchange contracts in the three and six months ended December 28, 2012, respectively. The fair value and balance sheet location of such contracts were as follows (in millions):

	Asset Derivatives		Liability Derivatives		
	December 27, 2013	June 28, 2013	December 27, 2013	June 28, 2013	
Derivatives Designated as Hedging Instruments	Balance Sheet Location	Fair Value Location	Fair Value Location	Fair Value Location	Fair Value
Foreign exchange contracts	Other current assets	Other current assets	Accrued expenses	Accrued expenses	
	\$—	\$—	\$73	\$57	

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 December 27, 2013 (in millions):

Derivatives Designated as Hedging Instruments	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets (Liabilities) Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		
				Financial Instruments	Cash Collateral Received or Pledged	Net Amount
Foreign exchange contracts						
Financial liabilities	\$(73)	\$—	\$(73)	\$—	\$—	\$(73)

Total derivative instruments \$(73 ) \$— \$(73 ) \$— \$— \$(73 )

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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 June 28, 2013 (in millions):

Derivatives Designated as Hedging Instruments	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets (Liabilities) Presented in the Balance Sheet	Gross Amounts Not Offset in the Balance Sheet		
				Financial Instruments	Cash Collateral Received or Pledged	Net Amount
Foreign exchange contracts						
Financial assets	\$10	\$(10)	\$—	\$—	\$—	\$—
Financial liabilities	(67)	) 10	(57)	—	—	(57)
Total derivative instruments	\$(57)	) \$—	\$(57)	\$—	\$—	\$(57)

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

	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives				Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Amount of Gain Reclassified From Accumulated OCI into Income				
	Three Months Ended		Six Months Ended			December 27, 2013	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012			December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Foreign exchange contracts	\$—	\$(11)	) \$14	\$45	Cost of revenue	\$30	\$3	\$16	\$19	

The total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements during the three and six months ended December 27, 2013 and December 28, 2012.

## 9. Stock-Based Compensation

In connection with the acquisition of Virident, the Company assumed all stock options that were outstanding and unvested as of the acquisition date. In connection with the acquisition of sTec, the Company assumed all of the unvested RSUs outstanding under sTec's stock plans as of the acquisition date. In addition, the Company assumed all of the stock options outstanding under sTec's stock plans as of the acquisition date with the exception of any unvested, unexercised and outstanding stock options that had an exercise price greater than the merger consideration as defined in the merger agreement. The assumed stock options and RSUs were converted into equivalent stock options and RSUs with respect to shares of the Company's common stock using an equity award exchange ratio.

### Stock-based Compensation Expense

During the three and six months ended December 27, 2013, the Company recognized in expense \$24 million and \$45 million for stock-based compensation related to the vesting of options issued under the Company's stock plans and the ESPP, respectively, as compared to \$24 million and \$49 million in the respective prior-year periods. The tax benefit realized as a result of the aforementioned stock-based compensation expense was \$6 million and \$11 million in the three and six months ended December 27, 2013, respectively, as compared to \$6 million and \$13 million in the three and six months ended December 28, 2012, respectively. As of December 27, 2013, total compensation cost related to unvested stock options and ESPP rights issued to employees but not yet recognized was \$161 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.2 years.

During the three and six months ended December 27, 2013, the Company recognized in expense \$18 million and \$39 million for stock-based compensation related to the vesting of awards of RSUs issued under the Company's stock

plans, respectively, as compared to \$12 million and \$25 million in the respective prior-year periods. The tax benefit realized as a result of the aforementioned stock-based compensation expense was \$5 million and \$9 million in the three and six months ended December 27, 2013, respectively, as compared to \$3 million and \$7 million in the three and six months ended December 28, 2012. As of December 27, 2013, the aggregate unamortized fair value of all unvested RSUs was \$127 million, which will be recognized on a straight-line basis over a weighted average vesting period of approximately 1.8 years. RSUs include performance stock unit awards (“PSUs”). The effect of PSUs was immaterial to the condensed consolidated financial statements in the three and six months ended December 27, 2013 and December 28, 2012.

During the three and six months ended December 27, 2013, the Company recognized in expense \$20 million and \$24 million related to adjustments to market value as well as the vesting of stock appreciation rights (“SARs”), as compared to \$4

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million and \$16 million in the respective prior-year periods. The tax benefit realized as a result of the aforementioned SARs expense was \$4 million and \$5 million in the three and six months ended December 27, 2013, as compared to \$1 million and \$4 million in the three and six months ended December 28, 2012, respectively. The SARs will be settled in cash upon exercise. As a result, the Company had a total liability of \$66 million related to SARs included in accrued expenses in the condensed consolidated balance sheet as of December 27, 2013. In addition, as of December 27, 2013, total compensation cost related to unvested SARs issued to employees but not yet recognized was \$5 million and will be recognized on a straight-line basis over a weighted average service period of approximately 0.3 years.

**Stock Option Activity**

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

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding at June 28, 2013	11.9	\$29.47		
Granted	1.6	68.40		
Assumed in acquisition	0.4	117.41		
Exercised	(0.7)	) 30.14		
Canceled or expired	(0.1)	) 29.93		
Options outstanding at September 27, 2013	13.1	36.77		
Assumed in acquisition	1.3	12.32		
Exercised	(1.6)	) 25.34		
Canceled or expired	(0.3)	) 76.28		
Options outstanding at December 27, 2013	12.5	34.99	4.8	\$610
Exercisable at December 27, 2013	4.8	\$32.45	3.2	\$253
Vested and expected to vest after December 27, 2013	12.3	\$34.79	4.8	\$602

If an option has an exercise price that is less than the quoted price of the Company's common stock at the particular time, the aggregate intrinsic value of that option at that time is calculated based on the difference between the exercise price of the underlying options and the quoted price of the Company's common stock at that time. As of December 27, 2013, the Company had options outstanding to purchase an aggregate of 12.3 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 \$610 million at that date. During the three and six months ended December 27, 2013, the aggregate intrinsic value of options exercised under the Company's stock option plans was \$80 million and \$107 million, respectively, determined as of the date of exercise, as compared to \$25 million and \$79 million in the respective prior-year periods.

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## RSU Activity

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

	Number of Shares	Weighted Average Grant-Date Fair Value
RSUs outstanding at June 28, 2013	3.6	\$35.82
Granted	1.3	68.41
Assumed in acquisition	0.2	62.73
Vested	(0.9	) 29.73
RSUs outstanding at September 27, 2013	4.2	48.39
Granted	0.1	74.54
Vested	(0.2	) 42.86
Forfeited	(0.1	) 46.19
RSUs outstanding at December 27, 2013	4.0	\$49.10
Expected to vest after December 27, 2013	3.8	\$48.86

The fair value of each RSU is the market price of the Company's stock at the date of grant. RSUs are generally payable in an equal number of shares of the Company's common stock at the time of vesting of the units. The grant-date fair value of the shares underlying the RSU awards at the date of grant was \$4 million and \$92 million in the three and six months ended December 27, 2013, respectively. These amounts are being recognized to expense over the corresponding vesting periods. For purposes of valuing these awards, the Company has assumed a forfeiture rate of 3.5% and 3.3%, for the three and six months ended December 27, 2013, respectively, based on a historical analysis indicating forfeitures for these types of awards.

## SARs Activity

The share-based compensation liability for SARs is recognized for the portion of fair value for which service has been rendered at the reporting date. The share-based liability is remeasured at each reporting date, using a binomial option-pricing model, through the requisite service period. As of December 27, 2013, 1.0 million SARs were outstanding with a weighted average exercise price of \$7.92. There were no SARs granted and all other SARs activity was immaterial to the condensed consolidated financial statements for the three and six months ended December 27, 2013.

## Fair Value Disclosure — Binomial Model

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

	Three Months Ended		Six Months Ended	
	December 27, 2013	December 28, 2012	December 27, 2013	December 28, 2012
Suboptimal exercise factor	2.20	1.92	2.06	1.90
Range of risk-free interest rates	0.12% to 2.44%	0.16% to 1.18%	0.10% to 2.44%	0.16% to 1.18%
Range of expected stock price volatility	0.29 to 0.49	0.42 to 0.52	0.29 to 0.50	0.42 to 0.53
Weighted average expected volatility	0.41	0.47	0.43	0.49
Post-vesting termination rate	3.18%	2.41%	3.09%	2.09%
Dividend yield	1.45%	2.41%	1.58%	2.58%
Fair value	\$25.29	\$13.08	\$24.03	\$15.56

The weighted average expected term of the Company's stock options granted during the three and six months ended December 27, 2013 was 5.4 years and 5.0 years, respectively, compared to 4.2 years and 4.0 years in the respective prior-year periods.

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## Fair Value Disclosure — Black-Scholes-Merton Model

The fair value of ESPP purchase rights issued is estimated at the date of grant of the purchase rights using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until options are exercised. Purchase rights under the current ESPP are granted on either June 1st or December 1st of each year. ESPP activity was immaterial to the condensed consolidated financial statements for the three and six months ended December 27, 2013 and December 28, 2012.

## Stock Repurchase Program

Since May 21, 2012, the Company's Board of Directors has authorized an additional \$3.0 billion for the repurchase of its common stock and the extension of its stock repurchase program through September 13, 2017. The Company repurchased 2.0 million and 4.3 million shares for a total cost of \$150 million and \$300 million during the three and six months ended December 27, 2013, respectively. The remaining amount available to be purchased under the Company's stock repurchase program as of December 27, 2013 was \$1.7 billion. The Company may continue to repurchase its stock as it deems appropriate and market conditions allow. Repurchases under the stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan. The Company expects stock repurchases to be funded principally by operating cash flows and borrowings under the Company's Credit Agreement.

## Dividends to Shareholders

On September 13, 2012, the Company announced that its Board of Directors had authorized the adoption of a quarterly cash dividend policy. Under the cash dividend policy, holders of the Company's common stock receive dividends when and as declared by the Company's Board of Directors. In the three months ended December 27, 2013, the Company declared a cash dividend of \$0.30 per share of the Company's common stock to shareholders of record as of December 27, 2013, totaling \$71 million, which was paid on January 15, 2014. In addition, in the three months ended September 27, 2013, the Company declared a cash dividend of \$0.25 per share of the Company's common stock to shareholders of record as of September 30, 2013, for a total of \$59 million which was paid on October 15, 2013. The Company may modify, suspend or cancel its cash dividend policy in any manner and at any time.

