WESTERN DIGITAL CORP
Form 10-K
August 29, 2017

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

FORM 10-K

(Mark One)
ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2017
Or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 1-8703

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

Delaware (State or other jurisdiction of incorporation or organization)	33-0956711 (I.R.S. Employer Identification No.)
5601 Great Oaks Parkway San Jose, California (Address of principal executive offices)	95119 (Zip Code)

Registrant's telephone number, including area code: (408) 717-6000

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 Par Value Per Share	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No ¨
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No ý
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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

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

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

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on December 30, 2016, the last business day of the registrant's most recently completed second fiscal quarter, was $15.0 billion, based on the closing sale price as reported on the NASDAQ Global Select Market.

There were 294,875,015 shares of common stock, par value $0.01 per share, outstanding as of the close of business on August 16, 2017.

Documents Incorporated by Reference

Part III incorporates by reference certain information from the registrant's definitive proxy statement (the "Proxy Statement") for the 2017 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of the 2017 fiscal year. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

WESTERN DIGITAL CORPORATION
INDEX

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

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

Table of Contents

FORWARD-LOOKING STATEMENTS

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

- expectations concerning the integration of, and anticipated benefits from, our acquisition of SanDisk Corporation;
- expectations regarding the integration of our HGST and WD subsidiaries following the decision by the Ministry of Commerce of the People’s Republic of China in October 2015;
- expectations regarding our Flash Ventures joint venture with Toshiba;
- expectations regarding the growth of digital data and demand for digital storage;
- expectations regarding our business strategy, our ability to execute that strategy and its intended benefits;
- expectations with respect to relationships with our customers, employees, suppliers and strategic partners;
- our plans to develop and invest in new products and expand into new storage markets and into emerging economic markets;
- expectations regarding the personal computer market and the emergence of new storage markets for our products;
- expectations regarding the amount and timing of charges and cash expenditures associated with our restructuring activities;
- our quarterly cash dividend policy;
- expectations regarding the outcome of legal proceedings in which we are involved;
- expectations regarding the repatriation of funds from our foreign operations;
- our beliefs regarding tax benefits and the timing of future payments, if any, relating to the unrecognized tax benefits, and the adequacy of our tax provisions;
- expectations regarding capital investments and sources of funding for those investments; and
- our beliefs regarding the sufficiency of our available liquidity to meet our working capital, debt, dividend and capital expenditure needs.

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

Table of Contents

PART I

Item 1. Business

General

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

We have a rich heritage of innovation and operational excellence, a wide range of IP assets and broad research and development ("R&D") capabilities. The growth and the value of data continues unabated which in turn is rapidly evolving the landscape of storage markets we serve. We estimate that on a worldwide basis, the rate at which data is stored will likely increase 400% by the year 2020. We are transforming ourselves to address this growth by providing the broadest range of storage technologies, deep product portfolio and global reach in the industry. Founded in 1970 in Santa Ana, California and now headquartered in San Jose, California, Western Digital has one of the technology industry's most valuable patent portfolios with more than 14,000 patents awarded worldwide. Since 2009, we have been a Standard & Poor's 500 ("S&P 500") company.

Built on decades of expertise in developing leading technology and components, we are enabling enterprises to collect virtually limitless data and helping cloud providers build more powerful, cost effective and efficient data centers. We have relationships with the full range of original equipment manufacturers ("OEM") and data center customers currently addressing storage opportunities, such as storage subsystem suppliers, major server OEMs, Internet and social media infrastructure players, and personal computer ("PC") and Mac™ OEMs. We have also built strong consumer brands by providing people with effective tools to manage fast-accumulating libraries of personal content. We market our products primarily under the HGST, SanDisk and WD brands, and our products are sold through distribution, retail and direct channels worldwide. We are a vertically integrated company with deep capabilities to transform disk drive and NAND-flash components into products and solutions in our broad portfolio. We operate a series of joint ventures in Yokkaichi, Japan, that provides us industry leading NAND-flash technology for use in our solid-state offerings (see "Ventures with Toshiba" Section below).

We believe we are well positioned to capitalize on the ongoing expansion in digital content generation and management. These trends are linked directly to commercial enterprises' and consumers' increasingly ubiquitous experience with data and the increasing value of that data. The continued growth of data and the value creation of this data are driving the need for the long-term retention of as much data as possible. The ways in which people and organizations are creating and using data are changing and that the amount of data considered useful to store is expanding. Increasingly, more and more digital content is being stored and managed in a cloud environment on both hard disk drives ("HDDs") and solid state drives ("SSDs"), and we believe we are well positioned to continue to play a role in this transition. With a focus on innovation and user value creation, our goal is to grow through continued strong execution and with targeted investments in data center infrastructure, mobility and the cloud.

Industry

We operate in the data storage and data management industry. Our devices and solutions are made using either rotating magnetic or NAND-flash technologies that together provide a broad range of reliability, performance, storage capacity and data retention capabilities to our customers. With increasing ability to capture and create meaning and value from data, we believe our customers view insights gained from data analytics as one of their most important assets. In a connected global marketplace, there is a proliferation in the methods by and the rates at which content is generated, consumed and stored by end users. When combined with fast global networks, these trends create tremendous need for cost effective, high-performance and/or high-capacity storage solutions in mobile, computing and consumer electronic devices, as well as in a wide range of storage systems, servers and data centers.

Table of Contents

The storage industry is increasingly utilizing tiered architectures with HDDs, SSDs and other NAND-flash storage devices to address an expanding set of uses and applications. The growth in computing complexity, cloud computing applications, connected mobile devices and Internet connected products in the world continues unabated, creating the need for greater volumes of digital content to be stored, which in turn, drives a proliferation of data storage form factors. In addition, we monitor the advantages, disadvantages and advances of the full array of storage technologies, and review these with our customers on an ongoing basis to ensure we are appropriately resourced to meet our customers' storage needs. Storage solutions that hold large amounts of data are a key enabler of the trends seen in the evolution of a data driven economy, underpinned by the proliferation of digital content creation, consumption and monetization.