## 10. Pensions and Other Post-retirement Benefit Plans

The Company's principal pension and other post-retirement benefit plans are in Japan. All pension and other post-retirement benefit plans outside of the Company's Japanese plans were immaterial to the Company's condensed consolidated financial statements for the three and six months ended December 27, 2013 and December 28, 2012. The expected long-term rate of return on the Japanese plan assets is 3.5%.

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

	December 27, 2013	June 28, 2013
Benefit obligation	\$234	\$234
Fair value of plan assets	(172	) (167
Unfunded status	\$62	\$67

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

	December 27, 2013	June 28, 2013
Current liabilities	\$1	\$1
Non-current liabilities	61	66
Net amount recognized	\$62	\$67

The net periodic benefit cost of the Company's pension plans was not material to the condensed consolidated financial statements for the three and six months ended December 27, 2013 and December 28, 2012. The Company's expected employer contribution for its Japanese defined benefit pension plans is \$13 million in fiscal 2014.



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## 11. Acquisitions

## Acquisition of Virident

On October 17, 2013, the Company acquired Virident, a provider of server-side flash storage solutions for virtualization, database, cloud computing and webscale applications. As a result of the acquisition, Virident was fully integrated into the Company's HGST subsidiary and became a wholly owned indirect subsidiary of the Company. The purchase price of the acquisition was approximately \$613 million, consisting of \$598 million which was funded with available cash and \$15 million related to the fair value of stock options assumed. The acquisition is expected to further HGST's strategy to address the rapidly changing needs of enterprise customers by delivering intelligent storage solutions that maximize application performance by leveraging the tightly coupled server, storage and network resources of today's converged datacenter infrastructures.

The Company identified and recorded the assets acquired and liabilities assumed at their estimated fair values at the date of acquisition, and allocated the remaining value of \$505 million to goodwill. The values assigned to the acquired assets and liabilities are based on preliminary estimates of fair value available as of the date of this Quarterly Report on Form 10-Q, and may be adjusted during the measurement period of up to 12 months from the date of the acquisition as further information becomes available with any changes in the fair values potentially resulting in material adjustments to goodwill. The individual tangible and intangible assets acquired as well as the liabilities assumed in the acquisition were immaterial to the Company's condensed consolidated financial statements. In addition, pro forma financial information has not been presented as the acquisition did not have a material impact on the Company's condensed consolidated financial statements for the three months ended December 27, 2013.

The preliminary purchase price allocation for Virident was as follows (in millions):

	October 17, 2013
Tangible net assets acquired and liabilities assumed	\$59
Intangible assets	49
Goodwill	505
Total	\$613

The \$505 million of goodwill recognized is primarily attributable to the benefits the Company expects to derive from an ability to create server-side flash storage solutions leveraging the core technology acquired and is not expected to be deductible for tax purposes. The impact to revenue and net income attributable to Virident was immaterial to the Company's condensed consolidated financial statements for the three months ended December 27, 2013.

## Acquisition of sTec

On September 12, 2013, the Company completed its acquisition of sTec, a provider of enterprise solid-state drives. As a result of the acquisition, sTec was fully integrated into the Company's HGST subsidiary and became a wholly owned indirect subsidiary of the Company. The purchase price of the acquisition was approximately \$336 million, consisting of \$325 million which was funded with available cash and \$11 million related to the fair value of stock options and RSUs assumed. The acquisition is intended to augment HGST's existing solid-state storage capabilities.

The Company identified and recorded the assets acquired and liabilities assumed at their estimated fair values at the date of acquisition, and allocated the remaining value of \$85 million to goodwill. The values assigned to the acquired assets and liabilities are based on preliminary estimates of fair value available as of the date of this Quarterly Report on Form 10-Q, and may be adjusted as further information becomes available during the measurement period of up to 12 months from the date of the acquisition. The primary areas of the preliminary purchase price allocation that are not yet finalized due to information that may become available subsequently include contingencies and income taxes and any changes in these fair values could potentially result in material adjustments to goodwill. The individual tangible and intangible assets acquired as well as the liabilities assumed in the acquisition were immaterial to the Company's condensed consolidated financial statements. In addition, pro forma financial information has not been presented as the acquisition did not have a material impact on the Company's condensed consolidated financial statements for the three and six months ended December 27, 2013.





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The preliminary purchase price allocation for sTec was as follows (in millions):

	September 12, 2013
Tangible net assets acquired and liabilities assumed	\$ 193
Intangible assets	58
Goodwill	85
Total	\$ 336

The \$85 million of goodwill recognized is primarily attributable to the benefits the Company expects to derive from augmenting HGST's existing solid-state storage capabilities and accelerating its ability to expand its participation in the growing area of enterprise solid-state drives ("SSDs") and is not expected to be deductible for tax purposes. The impact to revenue and net income attributable to sTec was immaterial to the Company's condensed consolidated financial statements for the three and six months ended December 27, 2013.

#### Acquisition of VeloBit

On July 10, 2013, the Company acquired VeloBit, a privately held provider of high-performance storage I/O optimization software. As a result of the acquisition, VeloBit was fully integrated into the Company's HGST subsidiary and became a wholly owned indirect subsidiary of the Company. The acquisition is intended to build on HGST's strategy to enhance the overall value of datacenter storage by integrating HGST SSDs with software. The acquisition was not material to the Company's condensed consolidated financial statements.

#### 12. Employee Termination Benefits and Other Charges

During 2013, the Company incurred charges of \$138 million to realign its operations with anticipated market demand. These charges consisted of \$109 million of employee termination benefits, \$14 million of asset impairment charges and \$15 million of contract and other termination charges and were classified as operating expenses and included within employee termination benefits and other charges in the consolidated statements of income. At June 28, 2013, the Company had a liability of \$46 million related to these charges. In the six months ended December 27, 2013, the Company paid \$30 million of employee termination benefits and settled \$9 million of contract and other termination charges. As a result, the Company's remaining liability totaled \$7 million at December 27, 2013 and is expected to be settled by the end of fiscal 2014.

#### 13. Recent Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2013-02, "Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02"). The new standard requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. The Company adopted this pronouncement in the first quarter of fiscal 2014. Since ASU 2013-02 related only to the presentation and disclosure of information, it did not have a material effect on the Company's condensed consolidated financial statements. In July 2013, the FASB issued ASU 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). The new standard requires the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the condensed consolidated balance sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new standard is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2013, which for the Company is the first quarter of fiscal 2015. The Company is currently evaluating the impact ASU 2013-11 will have to its condensed consolidated balance sheets.

#### 14. Subsequent Event

On January 9, 2014 (the "Closing Date"), WDI used existing cash to repay the outstanding term loan balance of \$1.8 billion under the Credit Facility, and subsequently, on the Closing Date, Western Digital Corporation, WDT and WDI, entered into a new Credit Agreement with JPMorgan Chase Bank, N.A., as administrative agent, and the lenders party thereto (the "Credit Agreement"); WDT paid the outstanding revolving credit facility balance of \$500 million under the Credit Facility; and the Company terminated the Credit Facility. The Credit Agreement provides for \$4.0 billion of

unsecured loan facilities consisting of a \$2.5 billion term loan facility to WDT and a \$1.5 billion revolving credit facility to WDT and WDI (the “Borrowers”). The revolving credit facility includes a \$100 million sublimit for letters of credit and a \$50 million sublimit for swing line loans. Subject to certain conditions, a Borrower may elect to expand the credit facilities by, or obtain incremental term loans of, up to \$1.0 billion

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if existing or new lenders provide additional term or revolving commitments. The loans under the Credit Agreement have a five-year term. The obligations of the Borrowers under the Credit Agreement are guaranteed by Western Digital Corporation and its material domestic subsidiaries, and the obligations of WDI under the Credit Agreement are also guaranteed by WDT.

As of the date of this Quarterly Report on Form 10-Q, the outstanding term loan balance under the Credit Agreement was \$2.5 billion. The Company is required to make quarterly principal payments on the term loan facility beginning in March 2014, totaling \$63 million for the remainder of fiscal 2014, \$125 million in fiscal 2015, \$156 million in fiscal 2016, \$219 million in fiscal 2017, \$250 million in fiscal 2018 and the remaining balance of \$1.7 billion in fiscal 2019. The Credit Agreement requires the Company to comply with a leverage ratio and an interest coverage ratio calculated on a consolidated basis for the Company and its subsidiaries. In addition, the Credit Agreement contains customary covenants, including covenants that limit or restrict the Company's and its subsidiaries' ability to incur liens, incur indebtedness, make certain restricted payments, merge or consolidate and enter into certain speculative hedging arrangements, and customary events of default. As of the date of this Quarterly Report on Form 10-Q, the Company was in compliance with all covenants.

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

This information should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in our Annual Report on Form 10-K for the year ended June 28, 2013.

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

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

Forward-Looking Statements

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

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

- expectations regarding industry demand and pricing in the March quarter and the ability of the industry to support this demand;
- expectations concerning the anticipated benefits of our acquisitions;
- demand for hard drives and solid-state drives in the various markets and factors contributing to such demand;
- our position in the industry;
- our belief regarding our ability to capitalize on the expansion in, and our expectations regarding the growth and demand of, digital data;
- our plans to continue to develop new products and expand into new storage markets and into emerging economic markets;
- emergence of new storage markets for hard drives;
- emergence of competing storage technologies;
- our quarterly cash dividend policy;
- our share repurchase plans;
- our stock price volatility;
- our belief regarding our compliance with environmental laws and regulations;
- expectations regarding our external and internal supply base;
- our belief regarding component availability;
- expectations regarding the outcome of legal proceedings in which we are involved;



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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;  
contributions to our pension plans in fiscal 2014; and  
our beliefs regarding the sufficiency of our cash and cash equivalents to meet our working capital, capital expenditure and other cash needs.

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

### Our Company

We are a leading developer and manufacturer of data storage solutions that enable consumers, businesses, governments and other organizations to create, manage, experience and preserve digital content. Our principal products are hard drives. Our product portfolio also includes solid-state drives ("SSDs"). Hard drives are today's primary storage medium for digital data, with solid-state storage products growing rapidly. Our products are marketed under the HGST, WD and G-Technology brand names. We currently operate our global business through two independent subsidiaries due to regulatory requirements - HGST and WD.

### Acquisitions

#### Acquisition of Virident Systems, Inc. ("Virident")

On October 17, 2013, we acquired Virident, a provider of server-side flash storage solutions for virtualization, database, cloud computing and webscale applications. Virident was fully integrated into our HGST subsidiary and became our wholly owned indirect subsidiary. The purchase price of the acquisition was approximately \$613 million, consisting of \$598 million which was funded with available cash and \$15 million related to the fair value of stock options assumed. The acquisition is expected to further HGST's strategy to address the rapidly changing needs of enterprise customers by delivering intelligent storage solutions that maximize application performance by leveraging the tightly coupled server, storage and network resources of today's converged datacenter infrastructures. The acquisition of Virident did not have a material impact on our condensed consolidated financial statements for the three months ended December 27, 2013.

#### Acquisition of sTec, Inc. ("sTec")

On September 12, 2013, we completed the acquisition of sTec, a provider of enterprise SSDs. As a result of the acquisition, sTec was fully integrated into our HGST subsidiary and became our wholly owned indirect subsidiary. The acquisition is intended to augment HGST's existing solid-state storage capabilities. The purchase price of the acquisition was approximately \$336 million, consisting of \$325 million which was funded with available cash and \$11 million related to the fair value of stock options and RSUs assumed. The acquisition of sTec did not have a material impact on our condensed consolidated financial statements for the three and six months ended December 27, 2013.

#### Acquisition of VeloBit, Inc. ("VeloBit")

On July 10, 2013, we acquired VeloBit, a privately held provider of high-performance storage I/O optimization software. As a result of the acquisition, VeloBit was fully integrated into our HGST subsidiary and became our wholly owned indirect subsidiary. The acquisition is intended to build on HGST's strategy to enhance the overall value of datacenter storage by integrating HGST SSDs with software. The acquisition was not material to our condensed consolidated financial statements.

### Second Quarter Overview

In accordance with accounting principles generally accepted in the United States ("U.S. GAAP"), operating results for Virident, which was acquired on October 17, 2013, sTec, which was acquired on September 12, 2013, and VeloBit,

which was acquired on July 10, 2013, are included in our operating results only after the dates of acquisition. For the quarter ended December 27, 2013, we believe that overall hard drive industry shipments totaled approximately 142 million units, up 5% from the prior-year period and up 1% from the September quarter.

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

	Three Months Ended				Six Months Ended			
	December 27, 2013		December 28, 2012		December 27, 2013		December 28, 2012	
Net revenue	\$3,972	100.0 %	\$3,824	100.0 %	\$7,776	100.0 %	\$7,859	100.0 %
Gross profit	1,141	28.7	1,059	27.7	2,229	28.7	2,252	28.7
Total operating expenses	663	16.7	581	15.2	1,209	15.5	1,182	15.0
Operating income	478	12.0	478	12.5	1,020	13.1	1,070	13.6
Net income	430	10.8	335	8.8	925	11.9	854	10.9

The following is a summary of our financial performance for the second quarter of fiscal 2014:

Consolidated net revenue totaled \$4.0 billion.

54% of our net revenue was derived from non-PC (personal computer) markets, which include enterprise applications, branded products and CE (consumer electronics) products, as compared to 49% in the prior-year period.

Net revenue derived from enterprise SSDs was \$155 million as compared to \$89 million in the prior-year period.

Hard drive unit shipments increased 7% from the prior-year period to 63.1 million units.

Gross margin increased to 28.7%, compared to 27.7% for the prior-year period.

Operating income was \$478 million, flat with the prior-year period.

We generated \$727 million in cash flow from operations in the second quarter of fiscal 2014, and we ended the quarter with \$4.7 billion in cash and cash equivalents.

For the quarter ending March 28, 2014, we expect overall hard drive industry shipments and our revenue to decrease slightly from the December quarter as a result of seasonality.

## Results of Operations

## Net Revenue

(in millions, except percentages and average selling price)	Three Months Ended			Six Months Ended		
	December 27, 2013	December 28, 2012	Percentage Change	December 27, 2013	December 28, 2012	Percentage Change
Net revenue	\$3,972	\$3,824	4 %	\$7,776	\$7,859	(1) %
Average selling price (per unit)*	\$60	\$62	(3) %	\$59	\$62	(5) %
Revenues by Geography (%)						
Americas	25 %	27 %		26 %	25 %	
Europe, Middle East and Africa	23	23		21	20	
Asia	52	50		53	55	
Revenues by Channel (%)						
OEM	62 %	61 %		63 %	62 %	
Distributors	24	24		24	24	
Retailers	14	15		13	14	
Unit Shipments*						
PC	39.5	39.0		79.7	81.7	
Non-PC	23.6	20.2		46.0	40.0	
Total units shipped	63.1	59.2	7 %	125.7	121.7	3 %

\* Based on sales of hard drive units only.



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For the quarter ended December 27, 2013, net revenue was \$4.0 billion, an increase of 4% from the prior-year period. Total hard drive shipments increased to 63.1 million units for the quarter ended December 27, 2013 as compared to 59.2 million units in the prior-year period. For the six months ended December 27, 2013, net revenue was \$7.8 billion, a decrease of 1% from the

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prior year period. Total hard drive shipments increased to 125.7 million units for the six months ended December 27, 2013, as compared to 121.7 million units in the prior-year period. For the quarter ended December 27, 2013, average selling price ("ASP") decreased by \$2 from the prior-year period, from \$62 to \$60. For the six months ended December 27, 2013, ASP decreased by \$3 from the prior-year period, from \$62 to \$59. These decreases in ASP were primarily driven by a competitive pricing environment.

Changes in revenue by geography and channel generally reflect normal fluctuations in market demand and competitive dynamics. For the three and six months ended December 27, 2013, Hewlett-Packard Company accounted for approximately 11% and 12% of our net revenue, respectively. For the three and six months ended December 28, 2012, no customer accounted for 10% or more 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 the three and six months ended December 27, 2013, these programs represented 7% of gross revenues, as compared to 9% and 8% in the respective prior-year periods. These amounts generally vary according to several factors, including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product.

**Gross Margin**

(in millions, except percentages)	Three Months Ended			Six Months Ended		
	December 27, 2013	December 28, 2012	Percentage Change	December 27, 2013	December 28, 2012	Percentage Change
Net revenue	\$3,972	\$3,824	4 %	\$7,776	\$7,859	(1) %
Gross profit	1,141	1,059	8 %	2,229	2,252	(1) %
Gross margin	28.7 %	27.7 %		28.7 %	28.7 %	

For the three months ended December 27, 2013, gross margin as a percentage of revenue increased to 28.7% as compared to 27.7% for the prior-year period. This increase was primarily a result of cost improvements due to operational efficiencies. For the six months ended December 27, 2013, gross margin as a percentage of revenue remained flat at 28.7%.

**Operating Expenses**

(in millions, except percentages)	Three Months Ended			Six Months Ended		
	December 27, 2013	December 28, 2012	Percentage Change	December 27, 2013	December 28, 2012	Percentage Change
R&D expense	\$421	\$378	11 %	\$822	\$774	6 %
SG&A expense	229	162	41 %	361	341	6 %
Charges related to arbitration award	13	—		26	—	
Employee termination benefits and other charges	—	41		—	67	
Total operating expenses	\$663	\$581		\$1,209	\$1,182	

Research and development ("R&D") expense was \$421 million for the three months ended December 27, 2013, an increase of \$43 million from the prior-year period. For the six months ended December 27, 2013, R&D expense was \$822 million, an increase of \$48 million from the prior-year period. These increases were primarily due to the inclusion of Virident and sTec's R&D expenses from the dates of acquisition as well as expense related to adjustments to market value on our stock appreciation rights ("SARs"). As a percentage of net revenue, R&D expense increased to 10.6% in both the three and six months ended December 27, 2013, respectively, compared to 9.9% and 9.8% in the respective prior-year periods.

Selling, general and administrative ("SG&A") expense was \$229 million for the three months ended December 27, 2013, an increase of \$67 million from the prior-year period. For the six months ended December 27, 2013, SG&A expense was \$361 million, an increase of \$20 million from the prior-year period. These increases were primarily due

to the inclusion of Virident and sTec's SG&A expenses from the dates of acquisition as well as expense related to adjustments to market value on our SARs. SG&A expense as a percentage of net revenue increased to 5.8% and 4.6% in the three and six months ended December 27, 2013, compared to 4.2% and 4.3% in the respective prior-year periods.

During the three and six months ended December 27, 2013, we recorded \$13 million and \$26 million, respectively, of interest charges related to an arbitration award for claims brought against us and a now former employee of ours by Seagate

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Technology LLC ("Seagate"), alleging misappropriation of confidential information and trade secrets. For further details see the "Arbitration Award" section below.

During the three months ended December 28, 2012, we recorded charges of \$41 million consisting of \$26 million of employee termination benefits, \$12 million of asset impairments and \$3 million of contract and other termination costs in order to realign our operations with anticipated market demand. During the six months ended December 28, 2012, we recorded charges of \$67 million consisting of \$51 million of employee termination benefits, \$12 million of asset impairments and \$4 million of contract and other termination costs in order to realign our operations with anticipated market demand.

Other Income (Expense)

Interest income for the three months ended December 27, 2013 remained flat with the prior-year period. Interest income for the six months ended December 27, 2013 increased \$1 million as compared to the prior-year period primarily due to a higher average daily invested cash balance for the period. Interest and other expense for the three months ended December 27, 2013 increased \$1 million as compared to the prior-year period primarily due to interest on an increased weighted average debt balance as a result of borrowings under the revolving credit facility. Interest and other expense for the six months ended December 27, 2013 decreased \$2 million as compared to the prior-year period primarily due to interest on a decreased weighted average debt balance.

Income Tax Provision

Our income tax provision for the three months ended December 27, 2013 was \$37 million as compared to \$133 million in the prior-year period. Our income tax provision for the six months ended December 27, 2013 was \$74 million as compared to \$192 million in the prior-year period. We recorded an \$88 million charge to reduce our previously recognized California deferred tax assets in the six months ended December 28, 2012 as a result of the enactment of California Proposition 39. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2014 through 2025 and the current year generation of income tax credits.