We are a market and customer driven company, focused on growth, innovation and value creation for our customers, employees and shareholders. We develop deep and collaborative relationships with our customers with a goal of enabling their continued success, an approach that has made us a trusted advisor and market maker in our served markets. As our portfolio of storage solutions expands further, we believe our customer engagement approach is one of the key factors that will help us continue to achieve strong financial performance over the long term. We believe that our product platform is broad-based and compelling, and our unique competitive advantages with growth drivers will continue to provide us the opportunity to expand our value-creation model within an evolving, changing and growing storage ecosystem.

Competition

Our industry is highly competitive. We compete with manufacturers of HDDs and NAND-flash memory for client devices and solutions, and data center devices and solutions. The HDD market consists of three principal manufacturers: Seagate Technology plc, with its Maxtor and Samsung brands, Toshiba Corporation ("Toshiba") and Western Digital, with our HGST and WD brands. In NAND-flash memory, we compete with a wide range of manufacturers, from numerous small startup companies to large multinational corporations, including captive NAND suppliers SK Hynix, Inc. ("SK Hynix"), Intel Corporation ("Intel"), Micron Technology, Inc., Samsung Electronics Co., Ltd. ("Samsung Electronics") and Toshiba.

Business Strategy

Our overall strategy is to leverage our innovation and execution capabilities to be an industry-leading and broad-based developer, manufacturer and provider of storage devices and solutions that support the evolving IT industry infrastructure that enables the unabated proliferation of data. We strive to successfully execute our strategy through the following foundational elements:

- Focus on strategy and execution: We focus on both strategy and execution to deliver the best outcome for our customers, partners and employees;

- Optimize our core HDD business: We are focused on delivering the best value for our customers in data center and client markets through a relentless focus on operational excellence and continued innovation;

- Lead in NAND-flash memory and solutions: We strategically align our investments to focus on established profitable and growing markets, as well as on emerging markets such as "Internet of Things", commonly referred to as "IoT", to enable our future growth;

- Grow in higher value markets with a blend of HDD and NAND-flash technologies: We leverage our capabilities in firmware, software and systems to deliver compelling storage solutions to our customers that offer the best combinations of performance, cost, power consumption, form factor, quality and reliability; and

- Align our retail offerings and client solutions portfolio: We compete with the industry's broadest portfolio of storage offerings for consumers in all the channels we serve while creating new use cases for our solutions in emerging markets.

We believe our strategy provides the following benefits, which distinguish us in the dynamic and competitive storage industry:

- enables scaling for efficiency and flexibility, allowing us to leverage our R&D and capital expenditures to deliver storage solutions to multiple markets;

- results in continued diversification of our storage solutions portfolio and entry into additional growing adjacent markets; and

- allows us to achieve strong financial performance, including healthy cash generation, thereby enabling allocation of capital to shareholders and strategic long-term investments in innovative technologies.

Data Storage Solutions

We offer a broad line of data storage solutions to meet the evolving storage needs of end markets which include the following:

Data Center Devices and Solutions

Data Center Devices and Solutions consist of high-performance and high-capacity enterprise HDDs and enterprise SSDs, data center software and system solutions. Our nearline capacity helium hard drives provide the massive high capacity storage needs and low total cost of ownership benefits for the growing hyperscale data center market. Our high-performance enterprise class HDDs are optimized for performance applications providing a range of capacity and performance levels primarily for use in enterprise servers, supporting high volume on-line transactions, data analysis and other enterprise applications. Our data center solutions also include a wide range of high-capacity HDDs and drive configurations which provide enterprise class reliability at the lowest cost per gigabyte (“GB”) and are primarily for use in data storage systems, in tiered storage models and where data must be stored reliably for years. Our enterprise SSDs include high-performance NAND-flash SSDs and software solutions designed to improve the performance in various enterprise workload environments and encompass all major storage interface protocols. Our system solutions provide petabyte scalable capacity with high performance at compelling economics. We also provide higher value data storage platforms and systems to the market through our vertically integrated scale-out object storage active archive systems.

Client Devices

Client Devices consist of HDDs and SSDs for computing devices, such as desktop and notebook PCs, security surveillance systems, gaming consoles and set top boxes; NAND-flash embedded storage products for mobile phones, tablets, notebook PCs and other portable and wearable devices, automotive, IoT and connected home applications; and NAND-flash memory wafers. Our HDDs and SSDs are designed for use in devices requiring high performance, reliability and capacity with various attributes such as low cost per GB, quiet acoustics, low power consumption and protection against shocks. Our embedded storage include custom embedded solutions and iNAND® embedded flash products, such as our multi-chip package (“MCP”) solutions that combine NAND-flash and mobile dynamic random-access memory (“DRAM”) in an integrated package.

Client Solutions

Client Solutions consist of HDDs and SSDs embedded into external storage products and removable NAND-flash products which include cards, universal serial bus (“USB”) flash drives and wireless drives. Our external HDD storage products in both mobile and desktop form factors provide affordable, high quality, reliable storage for backup and capacity expansion that are designed to keep digital content secure. We offer client SSDs with a range of capacities and performance characteristics to address a broad spectrum of the client storage market. Our removable cards are designed primarily for use in consumer devices, such as mobile phones, tablets, imaging systems, still cameras, action video cameras and security surveillance systems. Our USB flash drives are used in the computing and consumer markets and are designed for high-performance and reliability. Our wireless drive products allow in-field back up of created content, as well as wireless streaming of high-definition movies, photos, music and documents to tablets, smartphones and PCs.

Technology

Rotating Magnetic Storage

HDDs provide non-volatile data storage based on the recording of magnetic information on a rotating disk. We have successfully developed and commercialized HDDs that operate in an enclosed helium environment, instead of air, delivering industry leading HDD capacity and performance attributes. Our improvements in HDD capacity, which lower product costs over time, have been enabled largely through advancements in recording head and magnetic media technology. We develop and manufacture substantially all of the recording heads and magnetic media used in our hard drive products. We invest considerable resources in R&D, manufacturing infrastructure and capital equipment for recording head and media technology, as well as in other aspects of the magnetic recording system such as HDD mechanics, controller and firmware technology, in order to secure our competitive position and cost structure.