In the three months ended December 27, 2013, we recorded a net increase of \$13 million in our liability for unrecognized tax benefits. In the six months ended December 27, 2013, we recorded a net increase of \$23 million in our liability for unrecognized tax benefits. In addition, we recorded a \$3 million increase related to the Virident and sTec acquisitions in the six months ended December 27, 2013. As of December 27, 2013, we had a recorded liability for unrecognized tax benefits of approximately \$263 million. Interest and penalties recognized on such amounts were not material to the condensed consolidated financial statements during the three and six months ended December 27, 2013.

The Internal Revenue Service ("IRS") completed its field examination of our federal income tax returns for fiscal years 2006 and 2007 and issued Revenue Agent Reports that proposed adjustments to income before income taxes of approximately \$970 million primarily related to transfer pricing and intercompany payable balances. We disagreed with the proposed adjustments and filed a protest with the IRS Appeals Office. In June 2013, we reached an agreement with the IRS to resolve the transfer pricing issue. This agreement resulted in a decrease in the amount of net operating loss and tax credits realized, but did not have an impact on our consolidated statements of income. The proposed adjustment relating to intercompany payable balances for fiscal years 2006 and 2007 will be addressed in conjunction with the IRS's examination of our fiscal years 2008 and 2009, which commenced in January 2012. In addition, in January 2012, the IRS commenced an examination of the 2007 fiscal period ended September 5, 2007 of Komag, Incorporated, which was acquired by us on September 5, 2007. In February 2013, the IRS commenced an examination of calendar years 2010 and 2011 of HGST, which was acquired by us on March 8, 2012.

We believe that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in our tax audits are resolved in a manner not consistent with management's expectations, we could be required to adjust our provision for income taxes in the period such resolution occurs. As of December 27, 2013, 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.

Arbitration Award

As disclosed above in Part I, Item 1, Note 5 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, on November 18, 2011, a sole arbitrator ruled against us in an arbitration in Minnesota. The arbitration involves claims brought by Seagate against us and a now former employee, alleging misappropriation of confidential

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information and trade secrets. The arbitrator issued an interim award against us in the amount of \$525 million plus pre-award interest. On January 23, 2012, the arbitrator issued a final award adding pre-award interest in the amount of \$105.4 million, for a total award of \$630.4 million. On January 23, 2012, we filed a petition in the District Court of Hennepin County, Minnesota to have the final arbitration award vacated, and a hearing on the petition to vacate was held on March 1, 2012. On October 12, 2012, the District Court of Hennepin County, Minnesota vacated, in full, the \$630.4 million final arbitration award and ordered that a rehearing be held concerning certain trade secret claims before a new arbitrator. On October 30, 2012, Seagate initiated an appeal of the District Court's decision with the Minnesota Court of Appeals. On July 22, 2013, the Minnesota Court of Appeals reversed the District Court's decision and remanded for entry of an order and judgment confirming the arbitration award. We strongly disagree with the decision of the Court of Appeals and believe that the District Court's decision was correct. On August 20, 2013, we filed a petition for review with the Minnesota Supreme Court and, on October 15, 2013, we were informed that the Minnesota Supreme Court granted our petition. The appeal before the Minnesota Supreme Court has been fully briefed, and oral argument is scheduled for February 5, 2014. We will continue to vigorously defend ourselves in this matter. In light of uncertainties with respect to this matter, we recorded an accrual of \$681 million for this matter in our financial statements for the three months ended June 28, 2013. This amount was in addition to the \$25 million previously accrued in the fourth quarter of fiscal 2011. In the three and six months ended December 27, 2013, we recorded an additional \$13 million and \$26 million, respectively, for interest related to the arbitration award. As a result, the total amount accrued of \$732 million represents the amount of the final arbitration award, plus interest accrued on the initial arbitration award at the statutory rate of 10% from January 24, 2012 through December 27, 2013.

**Liquidity and Capital Resources**

We ended the first quarter of fiscal 2014 with total cash and cash equivalents of \$4.7 billion. The following table summarizes our statements of cash flows (in millions):

	Six Months Ended	
	December 27, 2013	December 28, 2012
Net cash flow provided by (used in):		
Operating activities	\$1,406	\$1,708
Investing activities	(1,125	) (670
Financing activities	65	(430
Net increase in cash and cash equivalents	\$346	\$608

Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing return through the full investment of available funds. On January 9, 2014 (the "Closing Date"), the outstanding balance on the existing credit facility entered into on March 8, 2012 (the "Credit Facility") was repaid, the Credit Facility was terminated, and Western Digital Corporation, Western Digital Technologies, Inc. ("WDT") and Western Digital Ireland, Ltd. ("WDI") entered into a new credit agreement with JPMorgan Chase Bank, N.A., as administrative agent, and the lenders party thereto (the "Credit Agreement"). The Credit Agreement provides for \$4.0 billion of unsecured loan facilities consisting of a \$2.5 billion term loan facility to WDT, and a \$1.5 billion revolving credit facility to WDT and WDI. Subject to certain conditions, a Borrower may also elect to expand the credit facilities by, or obtain incremental term loans of, up to \$1.0 billion if existing or new lenders provide additional term or revolving commitments. For additional information on the Credit Facility and the Credit Agreement, See Part I, Item 1, Notes 4 and 14, respectively, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. 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, stock repurchase and capital expenditure needs for at least the next twelve months. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

A total of \$4.0 billion and \$2.8 billion of our cash and cash equivalents was held outside of the United States at December 27, 2013 and June 28, 2013, respectively. Substantially all of the amounts held outside of the United States are intended to be indefinitely reinvested in foreign operations. If we are required to pay the arbitration award

described in the section “Arbitration Award” above, the award would be paid from one of our foreign subsidiaries using cash and cash equivalents held outside of the United States. On September 13, 2012, our Board of Directors approved a capital allocation plan which includes repurchases of our common stock and the adoption of a quarterly cash dividend policy. Our current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations or capital allocation plan. In the event funds from foreign operations are needed in the United States, any repatriation could result in the accrual and payment of additional U.S. income tax.

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## Operating Activities

Net cash provided by operating activities was \$1.4 billion during the six months ended December 27, 2013. 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 by working capital changes was \$157 million for the six months ended December 27, 2013 as compared to \$78 million provided by working capital changes in the prior-year period.

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

	Three Months Ended	
	December 27, 2013	December 28, 2012
Days sales outstanding	45	41
Days in inventory	42	40
Days payables outstanding	(68	) (72
Cash conversion cycle	19	9

For the three months ended December 27, 2013, our average days sales outstanding (“DSOs”) increased by 4 days, days in inventory (“DIOs”) increased by 2 days, and days payable outstanding (“DPOs”) decreased by 4 days compared to the prior year period. Changes in average DSOs and DIOs are generally related to linearity of shipments and the timing of inventory builds, respectively. 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 modifications through negotiations with our vendors or by granting to, or receiving from, our vendors’ payment term accommodations.

## Investing Activities

Cash used in investing activities for the six months ended December 27, 2013 was \$1.1 billion and consisted primarily of \$823 million related to acquisitions, net of cash acquired, and \$306 million of capital expenditures, partially offset by a net \$4 million for other investing activities, consisting of a flood-related insurance recovery and strategic investments. Cash used in investing activities for the six months ended December 28, 2012 was \$670 million and consisted of \$628 million of capital expenditures, \$27 million related to acquisitions, net of cash acquired, and \$15 million related to the purchase of an investment.

Our cash equivalents are invested in highly liquid money market funds that are invested in U.S. Treasury securities and U.S. Government Agency securities. We also have \$14 million of auction-rate securities, which are classified as available-for-sale securities in our condensed consolidated balance sheets.

## Financing Activities

Net cash provided by financing activities for the six months ended December 27, 2013 was \$65 million as compared to \$430 million used in financing activities in the prior-year period. Net cash provided by financing activities for the six months ended December 27, 2013 consisted of \$500 million of debt proceeds under the revolving credit facility and a net \$98 million provided by employee stock plans, offset by \$300 million used to repurchase shares of our common stock, \$118 million used to pay dividends on our common stock and \$115 million used to repay long-term debt. Net cash used in financing activities for the six months ended December 28, 2012 consisted of \$364 million used to repurchase shares of our common stock, \$121 million used to pay dividends and \$58 million used to repay long-term debt, offset by a net \$113 million provided by employee stock plans.

## Off-Balance Sheet Arrangements

Other than facility lease commitments incurred in the normal course of business and certain indemnification provisions (see “Contractual Obligations and Commitments” below), we do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in our condensed consolidated financial statements. Additionally, we do not have an interest in,



or relationships with, any special-purpose entities.

**Contractual Obligations and Commitments**

**Long-Term Debt** — On March 8, 2012, we, in our capacity as the parent entity and guarantor, WDT and WDI, entered into the Credit Facility. The Credit Facility provided for \$2.8 billion of unsecured loan facilities, consisting of a \$2.3 billion term loan facility and a \$500 million revolving credit facility. As of December 27, 2013, the outstanding balance was \$1.8 billion for the

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term loan facility and \$500 million for the revolving credit facility, totaling \$2.3 billion. On January 9, 2014, the outstanding balance on the existing Credit Facility was repaid, the Credit Facility was terminated, and the new Credit Agreement was entered into.

As of the date of this Quarterly Report on Form 10-Q, the outstanding term loan balance under the Credit Agreement was \$2.5 billion. We are required to make quarterly principal payments on the term loan facility beginning in March 2014, totaling \$63 million for the remainder of fiscal 2014, \$125 million in fiscal 2015, \$156 million in fiscal 2016, \$219 million in fiscal 2017, \$250 million in fiscal 2018 and the remaining balance of \$1.7 billion in fiscal 2019. For additional information, see Part I, Item 1, Note 4 and Note 14 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

**Purchase Orders** — In the normal course of business, we enter into purchase orders with suppliers for the purchase of components used to manufacture our products. These purchase orders generally cover forecasted component supplies needed for production during the next quarter, are recorded as a liability upon receipt of the components, and generally may be changed or canceled at any time prior to shipment of the components. We also enter into purchase orders with suppliers for capital equipment that are recorded as a liability upon receipt of the equipment. Our ability to change or cancel a capital equipment purchase order without penalty depends on the nature of the equipment being ordered. In some cases, we may be obligated to pay for certain costs related to changes to, or cancellation of, a purchase order, such as costs incurred for raw materials or work in process of components or capital equipment. We have entered into long-term purchase agreements with various component suppliers, containing minimum quantity requirements. However, the dollar amount of the purchases may depend on the specific products ordered, achievement of pre-defined quantity or quality specifications or future price negotiations. We have also entered into long-term purchase agreements with various component suppliers that carry fixed volumes and pricing which obligate us to make certain future purchases, contingent on certain conditions of performance, quality and technology of the vendor's components.