Table of Contents

Solid State Storage

Solid state storage products provide non-volatile storage based on NAND-flash technology. We develop and manufacture solid state storage products in different form factors for a variety of different markets, including enterprise or cloud storage, client storage, automotive, mobile devices and removable memory devices.

Our solid state storage products utilize our captive NAND-flash technology which we develop and manufacture through our business ventures with Toshiba. We focus significant research, development and effort on developing highly reliable, high-performance, cost-effective NAND-flash technology. Over time, we have successfully developed and commercialized an increased number of bits per cell in an increasingly smaller form factor, further driving cost reductions.

In 2017, we achieved major milestones in NAND-flash technology. We have:

- successfully introduced and commercialized 3-dimensional (“3D”) NAND technology, which we refer to as BiCS3, with 64 layers of vertical storage capability which features advances in high aspect ratio semiconductor processing. A key focus for us in BiCS3 is the use of X3 technology;
- successfully developed and commercialized the world’s first 512-gigabit 64-layer 3D NAND chip based on our BiCS3 technology; and
- successfully developed our next generation of 3D NAND, which we refer to as BiCS4, with 96 layers of vertical storage capability, which will be available in 3-bits-per-cell and 4-bits-per-cell architectures.

We expect to develop and commercialize additional generations of 3D NAND technologies over the next several years while continuing to utilize our older technology for certain markets and applications.

We are leveraging our expertise, resources and strategic investments in non-volatile memories to explore a wide spectrum of persistent memory and storage class memory technologies. We have also initiated, defined and developed standards to meet new market needs and to promote wide acceptance of flash storage standards through interoperability and ease-of-use.

Our products generally leverage a common platform for various products within product families, and in some cases across product families, resulting in the commonality of components which reduces our exposure to changes in demand, facilitates inventory management and allows us to achieve lower costs through purchasing economies. This platform strategy also enables our customers to leverage their qualification efforts onto successive product models. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Research and Development

We devote substantial resources to the development of new products and the improvement of existing products. We focus our engineering efforts on coordinating our product design and manufacturing processes to bring our products to market in a cost-effective and timely manner. R&D expenses totaled $2.44 billion, $1.63 billion and $1.65 billion in 2017, 2016 and 2015, respectively. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Patents, Licenses and Proprietary Information

We rely on a combination of patents, trademarks, copyright and trade secret laws, confidentiality procedures and licensing arrangements to protect our IP rights.

We have more than 14,000 active patents worldwide and have many patent applications in process. We continually seek additional United States ("U.S.") and international patents on our technology. We believe that, although our active patents and patent applications have considerable value, the successful manufacturing and marketing of our products also depends upon the technical and managerial competence of our staff. Accordingly, the patents held and applied for cannot alone ensure our future success.

Table of Contents

In addition to patent protection of certain IP rights, we consider elements of our product designs and processes to be proprietary and confidential. We believe that our non-patented IP, particularly some of our process technology, is an important factor in our success. We rely upon non-disclosure agreements, contractual provisions and a system of internal safeguards to protect our proprietary information. Despite these safeguards, there is a risk that competitors may obtain and use such information. The laws of foreign jurisdictions in which we conduct business may provide less protection for confidential information than the laws of the U.S.

We rely on certain technology that we license from other parties to manufacture and sell our products. We believe that we have adequate cross-licenses and other agreements in place in addition to our own IP portfolio to compete successfully in the storage industry. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Manufacturing

We believe that we have significant know-how, unique product manufacturing processes, test and tooling, execution skills and human resources to continue to be successful and to grow our manufacturing operations as necessary. We strive to maintain manufacturing flexibility, high manufacturing yields, reliable products and high-quality components. The critical elements of our production of HDD and NAND-flash products are high-volume and utilization, low-cost assembly and testing, strict adherence to quality metrics and maintaining close relationships with our strategic component suppliers to access best-in-class technology and manufacturing capacity.

HDD and NAND-flash product manufacturing are complex processes involving the production and assembly of precision components with narrow tolerances and rigorous testing. The assembly process occurs in a “clean room” environment that demands skill in process engineering and efficient space utilization to control the operating costs of this manufacturing environment. Our clean room manufacturing process consists of modular production units, each of which contains a number of work cells. We continually evaluate our manufacturing processes in an effort to increase productivity, sustain and improve quality and decrease manufacturing costs. We continually evaluate which steps in the manufacturing process would benefit from automation and how automated manufacturing processes can improve productivity and reduce manufacturing costs.

A majority of our NAND-flash supply requirements for our NAND-flash products is obtained from our business ventures with Toshiba, which provide us with leading-edge, high-quality and low-cost NAND-flash memory wafers. This represents a captive supply and we are obligated to take our share of the output from these ventures or pay the fixed costs associated with that capacity. See “Ventures with Toshiba” below for additional information. While a majority of our flash memory supply utilized for our products is purchased from these ventures, from time-to-time, we also purchase flash memory from other NAND-flash manufacturers, which we refer to as non-captive. While we do not unilaterally control the operations of these ventures, we believe that our business venture relationship with Toshiba helps us to reduce the costs of producing our products, increases our ability to control the quality of our products and speeds delivery of our products to our customers. Our vertically integrated manufacturing operations for our NAND-flash products are concentrated in three locations, with our business ventures with Toshiba located in Yokkaichi, Japan, and our in-house assembly and test operations located in Shanghai, China and Penang, Malaysia.

We also leverage the efficiencies of contract manufacturers when strategically advantageous. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Materials and Supplies

HDD primarily consists of recording heads, magnetic media and a printed circuit board assembly. We design and manufacture substantially all of the recording heads and magnetic media required for our products. As a result, we are more dependent upon our own development and execution efforts and less reliant on recording head and magnetic media technologies developed by other manufacturers. We depend on an external supply base for all remaining components and materials for use in our HDD product design and manufacturing.

Our NAND-flash product consists of NAND-flash memory and controllers. A majority of our NAND-flash memory is primarily supplied by our business ventures with Toshiba. Controllers are primarily designed in-house and manufactured by third-party foundries or acquired from third-party suppliers. We believe the use of our in-house assembly and test facilities, as well as contract manufacturers, provides flexibility and gives us access to increased production capacity. We have developed deep relationships with these vendors and Toshiba to establish continuous supply of NAND-flash memory and controllers.

Table of Contents

We generally retain multiple suppliers for our component requirements but in some instances use sole or single sources for business or technology reasons. Currently, we believe that there are no major issues with component availability. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Ventures with Toshiba

We and Toshiba currently operate three business ventures in 300-millimeter NAND-flash manufacturing facilities in Yokkaichi, Japan, which provide us leading-edge, cost-competitive NAND-flash memory wafers for our end products. Through Flash Partners Ltd., Flash Alliance Ltd., and Flash Forward Ltd., which we collectively refer to as Flash Ventures, we and Toshiba collaborate in the development and manufacture of NAND-flash memory wafers using semiconductor manufacturing equipment owned or leased by each of the Flash Venture entities. We hold a 49.9% ownership position in each of the Flash Venture entities. Each Flash Venture entity purchases wafers from Toshiba at cost and then resells those wafers to us and Toshiba at cost plus a mark-up. We are obligated to purchase half of Flash Ventures' NAND-flash memory wafer supply or pay for half of Flash Ventures' fixed costs regardless of the output we choose to purchase. We are also obligated to fund 49.9% to 50% of Flash Ventures' investments to the extent that Flash Ventures' operating cash flow is insufficient to fund these investments. We and Toshiba also collaborate on certain R&D activities in support of Flash Ventures.

The agreements governing the operations of the Flash Venture entities also set out a framework for any investment by the joint venture partners in NAND manufacturing capacity. We have a facility agreement with Toshiba related to the construction and operation of Toshiba's "New Fab 2" fabrication facility, which is primarily intended to provide additional clean room space to convert a significant portion of existing 2-dimensional ("2D") NAND wafer capacity to 3D NAND. In addition, Toshiba has announced that it is investing in a new "Fab 6" fabrication facility in Yokkaichi, Japan. Similar to New Fab 2, the additional clean room space in Fab 6 is primarily intended to support the continued conversion of 2D NAND capacity to 3D NAND. Pursuant to our agreements governing Flash Ventures, which give us priority to participate in expansions and conversions of NAND manufacturing capacity, we intend to jointly invest in Fab 6 equipment with Toshiba and our board of directors has authorized investments for our share of initial Fab 6 equipment. We have been in discussions with Toshiba to come to mutually acceptable terms around our planned investment in Fab 6.

Toshiba has announced significant losses related to its U.S. nuclear business and substantial doubt about its ability to continue as a going concern. Due to Toshiba's financial condition, Toshiba's working capital and access to credit and capital markets are severely limited. Toshiba could become unable to, or otherwise fail to, timely fund investments in Flash Ventures or our joint development efforts or fulfill its payment obligations to suppliers, which could harm Flash Ventures' operations, our joint technology roadmap and supplier relationships. Lease financings guaranteed by both Toshiba and us are not currently available to Flash Ventures on favorable terms and we are pursuing alternative forms of financing to fund our share of investments, which might not continue to be accessible. Toshiba has also announced various efforts to stabilize its financial condition, including a possible sale of a majority or the entire stake in its memory business, which includes its interests in Flash Ventures. According to Toshiba, on April 1, 2017, it transferred its memory business, including its interests in Flash Ventures, to a newly formed affiliate as part of those efforts. We have asserted our consent rights under the terms of the Flash Ventures agreements with respect to transactions involving the transfer of Toshiba's interests in Flash Ventures. See Part II, Item 8, Note 17, Legal Proceedings, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K. We are monitoring and evaluating other potential impacts of Toshiba's financial condition and efforts to sell its memory business on Flash Ventures and, in turn, on our own memory business and financial condition.

For a discussion of risks associated with our business ventures with Toshiba, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Sales and Distribution

We maintain sales offices in selected parts of the world including the major geographies of the Americas, Asia Pacific, Europe and the Middle East. Our international sales, which include sales to foreign subsidiaries of U.S. companies but do not include sales to U.S. subsidiaries of foreign companies, represented 80%, 72% and 79% of our net revenue for 2017, 2016 and 2015, respectively. Sales to international customers are subject to certain risks not normally encountered in domestic operations, including exposure to tariffs and various trade regulations. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Table of Contents

We perform our marketing and advertising functions internally and through outside firms utilizing both consumer media and trade publications targeting various reseller and end-user categories. We also maintain customer relationships through direct communication and by providing information and support through our website. In accordance with standard storage industry practice, we provide distributors and retailers with limited price protection and programs under which we reimburse certain marketing expenditures. We also provide distributors, resellers and OEMs with other sales incentive programs. While these groups of customers make up our end markets, some of these customers cross into multiple groups. We define these customers as follows:

Original Equipment Manufacturers. OEMs, including large-scale data center operators, system integrators and hyperscale customers who bundle, embed, or integrate our storage solutions, purchase our products either directly or through a contract manufacturer such as an original design manufacturer (“ODM”) and assemble them into the devices they build. OEMs typically seek to qualify two or more providers for each generation of products and generally will purchase products from those vendors for the life of that product. Many of our OEM customers utilize just-in-time inventory management processes. As a result, for certain OEMs, we maintain a base stock of finished goods inventory in facilities located near or adjacent to the OEM’s operations. In addition, we sell directly to cloud infrastructure players as well as flash storage solutions to customers that offer our products under their own brand name in the retail market, which we also classify as OEMs.