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

See Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations — Contractual Obligations and Commitments" in our Annual Report on Form 10-K for the year ended June 28, 2013, for further discussion of our purchase orders and purchase agreements and the associated dollar amounts. See Part II, Item 1A of this Quarterly Report on Form 10-Q for a discussion of the risks associated with these commitments.

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

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

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

Unrecognized Tax Benefits — As of December 27, 2013, the cash portion of our total recorded liability for unrecognized tax benefits was \$222 million. We estimate the timing of the future payments of these liabilities to be within the next one to eight years. See Part I, Item 1, Note 6 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for information regarding our total tax liability for unrecognized tax benefits.

Stock Repurchase Program — Since May 21, 2012, our Board of Directors has authorized an additional \$3.0 billion for the repurchase of our common stock and the extension of our stock repurchase program until September 13, 2017. We repurchased

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2.0 million and 4.3 million shares of our common stock for a total cost of \$150 million and \$300 million during the three and six months ended December 27, 2013, respectively. The remaining amount available to be purchased under our stock repurchase program as of December 27, 2013 was \$1.7 billion. Subsequent to December 27, 2013 and through January 30, 2014, we repurchased an additional 2.2 million shares of our common stock for a total cost of \$186 million. We may continue to repurchase our common stock as we deem appropriate and market conditions allow. Repurchases under our stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan. We expect stock repurchases to be funded principally by operating cash flows and borrowings under our Credit Agreement.

**Cash Dividend Policy** — On September 13, 2012, we announced that our Board of Directors had authorized the adoption of a quarterly cash dividend policy. Under the cash dividend policy, holders of our common stock receive dividends when and as declared by our Board of Directors. In the three months ended December 27, 2013, we declared a cash dividend of \$0.30 per share of our common stock to our shareholders of record as of December 27, 2013, totaling \$72 million, which we paid on January 15, 2014. In addition, in the three months ended September 27, 2013, the Company declared a cash dividend of \$0.25 per share of the Company's common stock to shareholders of record as of September 30, 2013, which was paid on October 15, 2013. 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 unaudited condensed consolidated financial statements in accordance with U.S. GAAP. The preparation of the financial statements requires the use of judgments and estimates that affect the reported amounts of revenues, expenses, assets, liabilities and shareholders' equity. We have adopted accounting policies and practices that are generally accepted in the industry in which we operate. We believe the following are our most critical accounting policies that affect significant areas and involve judgment and estimates made by us. If these estimates differ significantly from actual results, the impact to the condensed consolidated financial statements may be material. Since our fiscal year ended June 28, 2013, there have been no material changes in our critical accounting policies and estimates.

**Revenue and Accounts Receivable**

In accordance with standard industry practice, we provide distributors and retailers (collectively referred to as "resellers") with limited price protection for inventories held by resellers at the time of published list price reductions, and we provide resellers and original equipment manufacturers ("OEMs") with other sales incentive programs. At the time we recognize revenue to resellers and OEMs, we record a reduction of revenue for estimated price protection until the resellers sell such inventory to their customers and we also record a reduction of revenue for the other programs in effect. We base these adjustments on several factors including anticipated price decreases during the reseller holding period, resellers' sell-through and inventory levels, estimated amounts to be reimbursed to qualifying customers, historical pricing information and customer claim processing. If customer demand for our products or market conditions differs from our expectations, our operating results could be materially affected. We also have programs under which we reimburse qualified distributors and retailers for certain marketing expenditures, which are recorded as a reduction of revenue. These amounts generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product. Generally, total sales incentive and marketing programs range from 7% to 11% of gross revenues per quarter. For the three months ended December 27, 2013, sales incentive and marketing programs were 7% of gross revenues. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue from the current range. Adjustments to revenues due to changes in accruals for these programs related to revenues reported in prior periods have averaged 0.8% of quarterly gross revenue since the first quarter of fiscal 2013. Customer sales incentive and marketing programs are recorded as a reduction of revenue.

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

an adjustment in our allowance for doubtful accounts would be required, which could materially affect operating results.

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

#### Warranty

We record an accrual for estimated warranty costs when revenue is recognized. We generally warrant our products for a period of one to five years. Our warranty provision considers estimated product failure rates and trends, estimated replacement

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

Inventory

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

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

Litigation and Other Contingencies

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

Income Taxes

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

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

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### Stock-based Compensation

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

### Goodwill and Other Long-Lived Assets

The fair value of assets acquired and liabilities assumed in a business acquisition are recognized at the acquisition date, with amounts exceeding the fair values being recognized as goodwill. Goodwill is not amortized. Instead, it is tested for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that goodwill may be impaired. We perform our annual impairment test as of the first day of our fiscal fourth quarter. We first use qualitative factors to determine whether goodwill is more likely than not impaired. If we conclude from the qualitative assessment that goodwill is more likely than not impaired, we follow a two-step approach to quantify the impairment.

We are required to use judgment when applying the goodwill impairment test, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units, and determination of the fair value of each reporting unit. In addition, the estimates used to determine the fair value of each reporting unit may change based on results of operations, macroeconomic conditions or other factors. Changes in these estimates could materially affect our assessment of the fair value and goodwill impairment for each reporting unit.

Other intangible assets consist primarily of technology acquired in business combinations and in-process research and development. In-process research and development is not amortized until the point at which it reaches technological feasibility. Instead, it is tested for impairment on an annual basis or more frequently whenever events or changes in circumstances indicate that it may be impaired. Acquired intangibles are amortized on a straight-line basis over their respective estimated useful lives. Long-lived assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. If impairment is indicated, the impairment is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets.

### Recent Accounting Pronouncements

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operations and financial condition, refer to Part I, Item I, Note 13 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

## Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Disclosure About Foreign Currency Risk

Although the majority of our transactions are in U.S. dollars, some transactions are based in various foreign currencies. We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, revenue, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on our results of operations. The contract maturity dates do not exceed 12 months. We do not purchase foreign exchange contracts for trading purposes. See Part I, Item 1, Note 8 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.





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As of December 27, 2013, we had outstanding the following purchased foreign exchange contracts (in millions, except weighted average contract rate):

	Contract Amount	Weighted Average Contract Rate*	Unrealized Gains (Losses)
Foreign exchange contracts:			
Cash flow hedges:			
Japanese Yen	\$246	\$ 99.50	\$(11 )
Malaysian Ringgit	\$195	\$ 3.17	\$(7 )
Philippine Peso	\$46	\$ 43.37	\$(1 )
Singapore Dollar	\$54	\$ 1.26	\$—
Thai Baht	\$956	\$ 31.39	\$(41 )
Fair value hedges:			
British Pound Sterling	\$5	\$ 0.61	\$—
Euro	\$13	\$ 0.73	\$—
Japanese Yen	\$93	\$ 104.33	\$—
Philippine Peso	\$26	\$ 44.36	\$—
Thai Baht	\$41	\$ 32.88	\$—

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

During the three and six months ended December 27, 2013, total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements.

## Disclosure About Other Market Risks

## Variable Interest Rate Risk

On the Closing Date, the outstanding balance on the existing Credit Facility was repaid, the Credit Facility was terminated, and the new Credit Agreement was entered into.

Borrowings under the Credit Agreement bear interest at a rate equal to, at the option of the applicable Borrower, either (a) a customary London interbank offered rate (a “Eurodollar Rate”) or (b) a customary base rate (a “Base Rate”), in each case plus an applicable margin. The applicable margins range from 1.25% to 2.00% with respect to Eurodollar Rate borrowings and 0.25% to 1.00% with respect to Base Rate borrowings. We are also required to pay a commitment fee for the unused portion of the revolving credit facility, which ranges from 0.175% to 0.300% per annum. The applicable margins for borrowings and the commitment fee ranges are determined based upon a leverage ratio of us and our subsidiaries calculated on a consolidated basis. A one percent increase in the variable rate of interest on the term loan and revolving credit facility would increase interest expense by approximately \$25 million annually. For additional information on the Credit Agreement, see Part I, Item 1, Note 14 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

## Item 4. CONTROLS AND PROCEDURES

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

There has been no change in our internal control over financial reporting during the second fiscal quarter ended December 27, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

For a description of our legal proceedings, refer to Part I, Item 1, Note 5 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated by reference in response to this item.

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Item 1A. RISK FACTORS

We have updated a few of the risk factors affecting our business since those presented in our Report on Form 10-Q, Part I, Item 1A, for the fiscal quarter ended September 27, 2013. Except for risks related to cyber attacks, there have been no material changes in our assessment of our risk factors from those set forth in our Quarterly Report on Form 10-Q, Part I, Item 1A, for the fiscal quarter ended September 27, 2013. For convenience, all of our risk factors are included below.

If we fail to realize the anticipated benefits from our acquisition of HGST on a timely basis, or at all, 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 agrees otherwise (with the minimum period being two years from the March 8, 2012 closing date of the acquisition). We worked closely with MOFCOM to finalize an operations plan that outlines in more detail the conditions of the competitive requirement. Compliance with these measures has affected, and may continue to affect, our business and financial conditions in the following ways:

- limits our ability to integrate HGST's business with our business (and we do not expect to achieve significant operating expense synergies while the conditions remain in place),
- has caused, and could cause further, difficulties in retaining key employees and delays or uncertainties in making decisions about the combined business,
- has resulted in, and could result in additional, significant costs (including capital expenditures relative to our competitors as a result of maintaining separate research and development functions), and
- has required, and could require additional, changes in business practices.

We cannot predict when the conditions imposed by MOFCOM will be removed. In addition, in the event we fail to comply with these measures, the time during which we are required to comply with the conditions could be extended and we could be subject to other conditions or penalties that could adversely affect the business.