Distributors. We use a broad group of distributors to sell our products to non-direct customers such as small computer and consumer electronics (“CE”) manufacturers, dealers, value-added resellers, systems integrators, online retailers and other resellers. Distributors generally enter into non-exclusive agreements with us for the purchase and redistribution of our products in specific territories.

Retailers. We sell our branded products directly to a select group of major retailers such as computer superstores, warehouse clubs, online retailers and computer electronics stores, and authorize sales through distributors to smaller retailers. The retail channel complements our other sales channels while helping to build brand awareness for us and our products. We also sell our branded products through our websites.

For both 2017 and 2016, no single customer accounted for 10% or more of our net revenue. For 2015, Hewlett-Packard Company accounted for 11% of our net revenue. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K. For additional information regarding revenue recognition, sales by geographic region and major customers, see Part II, Item 8, Note 1, Organization and Basis of Presentation and Note 10, Business Segment, Geographic Information and Concentration of Risk, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Backlog

A substantial portion of our orders are generally for shipments within 60 days of the placement of the order. Customers’ purchase orders may be canceled with relatively short notice to us, with little or no cost to the customer, or modified by customers to provide for delivery at a later date. In addition, for many of our OEMs utilizing just-in-time inventory, we do not generally require firm order commitments and instead, receive a periodic forecast of requirements. Therefore, backlog information as of the end of a particular period is not necessarily indicative of future levels of our revenue and profit and may not be comparable to prior periods.

Seasonality

We have historically experienced seasonal fluctuations in our business with higher levels of demand in the first and second quarters of our fiscal year as a result of increased customer spending. Seasonality can also be impacted by the growth in emerging markets and macroeconomic conditions. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Service and Warranty

We generally warrant our newly manufactured products against defects in materials and workmanship from one to five years from the date of manufacture depending on the type of product, with a small number of products having a warranty ranging up to ten years or more. Our warranty obligation is generally limited to repair or replacement. We have engaged third parties in various countries in multiple regions to provide various levels of testing, processing, or recertification of returned products for our customers. For additional information regarding our service and warranty policy, see Part II, Item 8, Note 1, Organization and Basis of Presentation, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Table of Contents

Environmental Regulation

We are subject to a variety of U.S. and foreign laws and regulations in connection with our operations and relating to the protection of the environment, including those governing discharges of pollutants into the air and water, the management and disposal of hazardous substances and the clean-up of contaminated sites. Some of our operations require environmental permits and controls to prevent and reduce air and water pollution. These permits are subject to modification, renewal and revocation by issuing authorities. We believe that we have obtained or are in the process of obtaining all necessary environmental permits for our operations.

We have established environmental management systems and continually update our environmental policies and standard operating procedures for our operations worldwide. We believe that our operations are in material compliance with applicable environmental laws, regulations and permits. We budget for operating and capital costs on an ongoing basis to comply with environmental laws.

Our properties have in some cases been operated for many years and may contain soil or groundwater contamination. In certain of our facilities we are undertaking voluntary monitoring of soil and groundwater. Based on available information, including our voluntary monitoring activities, we do not believe that we have a current affirmative legal obligation for any remedial action.

For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Employees

As of June 30, 2017, we employed a total of approximately 68,000 employees worldwide, excluding temporary employees and contractors. Many of our employees are highly skilled and our continued success depends in part upon our ability to attract and retain such employees. Accordingly, we offer employee benefit programs that we believe are, in the aggregate, competitive with those offered by our competitors.

While the substantial majority of our employees are not party to a collective bargaining agreement, a majority of our employees in Japan and China are subject to collective bargaining agreements. We consider our employee relations to be good. For a discussion of associated risks, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Corporate Responsibility and Sustainability

We believe that corporate social responsibility is an essential factor for our overall success. This includes adopting ethical and sustainable practices to direct how we do business while keeping the interests of our stakeholders and the environment in mind.

We strive to uphold the following principles:

- treat all employees with dignity and respect;
- set up processes and procedures intended to comply with applicable laws and regulations as well as our internal guidelines and uphold ethical standards;
- establish policies and procedures intended to promote the idea that the quality of our products and services, consistency of production and employee well-being are predicated on a safe and healthy work environment; and

- establish policies and procedures intended to promote environmental responsibility as an integral part of our culture.

Table of Contents

Available Information

We maintain an Internet website at www.wdc.com. Our Annual Report on Form 10 K, Quarterly Reports on Form 10 Q, Current Reports on Form 8 K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on our website at www.wdc.com, free of charge, as soon as reasonably practicable after the electronic filing of these reports with, or furnishing of these reports to, the Securities and Exchange Commission ("SEC"). Any materials we file with the SEC are available at the SEC's Public Reference Room at 100 F Street NE, Washington, DC 20549. Additional information about the operation of the Public Reference Room can also be obtained by calling the SEC at 1 800 SEC 0330. In addition, the SEC maintains a website at www.sec.gov that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC, including us.

Item 1A. Risk Factors

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

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

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

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

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

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

Table of Contents

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

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

We are dependent on our ventures with Toshiba to develop and manufacture NAND-flash memory products for our NAND-flash memory supply, and therefore our business, financial condition and operating results, and our ability to realize the anticipated benefits from our acquisition of SanDisk Corporation (“SanDisk”), pursuant to an Agreement and Plan of Merger (the “Merger”), will be dependent on the success of Flash Ventures.

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

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

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

Flash Ventures requires significant investments by both Toshiba and us for technology transitions, including the transition to 3D NAND, and capacity expansions. In March 2016, Toshiba announced plans to construct a new wafer fab in Yokkaichi, Japan, to provide additional cleanroom space to support the continued conversion of 2D NAND capacity to 3D NAND, and we intend to participate in that wafer fab. Although we have had discussions to extend the joint venture partnership with Toshiba to the new wafer fab, there is no certainty as to when, and on what terms, we will participate with Toshiba in any investment in equipment for the new wafer fab, if at all. Failure to extend the joint venture partnership or failure to continue to secure and invest in additional cleanroom space to support the continued 3D NAND transition could adversely impact our supply of captive NAND-flash memory and financial results. If Toshiba does not or we do not provide sufficient resources or have adequate access to credit, investments in Flash Ventures could be delayed or reduced. In addition, in the event that lease financings for Flash Ventures are not available on favorable terms or at all, more cash would be required to fund these investments.

Table of Contents

Toshiba has announced significant losses related to its U.S. nuclear business and substantial doubt about its ability to continue as a going concern. Due to Toshiba's financial condition, Toshiba's working capital and access to credit and capital markets are severely limited. Toshiba could become unable to, or otherwise fail to, timely fund investments in Flash Ventures or our joint development efforts or fulfill its payment obligations to suppliers, which could harm Flash Ventures' operations, our joint technology roadmap and supplier relationships. Lease financings guaranteed by both Toshiba and us are not currently available to Flash Ventures on favorable terms and we are pursuing alternative forms of financing to fund our share of investments, which might not continue to be accessible. Toshiba has also announced various efforts to stabilize its financial condition, including a possible sale of a majority or the entire stake in its memory business. According to Toshiba, on April 1, 2017, it transferred its memory business, including its interests in Flash Ventures, to a newly formed affiliate as part of those efforts. On May 14, 2017, several of our SanDisk subsidiaries filed a request for arbitration with the ICC International Court of Arbitration seeking an order requiring Toshiba to unwind the transfer to its affiliate, and injunctive relief preventing Toshiba from further breaching the Flash Ventures agreements (copies of which are incorporated by reference into this Annual Report on Form 10 K) by transferring its interests in Flash Ventures without SanDisk's consent. Numerous proceedings and actions related to Flash Ventures and our consent and other rights under the terms of the Flash Ventures agreements followed and are ongoing. Please see Part II, Item 8, Note 17, Legal Proceedings, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K for a further description of these proceedings and actions. While we have asserted our consent rights under the terms of the Flash Ventures agreements with respect to transactions involving the transfer of Toshiba's interests in Flash Ventures, our request for arbitration, legal proceedings, other potential litigation, a change in the management or control of Flash Ventures or of Toshiba's memory business could lead to delays in decision-making, disputes, or changes in strategic direction that could adversely impact Flash Ventures, and therefore adversely affect our business prospects, results of operations and financial condition.

If a third party acquires any of Toshiba's interests in Flash Ventures, that third party might not have the same interest that we do in protecting and growing Flash Ventures' business and might have conflicts of interest between itself and Flash Ventures or us. Reduced investment in manufacturing capacity or research and development, or other misalignment between us and our partner or any third party acquirer on strategic direction, could impact Flash Ventures' ability to stay at the forefront of technological advancement. Flash Ventures' competitiveness could also be harmed by a mishandling or misuse of IP or other competitively sensitive confidential information regarding Flash Ventures, such as its technology roadmap, business or investment plans, by any acquirer or other third party that might gain access to such information during the bidding process.

A failure by Toshiba to successfully stabilize its financial condition could lead to insolvency or bankruptcy proceedings, which could result in Flash Ventures and related agreements being terminated early or modified unfavorably for us. We are monitoring and evaluating other potential impacts of Toshiba's financial condition and efforts to sell its memory business on Flash Ventures and, in turn, on our own memory business and financial condition. The deterioration of our partner's financial condition could adversely affect the value of our investments in Flash Ventures and our business prospects, results of operations and financial condition.

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

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

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

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

- successfully managing relationships with our strategic partners and our combined supplier and customer base;

- coordinating and integrating independent R&D and engineering teams across technologies and product platforms to enhance product development while reducing costs;
- increased levels of investment in R&D, manufacturing capability and technology enhancement relating to SanDisk's business;
- successfully transitioning to 3D NAND and future technologies;
- coordinating sales and marketing efforts to effectively position the combined company's capabilities and the direction of product development;
- difficulties in integrating the systems and processes of two companies with complex operations and multiple manufacturing sites;
- the increased scale and complexity of our operations resulting from the Merger;
- retaining key employees;
- obligations that we have to counterparties of SanDisk that arose as a result of the change in control of SanDisk; and
- the diversion of management attention from other important business objectives.

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

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

In connection with the Merger, we substantially increased our indebtedness, which could adversely affect our ability to fulfill our obligations and have a negative impact on our financing options and liquidity position. As of June 30, 2017, our total indebtedness was $13.36 billion in aggregate principal, and we had $1.00 billion of additional borrowing availability under our revolving credit facility.

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

- limiting our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions or other general corporate purposes;
- requiring a substantial portion of our cash flows to be dedicated to debt service payments instead of other purposes, thereby reducing the amount of cash flows available for working capital, capital expenditures, acquisitions, R&D and other general corporate purposes;
- imposing financial and other restrictive covenants on our operations, including limiting our ability to (i) declare or pay dividends or purchase our common stock; (ii) purchase assets, make investments, complete acquisitions, consolidate or merge with or into, or sell all or substantially all of our assets to, another person; (iii) dispose of assets; (iv) incur liens; and (v) enter into transactions with affiliates;

- placing us at a competitive disadvantage to competitors carrying less debt; and
- making us more vulnerable to economic downturns and limiting our ability to withstand competitive pressures or take advantage of new opportunities to grow our business.

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

17

Table of Contents

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

During 2017, 36% of our revenue came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, often resulting in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results and financial condition would likely be harmed.

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

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

Table of Contents

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

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

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

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

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

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

20

Table of Contents

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

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

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

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

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

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

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.