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

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In connection with obtaining the regulatory approvals required to complete our acquisition of HGST, we divested certain assets to Toshiba and agreed to provide certain support services for those assets for a period of time, and our business will be adversely affected in the event we fail to successfully meet our obligations to Toshiba under the divestiture transaction.

In connection with obtaining the regulatory approvals required to complete our acquisition of HGST, we agreed, subject to review by regulatory agencies in certain jurisdictions, to divest certain assets to Toshiba that will expand Toshiba's capacity to manufacture 3.5-inch hard drives for the desktop, consumer electronics and near-line (business critical) applications. While this divestiture transaction closed in May 2012, we agreed to provide certain support service for those assets for a period of time. If we are not able to meet our continuing service obligations under our agreement with Toshiba, the jurisdictions that conditioned their approval of the HGST acquisition on the divestiture could impose certain obligations on us, including a requirement that we divest the assets subject to the Toshiba divestiture (or other assets) to another purchaser, which could adversely affect our business, financial condition and results of operations.

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

Adverse global economic conditions and uncertain conditions in the credit market have had, and in the future could have, a significant adverse effect on our company and on the storage industry as a whole. Some of the risks and uncertainties we face as a result of these global economic and credit market conditions include the following:

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

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

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

- **Impairment Charges.** Negative or uncertain global economic conditions could result in circumstances, such as a sustained decline in our stock price and market capitalization or a decrease in our forecasted cash flows such that they are insufficient, indicating that the carrying value of our long-lived assets or goodwill may be

impaired. If we are required to record a significant charge to earnings in our consolidated financial statements because an impairment of our long-lived assets or goodwill is determined, our results of operations will be adversely affected.

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

Demand for our hard drives depends in large part on the demand for systems manufactured by our customers and on storage upgrades to existing systems. The demand for systems has been volatile in the past and often has had an exaggerated effect on the demand for hard drives in any given period. As a result, the hard drive market has experienced periods of excess capacity, which can lead to liquidation of excess inventories and more intense price competition. If more intense price competition occurs, we may be forced to lower prices sooner and more than expected, which could adversely impact revenue and gross margins. Our ASPs and gross margins also tend to decline when there is a shift in the mix of product sales, and sales of lower priced products increase relative to those of higher priced products. In addition, rapid technological changes often reduce the volume and profitability of sales of existing products and increase the risk of inventory obsolescence. These factors, along with others, may result in significant shifts in market share among the industry's major participants, including a substantial decrease in our market share. Our failure to accurately forecast market and customer demand for our products, or to quickly adjust to forecast changes, could adversely affect our business and financial results or operating efficiencies.

The data storage industry faces difficulties in accurately forecasting market and customer demand for its products. The variety and volume of products we manufacture is based in part on these forecasts. Accurately forecasting demand has become increasingly difficult for us, our customers and our suppliers in light of the volatility in global economic conditions and industry consolidation, resulting in less availability of historical market data for certain product segments. In addition, because hard drives are designed to be largely interchangeable with competitors' products, our demand forecasts may be impacted significantly by the strategic actions of our competitors. As forecasting demand becomes more difficult, the risk that our forecasts are not in line with demand increases. If our forecasts exceed actual market demand, then we could experience periods of product oversupply and price decreases, which could impact our financial performance. If market demand increases significantly beyond our forecasts or beyond our ability to add manufacturing capacity, then we may not be able to satisfy customer product needs, possibly resulting in a loss of market share if our competitors are able to meet customer demands.

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

Our sales to the non-compute and enterprise markets (collectively, the "non-PC markets"), representing an increasing percentage of our overall revenue, may not continue to grow at current estimates, which could materially adversely impact our operating results.

The secular growth of digital data is resulting in a more diversified mix of revenue. For example, for the quarter ended December 27, 2013, approximately 54% of our net revenue was derived from the non-PC markets. As sales to the non-PC markets 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, the non-PC 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 may 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, demand for our products in the non-PC markets may decrease and our financial results could be materially adversely affected.



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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. Over the last few years, cloud computing has emerged whereby applications and data are hosted, accessed and processed through a third-party provider over a broadband Internet connection, potentially reducing or eliminating the need for, among other things, significant storage inside the accessing computer. If we are not successful in manufacturing compelling products to address the cloud computing opportunity, demand for our products in the non-PC markets may decrease and our financial results could be materially adversely affected.

- Obsolete Inventory. In some cases, products we manufacture for the non-PC markets are uniquely configured for a single customer's application, creating a risk of obsolete inventory if anticipated demand is not actually realized.

Macroeconomic Conditions. Consumer spending in the non-PC markets has been, and may continue to be, adversely affected in many regions due to negative macroeconomic conditions and high unemployment

- levels. Please see the risk factor entitled "Adverse global economic conditions and credit market uncertainty could harm our business, results of operations and financial condition." for more risks and uncertainties relating to macroeconomic conditions.

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

Sales in the client compute market (the "PC market") are important to our business, and if we fail to respond to changes in the PC market, our operating results could suffer.

While sales to the non-PC market are becoming a more significant source of revenue, sales to the PC market remain an important part of our business. The PC market, however, has been, and may continue to be, adversely affected by the growth of tablet computers, smart phones and similar devices that perform many of the same capabilities as PCs, the lengthening of product life cycles and macroeconomic conditions. If we fail to respond to changes in the PC market, our operating results could suffer. Additionally, if demand in the PC market is worse than expected as a result of these or other conditions, demand for our products in the PC market may decrease and our operating results may be adversely affected.

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

Selling branded products is an important part of our business, and as our branded products revenue increases as a portion of our overall revenue, our success in the retail market becomes increasingly important to our operating results. Our success in the retail market depends in large part on our ability to maintain our brand image and corporate reputation and to expand into and gain market acceptance of our products in multiple channels, including the e-tail channel. 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 G-Technology™ brand products, our operating results may be adversely affected.

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

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

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change in consumer buying preference, or if we experience significant price declines due to demand changes in the distribution channel, then our operating results would be adversely affected.

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

During the quarter ended December 27, 2013, 42% of our revenue came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, often resulting in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results would likely be harmed.

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

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

As we expand our product line to sell into additional markets, the overall complexity of our business increases at an accelerated rate and we become subject to different market dynamics. The new markets into which we are expanding, or may expand, may have different characteristics from the markets we currently serve. These different characteristics may include, among other things, demand volume requirements, demand seasonality, product generation development rates, customer concentrations, warranty and product return policies and performance and compatibility requirements. Our failure to make the necessary adaptations to our business model and product offerings to address these different characteristics, complexities and new market dynamics could adversely affect our operating results.

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

To remain a significant supplier in the storage industry, we will need to offer a broad range of storage products to our customers. We currently offer a variety of 3.5-inch or 2.5-inch hard drives for the PC and non-PC storage markets, as well as a variety of solid state drives. However, demand for storage devices may shift to products in form factors or with interfaces that our competitors offer but which we do not. Expansion into other markets and resulting increases in manufacturing capacity requirements may require us to make substantial additional investments in part because our operations are largely vertically integrated. If we fail to successfully expand into new markets with products that we do not currently offer, we may lose business to our competitors who offer these products.

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

Under our business plan, we are developing and manufacturing a substantial portion of the heads and magnetic media used in the hard drive products we manufacture. Consequently, we are more dependent upon our own development and execution efforts and less able to take advantage of head and magnetic media technologies developed by other manufacturers. Technology transition for head and magnetic media designs is critical to increasing our volume production of heads and magnetic media. There can be no assurance, however, that we will be successful in timely and cost-effectively developing and manufacturing heads or magnetic media for products using future technologies. We also may not effectively transition our head or magnetic media design and technology to achieve acceptable manufacturing yields using the technologies necessary to satisfy our customers' product needs, or we may encounter

quality problems with the heads or magnetic media we manufacture. If we are unable to timely and cost-effectively develop heads and magnetic media with leading technology and overall quality, our ability to sell our products may be significantly diminished, which could materially and adversely affect our business and financial results.

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

We make significant investments in research and development to improve our technology and develop new technologies, and unsuccessful investments could materially adversely affect our business, financial condition and results of operations.

Over the past several years, our business strategy has been to derive a competitive advantage by moving from being a follower of new technologies to being a leader in the innovation and development of new technologies. This strategy requires us to make significant investments in research and development and, in attempting to remain competitive, we may increase our capital expenditures and expenses above our historical run-rate model. There can be no assurance that these investments will result in viable technologies or products, or if these investments do result in viable technologies or products, that they will be profitable or accepted by the market. Significant investments in unsuccessful research and development efforts could materially adversely affect our business, financial condition and results of operations. In addition, increased investments in technology could cause our cost structure to fall out of alignment with demand for our products, which would have a negative impact on our financial results.

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

It may be possible for our current or future competitors to gain an advantage in product technology, manufacturing technology, or process technology, which may allow them to offer products or services that have a significant advantage over the products and services that we offer. Advantages could be in capacity, performance, reliability, serviceability, or other attributes. A competitive cost structure for our products, including critical components, labor and overhead, is also critical to the success of our business. We may be at a competitive disadvantage to any companies that are able to gain a technological or cost structure advantage.

Industry consolidation could provide competitive advantages to our competitors.

The storage industry has experienced consolidation over the past several years. Consolidation by our competitors may enhance their capacity, abilities and resources and lower their cost structure, causing us to be at a competitive disadvantage.

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

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

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

We regularly engage in new product qualification with our customers. Once a product is accepted for qualification testing, failures or delays in the qualification process can result in delayed or reduced product sales, reduced product margins caused by having to continue to offer a more costly current generation product, or lost sales to that customer until the next generation of products is introduced. The effect of missing a product qualification opportunity is

magnified by the limited number of high volume OEMs, which continue to consolidate their share of the storage markets. Likewise, if product life cycles lengthen, we may have a significantly longer period to wait before we have an opportunity to qualify a new product with a customer, which could reduce our profits because we expect declining gross margins on our current generation products as a result of competitive pressures.

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We are subject to risks related to product defects, which could result in product recalls or epidemic failures and could subject us to warranty claims in excess of our warranty provisions or which are greater than anticipated.