Table of Contents

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

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

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

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

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

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

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

Table of Contents

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

We have entered into strategic relationships with various partners for future product development, sales growth and the supply of technologies, components, equipment and materials for use in our product design and manufacturing, including our relationships with Toshiba for NAND-flash memory supply. In addition, in the first quarter of 2017, our joint venture with Unisplendour Corporation Limited (“Unis”) to market and sell our current data center storage systems in China and to develop data storage systems for the Chinese market in the future became operational; the joint venture is 49% owned by us and 51% owned by Unis and its subsidiary, Unissoft (Wuxi) Group Co. Ltd. Please see the risk factor entitled “Because we are dependent on a limited number of qualified suppliers for components, sub-assemblies, testing, equipment, consumables, raw materials, and logistics, a supplier’s inability, unwillingness, or failure to support us in a timely manner with goods or services at a quality level and cost acceptable to us can adversely affect our margins, revenues and operating results” for a further description of the risks associated with our reliance on external suppliers. These strategic relationships are subject to various risks that could adversely affect the value of our investments and our results of operations and financial condition. These risks include, but are not limited to, the following:

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

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

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

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

Table of Contents

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

In addition to an external supply base, we also rely on an internal supply chain of heads, media and media substrate, and we rely on our business ventures with Toshiba for the supply of NAND-flash memory. Please see the risk factors entitled, "The substitution or replacement of our technologies and products by new technologies could make our products obsolete and harm our operating results," "If we do not properly manage technology transitions, our competitiveness and operating results may be negatively affected," and "We rely substantially on our business ventures with Toshiba for the supply of NAND-flash memory, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results" for a review of some of the risks related to these supplies.

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

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

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

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

Table of Contents

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

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

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

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

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

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

Table of Contents

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

- our ability to increase our software development capability; and

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

In particular, as part of our growth strategy, we have made significant investments in active archive systems, which are designed to enable organizations to rapidly access massive long-term data stores. For example, our acquisition of Amplidata NV in March 2015 was partially driven by our strategy to expand in this area. We expect to continue to make significant investments in active archive systems. Our active archive systems may fail to gain market acceptance, or the market for active archive systems may not grow as we anticipate.

Table of Contents

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

- currency exchange rate fluctuations or restrictions;

- political and economic instability, civil unrest and natural disasters;

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

- higher freight rates;

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

- trade restrictions or higher tariffs and fees;

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

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

- exchange, currency and tax controls and reallocations;

- increasing labor and overhead costs;

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

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

Table of Contents

Terrorist attacks may adversely affect our business and operating results.

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

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

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

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

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

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

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

Table of Contents

As a result of MOFCOM's decision, we immediately began planning for the integration of the substantial portions of our HGST and WD subsidiaries that we are now allowed to integrate (including corporate functions, R&D, recording heads and magnetic media operations, engineering and manufacturing). We expect this integration to continue through the end of calendar year 2017. Our integration efforts during this time may involve significant management time and create uncertainty for employees and customers. Any delays in the integration process could have a material adverse effect on our business, results of operations and financial condition. It is possible that the integration process could result in the loss of key employees, the loss of customers, the disruption of our company's ongoing business or in unexpected integration issues, higher than expected integration costs and an overall integration process that takes longer than originally anticipated. Additionally, the integration of the operations of our HGST and Western Digital Technologies, Inc. ("WDT") subsidiaries may also increase the risk that our internal controls are found to be ineffective. Further, until we are able to begin combining our HGST and WD product brands and sales teams following the expiration of the MOFCOM restrictions on October 19, 2017, we will continue to incur additional costs to maintain separate brands and sales teams. These additional costs, along with any delay in the integration process or higher than expected integration costs or other integration issues, could adversely affect our ability to achieve the full operating expense synergies we expect from integration of the businesses of our HGST and WDT subsidiaries. Any failure to achieve the full operating expense synergies that we expect from this integration could harm our business and financial condition. Achieving these synergies is also subject to significant business, operational, economic and competitive uncertainties and contingencies, and we cannot assure you that any or all of these synergies will be achieved in the anticipated amounts or within the anticipated time frames or cost expectations or at all.

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

- damaging our reputation;

- forcing us to find alternate component sources;

- reducing demand for our products (for example, through a consumer boycott); or

- exposing us to potential liability for our suppliers', customers' or partners' wrongdoings.

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

Flash Ventures sells and leases back from a consortium of financial institutions ("lessors") a portion of its equipment and Flash Ventures has entered into equipment lease agreements, most of which we and Toshiba each guarantee half of the total outstanding obligations and some of which we guarantee in full for our share of the Flash Ventures investment. As of June 30, 2017, the portion of outstanding Flash Ventures' lease obligations covered by our guarantees totaled approximately $968 million, based upon the Japanese yen to U.S. dollar exchange rate at June 30, 2017. The equipment lease agreements contain covenants and cancellation events that are customary for Japanese lease facilities and that relate to Flash Ventures and each of the guarantors. Cancellation events relating to the guarantors include, among other things, an assignment of all or a substantial part of a guarantor's business, a bankruptcy event involving a guarantor and acceleration of other monetary debts of a guarantor above a specified threshold.

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

- weakness in demand for one or more product categories;

Table of Contents

- the timing of orders from and shipment of products to major customers, loss of major customers;
- our product mix;
- reductions in the ASPs of our products and lower margins;
- excess output, capacity or inventory, resulting in lower ASPs, financial charges or impairments, or insufficient output, capacity or inventory, resulting in lost revenue opportunities;
- inability to successfully transition to 3D NAND or other technology developments, or other failure to reduce product costs to keep pace with reduction in ASPs;
- manufacturing delays or interruptions;
- delays in design wins or customer qualifications, acceptance by customers of competing products in lieu of our products;
- success of our partnerships and joint ventures, in particular the volume, timing and cost of wafer production at Flash Ventures, and our success in managing the relationships with our strategic partners;
- inability to realize the potential benefits of our acquisitions and the success of our integration efforts;
- ability to penetrate new markets for our storage solutions;
- variations in the cost of and lead times for components for our products, disruptions of our supply chain;
- limited availability of components that we obtain from a single or a limited number of suppliers;
- seasonal and other fluctuations in demand often due to technological advances;
- increase in costs due to warranty claims;
- higher costs as a result of currency exchange rate fluctuations; and
- availability and rates of transportation.