We warrant the majority of our products for periods of one to five years. We test our hard drives in our manufacturing facilities through a variety of means. However, there can be no assurance that our testing will reveal defects in our products, which may not become apparent until after the products have been sold into the market. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement and, if a product recall occurs during the product's warranty period, we may be required to replace the defective product. Moreover, there is a risk that product defects may trigger an epidemic failure clause in a customer agreement. If an epidemic failure occurs, we may be required to replace or refund the value of the defective product and to cover certain other costs associated with the consequences of the epidemic failure. In addition, a product recall or epidemic failure may damage our reputation or customer relationships, and may cause us to lose market share with our customers, including our OEM and original design manufacturers ("ODM") customers.

Our standard warranties contain limits on damages and exclusions of liability for consequential damages and for misuse, improper installation, alteration, accident or mishandling while in the possession of someone other than us. We record an accrual for estimated warranty costs at the time revenue is recognized. We may incur additional operating expenses if our warranty provision 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.

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

We depend on an external supply base for technologies, components, equipment and materials for use in our product design and manufacturing. We also depend on service suppliers for providing technical support for our products. In addition, we use logistics partners to manage our JIT (just-in-time) hubs, distribution centers and freight from suppliers to our factories and from our factories to our customers throughout the world. Many of these components and much of this equipment must be specifically designed to be compatible for use in our products or for developing and manufacturing our future products, and are only available from a limited number of suppliers, some of whom are our sole-source suppliers. We are therefore dependent on these suppliers to be able and willing to dedicate adequate engineering resources to develop components that can be successfully integrated into our products, technology and equipment that can be used to develop and manufacture our next-generation products efficiently. However, many of the risks that affect us also affect our supply base, including, but not limited to, having single site manufacturing locations based in high risk regions of the world, macro and local economic conditions, shortages of commodity materials, proper management of technology transitions, natural disasters, geo-political risks, compliance with legal requirements, financial instability and exposure to IP and other litigation. If any of these risks were to affect our suppliers, we could also be adversely affected, especially in the case of products, components or services that are single-sourced. For example, if suppliers are facing increased costs due to the above risks, they may require us to enter into long-term volume agreements to shift the burden of fixed costs to us. Further, we work closely with many of our suppliers to develop new technologies and, as a result, we may become subject to litigation from our suppliers or third parties.

Without a capable and financially stable supply base that has established appropriate relationships within the supply chain and has implemented business processes, strategies and risk management safeguards, we would be unable to develop our products, manufacture them in high volumes, and distribute them to our customers to execute our business plans effectively. As PC demand slows, competition increases from NAND and other consumer devices, the total available market (TAM) for hard disk drives decreases and costs increase, these suppliers may reevaluate their business models. Our suppliers may be acquired by our competitors, consolidate, or decide to exit the industry, redirect their investments and increase costs to us, each of which may have an adverse effect on our business and operations. In addition, moving to new technologies may require us to align to, and build, a new supply base, such as

NAND flash. In the case of NAND suppliers, many of which are involved in developing storage products such as SSD that, in some cases, compete with our products. Our success in these new product areas may be dependent on our ability and their willingness to develop close relationships, with preferential agreements. Where this cannot be done, our business and operations may be adversely affected.

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



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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 hard drives 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.

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

If product life cycles lengthen, we may need to develop new technologies or programs to reduce our costs on any particular product to maintain competitive pricing for that product. If product life cycles shorten, it may result in an increase in our overall expenses and a decrease in our gross margins, both of which could adversely affect our operating results. In addition, shortening of product life cycles also makes it more difficult to recover the cost of product development before the product becomes obsolete. Our failure to recover the cost of product development in the future could adversely affect our operating results.

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

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



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

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

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

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

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

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

- difficulties faced in manufacturing ramp;
- implementing at an acceptable cost product features expected by our customers;
- market acceptance/qualification;
- effective management of inventory levels in line with anticipated product demand; and
- 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 business may suffer if we fail to successfully anticipate and manage issues associated with our product development.

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

Our success depends in part on our ability to develop and introduce new products in a timely manner in order to keep pace with competing technologies. Alternative storage technologies like solid-state storage technology have successfully served digital entertainment markets for products that cannot be economically serviced using hard drive

technology. Advances in semiconductor technology have resulted in solid-state storage emerging as a technology that is competitive with hard drives for high performance needs in advanced digital computing markets such as enterprise servers and storage. There can be no assurance that we will be successful in anticipating and developing new products for the PC and non-PC storage markets in response to solid-state storage, as well as other competing technologies. If our hard drive technology fails to offer higher capacity, performance and reliability with lower cost-per-gigabyte than solid-state storage, we will be at a competitive disadvantage to companies using semiconductor technology and our business will suffer.

Our manufacturing 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.

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As a result of our cost structure and strategy of vertical integration, we conduct our manufacturing operations at large, high volume, purpose-built facilities in California and in Asia. The manufacturing facilities of many of our customers, our suppliers and our customers' suppliers are also concentrated in certain geographic locations in Asia and elsewhere. A localized health risk affecting our employees at these facilities or the staff of our or our customers' other suppliers, such as the spread of a pandemic influenza, could impair the total volume of hard drives 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 disaster, condition or event such as political instability, civil unrest or a power outage that adversely affects any of these facilities, including access to or from these facilities by employees or logistics operations, would significantly affect our ability to manufacture or sell hard drives, 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. 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 hard drives, and our business, financial condition and results of operations could suffer.

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

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

- obtaining requisite governmental permits and approvals;
- currency exchange rate fluctuations or restrictions;
- political instability and civil unrest;
- limited transportation availability, delays, and extended time required for shipping, which risks may be compounded in periods of price declines;
- higher freight rates;
- labor challenges, including difficulties finding and retaining talent or responding to labor disputes or disruptions;
- trade restrictions or higher tariffs;
- copyright levies or similar fees or taxes imposed in European and other countries;
- exchange, currency and tax controls and reallocations;
- increasing labor and overhead costs; and
- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

Terrorist attacks may adversely affect our business and operating results.

The continued threat of terrorist activity and other acts of war or hostility have created uncertainty in the financial and insurance markets and have significantly increased the political, economic and social instability in some of the geographic areas in which we operate. Additionally, it is uncertain what impact the reactions to such acts by various governmental agencies and security regulators worldwide will have on shipping costs. Acts of terrorism, either domestically or abroad, could create further uncertainties and instability. To the extent this results in disruption or

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

Sudden disruptions to the availability of freight lanes could have an impact on our operations.

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

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If we sustain system failures, cyber attacks to our systems or to our products or other data security breaches, we could suffer a loss of revenue and increased costs, exposure to significant liability, reputational harm and other serious negative consequences.

We are heavily dependent on our technology infrastructure, among other functions, to operate our factories, sell our products, fulfill orders, manage inventory and bill, collect and make payments. Our systems are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, cyber attacks such as computer viruses, computer denial-of-service attacks and other events. Our business is also subject to break-ins, sabotage and intentional acts of vandalism by third parties as well as employees. Computer programmers and hackers also may be able to develop and deploy viruses, worms, and other malicious software programs that attack our products or otherwise exploit any security vulnerabilities of our products. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including “bugs” and other problems that could unexpectedly interfere with the operation of the system.

The foregoing security problems could result in, among other consequences, loss or theft of our, our customers’ or our business partners’ intellectual property, proprietary business information or personally identifiable information. The costs to us to eliminate or address the foregoing security problems and security vulnerabilities before or after a cyber incident could be significant. Our remediation efforts may not be successful and could result in interruptions, delays or cessation of service and loss of existing or potential customers that may impede our sales, manufacturing, distribution, or other critical functions. We could lose existing or potential customers in connection with any actual or perceived security vulnerabilities in our products. In addition, breaches of our security measures and the unapproved dissemination of proprietary information or sensitive or confidential data about us or our customers or other third parties, could expose us, our customers, or other affected third parties to a risk of loss or misuse of this information, result in litigation, damage our brand and reputation, or otherwise harm our business, operating results and financial condition. Further, we rely in certain limited capacities on third-party data management providers whose possible security problems and security vulnerabilities may have similar effects on us.

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

As part of our growth strategy, we have completed, and we may continue to pursue, acquisitions of, investment opportunities in, or other significant transactions with companies that are complementary to our business. For example, we completed the acquisition of VeloBit on July 10, 2013, sTec on September 12, 2013, and Virident on October 17, 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 transaction, some of which may be large and complex, and manage post-closing issues such as integration of the acquired company or employees. We may not be able to continue to identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. Even if we identify and complete suitable corporate transactions, we may not be able to successfully address any integration challenges in a timely manner, or at all. If we fail to successfully integrate an acquisition, we may not realize all or any of the anticipated benefits of the acquisition, and our future results of operations could be adversely affected.

Please also see the risk factors above for specific risks and uncertainties regarding our acquisition of HGST.

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

Our success depends upon the continued contributions of our key staff and skilled employees, many of whom would be extremely difficult to replace. Global competition for skilled employees in the data storage industry is intense and, as we attempt to move to a position of technology leadership in the storage industry, our business success becomes increasingly dependent on our ability to retain our key staff and skilled employees as well as attract, integrate and retain new skilled employees. Volatility or lack of positive performance in our stock price and the overall markets may adversely affect our ability to retain key staff or skilled employees who have received equity compensation. Additionally, because a substantial portion of our key employees’ compensation is placed “at risk” and linked to the performance of our business, when our operating results are negatively impacted by global economic conditions, we

are at a competitive disadvantage for retaining and hiring key staff and skilled employees versus other companies that pay a relatively higher fixed salary. If we lose our existing key staff or skilled employees, or are unable to hire and integrate new key staff or skilled employees, or if we fail to implement succession plans for our key staff, our operating results would likely be harmed.

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



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The data storage industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may result in adverse rulings or decisions. We may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on our business, financial condition or operating results. As disclosed in Part I, Item 1, Note 5 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q on November 18, 2011, a sole arbitrator ruled against us in an arbitration in Minnesota. The arbitration involves claims brought by Seagate Technology LLC against us and a now former employee, alleging misappropriation of confidential information and trade secrets. The arbitrator issued an interim award against us in the amount of \$525 million plus pre-award interest. On January 23, 2012, the arbitrator issued a final award adding pre-award interest in the amount of \$105.4 million, for a total award of \$630.4 million. On January 23, 2012, we filed a petition in the District Court of Hennepin County, Minnesota to have the final arbitration award vacated, and a hearing on the petition was held on March 1, 2012. On October 12, 2012, the District Court of Hennepin County, Minnesota vacated, in full, the \$630.4 million final arbitration award and ordered that a rehearing be held concerning certain trade secret claims before a new arbitrator. On October 30, 2012, Seagate initiated an appeal of the District Court's decision with the Minnesota Court of Appeals. On July 22, 2013, the Minnesota Court of Appeals reversed the District Court's decision and remanded for entry of an order and judgment confirming the arbitration award. We strongly disagree with the decision of the Court of Appeals and believe that the District Court's decision was correct. On August 20, 2013, the Company filed a petition for review with the Minnesota Supreme Court and, on October 15, 2013, the Company was informed that the Minnesota Supreme Court granted the Company's petition. The appeal before the Minnesota Supreme Court has been fully briefed, and oral argument is scheduled for February 5, 2014.

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

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

Our success depends, in significant part, on the proprietary nature of our technology, including non-patentable intellectual property such as our process technology. If a competitor is able to reproduce or otherwise capitalize on our technology despite the safeguards we have in place, it may be difficult, expensive or impossible for us to obtain necessary legal protection. Also, the laws of some foreign countries may not protect our intellectual property to the same extent as do U.S. laws. In addition to patent protection of intellectual property rights, we consider elements of our product designs and processes to be proprietary and confidential. We rely upon employee, consultant and vendor non-disclosure agreements and contractual provisions and a system of internal safeguards to protect our proprietary information. However, any of our registered or unregistered intellectual property rights may be challenged or exploited by others in the industry, which could harm our operating results.

The costs of compliance with state, federal and international legal and regulatory requirements, such as environmental, labor, trade and tax regulations, and customers' standards of corporate citizenship 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 and tax practices. These laws and regulations, particularly those applicable

to our international operations, are or may be complex, extensive and subject to change. We will need to ensure that we and our component suppliers timely comply with such laws and regulations, which may result in an increase in our operating costs. For example, in August 2012, the Securities and Exchange Commission adopted final rules to implement Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act intended to improve transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo or adjoining countries, which obligates us to conduct a reasonable country of origin inquiry with respect to conflict minerals included in components of products we directly manufacture, contract to manufacture and purchase to include in products. Other legislation has been, and may in the future be, enacted in other locations where we manufacture or sell our products. In addition, climate change and financial reform legislation in the United States is a significant topic of discussion and has generated and may continue to generate federal or other regulatory responses in the near future. If we or our component suppliers fail to timely comply with applicable legislation, our customers

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

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

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

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

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

Failure to continue to pay quarterly cash dividends to our shareholders or repurchase shares of our common stock pursuant to our previously announced stock repurchase program could cause the market price for our common stock to decline.

Our payment of quarterly cash dividends and repurchase shares of our common stock pursuant to our stock purchase program will be subject to, among other things, our financial position and results of operations, available cash and cash flow, capital requirements, and other factors. Any reduction or discontinuance by us of the payment of quarterly cash dividends or repurchases of our common stock pursuant to our stock repurchase program could cause the market price of our common stock to decline. Moreover, in the event our payment of quarterly cash dividends or repurchases of shares of our common stock are reduced or discontinued, our failure or inability to resume paying cash dividends or repurchasing shares of our common stock at historical levels could result in a lower market valuation of our common stock.

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

Because we manufacture and sell our products abroad, our revenue, margins, operating costs and cash flows are impacted by fluctuations in foreign currency exchange rates. If the U.S. dollar exhibits sustained weakness against most foreign currencies, the U.S. dollar equivalents of unhedged manufacturing costs could increase because a significant portion of our production costs are foreign-currency denominated. Conversely, there would not be an offsetting impact to revenues since revenues are substantially U.S. dollar denominated. Additionally, we negotiate and procure some of our component requirements in U.S. dollars from non-U.S. based vendors. If the U.S. dollar weakens against other foreign currencies, some of our component suppliers may increase the price they charge for their components in order to maintain an equivalent profit margin. If this occurs, it would have a negative impact on our

operating results.

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

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We have attempted to manage the impact of foreign currency exchange rate changes by, among other things, entering into short-term, foreign exchange contracts. However, these contracts do not cover our full exposure and can be canceled by the counterparty if currency controls are put in place.

Increases in our customers' credit risk could result in credit losses and an increase in our operating costs.

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

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

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

- the timing of orders from and shipment of products to major customers;
- our product mix;
- changes in the prices of our products;
- manufacturing delays or interruptions;
- acceptance by customers of competing products in lieu of our products;
- variations in the cost of and lead times for components for our products;
- limited availability of components that we obtain from a single or a limited number of suppliers;
- seasonal and other fluctuations in demand for PCs often due to technological advances; and
- availability and rates of transportation.

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

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

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

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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;

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- reserves for doubtful accounts;
- accruals for product returns;
- accruals for warranty costs related to product defects;
- accruals for litigation and other contingencies;
- liabilities for unrecognized tax benefits; and
- expensing of stock-based compensation.

The market price of our common stock is volatile.

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

- actual or anticipated fluctuations in our operating results, including those resulting from the seasonality of our business;
- announcements of technological innovations by us or our competitors, which may decrease the volume and profitability of sales of our existing products and increase the risk of inventory obsolescence;
- new products introduced by us or our competitors;
- strategic actions by us or competitors, such as acquisitions and restructurings;
- periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures or industry consolidation;
- developments with respect to patents or proprietary rights;
- proposed or adopted regulatory changes or developments or anticipated or pending investigations, proceedings or litigation that involve or affect us or our competitors;
- conditions and trends in the hard drive, solid state storage, computer, data and content management, storage and communication industries;
- contraction in our operating results or growth rates that are lower than our previous high growth-rate periods;
- failure to meet analysts' revenue or earnings estimates or changes in financial estimates or publication of research reports and recommendations by financial analysts relating specifically to us or the storage industry in general; and
- macroeconomic conditions that affect the market generally and, in particular, developments related to market conditions for our industry.

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

fluctuations from time to time that particularly affect the stock prices of many high technology companies. These fluctuations often appear to be unrelated to the operating performance of the companies.

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



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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 November 6, 2013, Hitachi completed a secondary offering of 12.5 million of these shares. We are required by the terms of an Investor Rights Agreement we entered into with Hitachi to file a Form S-3 registration statement with the Securities and Exchange Commission to register the resale by Hitachi of the remaining shares of common stock by a date designated by Hitachi in consultation with the Company and after reasonable prior notice to the Company. Sales of these shares of our common stock in the public market, or the perception that these sales may occur, could adversely affect the market price of our common stock. Uncertainty about the market price of our common stock could extend for a significant period of time and impair our ability to raise capital through the sale of additional equity securities.

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

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

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

Our most recent evaluation resulted in our conclusion that as of December 27, 2013, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal control over financial reporting was effective. If our internal control over financial reporting is found to be ineffective or if we identify a material weakness in our financial reporting in future periods, investors may lose confidence in the reliability of our financial statements, which may adversely affect our stock price.

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

We are subject to income taxes in the United States and certain foreign jurisdictions, and our determination of our tax liability is subject to review by applicable domestic and foreign tax authorities. For example, as we have previously disclosed, we are under examination by the Internal Revenue Service for certain fiscal years and in connection with that examination, we received Revenue Agent Reports seeking certain adjustments to income as disclosed in Part I, Item 1, Note 6 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. Although we believe our tax positions are properly supported, the final timing and resolution of the notice of proposed adjustment and the audits are subject to significant uncertainty and could result in our having to pay amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations or cash flows.

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

The following table provides information about repurchases by us of shares of our common stock during the quarter ended December 27, 2013:

(in millions, except average price paid per share)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased As Part of Publicly Announced Program(1)	Maximum Value of Shares that May Yet be Purchased Under the Program(1)
Sept. 28, 2013—Oct. 25, 2013	—	\$—	—	\$ 1,820
Oct. 26, 2013—Nov. 22, 2013	1.7	\$74.63	1.7	\$ 1,694
Nov. 23, 2013—Dec. 27, 2013	0.3	\$75.14	0.3	\$ 1,670
Total	2.0	\$74.71	2.0	\$ 1,670

(1) Since May 21, 2012, the Company's Board of Directors has authorized an additional \$3.0 billion for the repurchase of our common stock and extension of our stock repurchase program through September 13, 2017. Repurchases under our stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan.

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Item 6. EXHIBITS

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

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Exhibit Number	Description
2.1	Stock Purchase Agreement, dated March 7, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.1 to Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on May 2, 2011) ±
2.2	First Amendment to Stock Purchase Agreement, dated May 27, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.2 to the Company's Annual Report on Form 10-K (File No. 1-08703) with the Securities and Exchange Commission on August 12, 2011)
2.3	Second Amendment to Stock Purchase Agreement, dated November 23, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.3 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on January 27, 2012)
2.4	Third Amendment to Stock Purchase Agreement, dated January 30, 2012, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.4 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on May 9, 2012)
2.5	Fourth Amendment to Stock Purchase Agreement, dated February 15, 2012, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.5 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on May 9, 2012)
2.6	Fifth Amendment to Stock Purchase Agreement, dated March 6, 2012, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.6 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on May 9, 2012)
2.7	Sixth Amendment to Stock Purchase Agreement, dated March 6, 2012, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.7 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on May 9, 2012)
2.8	Amendment to Stock Purchase Agreement, dated July 9, 2012, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.8 to the Company's Annual Report on Form 10-K (File No. 1-08703) with the Securities and Exchange Commission on August 19, 2013)
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2.10	Amendment to Stock Purchase Agreement, dated August 29, 2012, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Filed as Exhibit 2.9 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on November 2, 2012)
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on February 8, 2006)
3.2	Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 14, 2013 (Filed as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on November 14, 2013)
10.1	Credit Agreement, dated as of January 9, 2014, among Western Digital Technologies, Inc. and Western Digital Ireland, Ltd., as borrowers, Western Digital Corporation, JPMorgan Chase Bank, N.A., as

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administrative agent, and the other lenders party thereto from time to time (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 January 9, 2014)

- 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.

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

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

WESTERN DIGITAL CORPORATION  
Registrant

/s/ TIMOTHY M. LEYDEN  
Timothy M. Leyden  
Chief Financial Officer  
(Principal Financial Officer and Principal Accounting  
Officer)

Date: January 31, 2014

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EXHIBIT INDEX

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

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