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

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

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

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

Table of Contents

- accruals for litigation and other contingencies; and
- liabilities for unrecognized tax benefits.

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

The market price of our common stock is volatile.

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

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

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

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.

Table of Contents

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

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

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

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

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

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

We are subject to income taxes in the U.S. and certain foreign jurisdictions, and our determination of our tax liability is subject to review by applicable domestic and foreign tax authorities. For example, as we have previously disclosed, we are under examination by the Internal Revenue Service for certain fiscal years and in connection with that examination, we received a Revenue Agent's Report seeking certain adjustments to income as disclosed in Part II, Item 8, Note 13, Income Tax Expense (Benefit), of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K. Although we believe our tax positions are properly supported, the final timing and resolution of any tax examinations are subject to significant uncertainty and could result in our having to pay amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations or cash flows.

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

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

Table of Contents

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

Tax laws are dynamic and subject to change as new laws and regulations are passed and new interpretations of the laws are issued or applied. While the former U.S. administration and members of Congress made public statements indicating that tax reform is a priority, and certain changes to the U.S. tax laws and regulations have been made and others proposed, additional changes may be proposed by the current U.S. administration or members of Congress and new U.S. tax laws and regulations may go into effect. In addition, many countries in the European Union and around the globe have adopted and/or proposed changes to current tax laws. Further, organizations such as the Organization for Economic Cooperation and Development, have published action plans that, if adopted by countries where we do business, could increase our tax obligations in these countries. Due to the large scale of our U.S. and international business activities, many of these enacted and proposed changes to the taxation of our activities could increase our worldwide effective tax rate and harm our financial position and results of operations.

Item 1B. Unresolved Staff Comments

Not applicable.

Table of Contents

Item 2. Properties

Our principal executive offices are located in San Jose, California. Our leased facilities are occupied under leases that expire at various times through 2027. Our principal manufacturing, R&D, marketing and administrative facilities as of June 30, 2017 were as follows:

Location	Buildings Owned or Leased	Approximate Square Footage	Description
United States			
California			
Fremont	Owned	392,000	Manufacturing of head wafers and R&D
Irvine	Leased	490,000	R&D, administrative, marketing and sales
Milpitas	Owned	589,000	R&D, marketing and sales, operations and administrative
San Jose	Owned and Leased	2,887,000	Manufacturing of head wafers, head, media and product development, R&D, administrative, marketing and sales
Colorado			
Longmont	Leased	62,000	R&D
Minnesota			
Rochester	Leased	118,000	Product development
Asia			
China			
Shanghai	Owned	715,000	Assembly and test
Shenzhen	Owned and Leased	548,000	Manufacturing of media and administrative
Japan			
Fujisawa	Owned	661,000	Product development
Malaysia			
Johor	Owned	271,000	Manufacturing of substrates
Kuala Lumpur	Owned	1,074,000	Manufacturing of hard drives and R&D
Kuching	Owned	285,000	Manufacturing and development of substrates
Penang	Owned	1,075,000	Assembly and test, manufacturing of media and SSDs, and R&D
Philippines			
Laguna	Owned	621,000	Manufacturing of HGAs and slider fabrication
Singapore	Leased	324,000	R&D and administrative
Thailand			
Bang Pa-In	Owned	1,665,000	Slider fabrication, manufacturing of hard drives and HGAs, and R&D
Navanakorn	Owned	290,000	Manufacturing of HGAs
Prachinburi	Owned	729,000	Manufacturing of hard drives
India			
Bangalore	Owned	240,000	R&D, marketing and administrative
Middle East			
Israel			
Kfar Saba	Owned	167,000	R&D, marketing and administrative
Tefen	Owned	64,000	R&D, marketing and administrative

We also lease office space in various other locations throughout the world primarily for R&D, sales, operations, administration and technical support. We believe our present facilities are adequate for our current needs, although we upgrade our facilities from time to time to meet anticipated future technological and market requirements. In general, new manufacturing facilities can be developed and become operational within approximately nine to eighteen months should we require such additional facilities.

Table of Contents

Item 3. Legal Proceedings

For a description of our legal proceedings, see Part II, Item 8, Note 17, Legal Proceedings, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K, which is incorporated by reference in response to this item.

Item 4. Mine Safety Disclosures

Not applicable.

Table of Contents

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information for Common Stock

Our common stock is listed on the NASDAQ Global Select Market ("NASDAQ") under the symbol "WDC." The approximate number of holders of record of our common stock as of August 16, 2017 was 1,069.

The high and low sales prices of our common stock as reported by NASDAQ for each quarter of 2017 and 2016 were as follows:

Quarter Ended	High	Low
September 30, 2016	$59.86	$43.09
December 30, 2016	$72.01	$52.10
March 31, 2017	$84.28	$68.58
June 30, 2017	$95.00	$80.51

Quarter Ended	High	Low
October 2, 2015	$88.46	$67.87
January 1, 2016	$86.39	$57.94
April 1, 2016	$60.97	$38.64
July 1, 2016	$51.27	$34.99

Repurchases of Equity Securities

There were no repurchases by us of shares of our common stock during 2017.

Dividends to Shareholders

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 2017, we declared aggregate cash dividends of $2.00 per share of our common stock, totaling $579 million. We may modify, suspend, or cancel our cash dividend policy in any manner and at any time.

The following table provides information about the quarterly dividends our Board of Directors declared in the last two fiscal years.

Record Date	Payment Date	Dividend Per Share
October 2, 2015	October 15, 2015	$0.50
January 1, 2016	January 15, 2016	$0.50
April 1, 2016	April 15, 2016	$0.50
July 1, 2016	July 15, 2016	$0.50
September 30, 2016	October 17, 2016	$0.50
December 30, 2016	January 17, 2017	$0.50
March 31, 2017	April 17, 2017	$0.50
June 30, 2017	July 17, 2017	$0.50

Table of Contents

Stock Performance Graph

The following graph compares the cumulative total stockholder return of our common stock with the cumulative total return of the S&P 500 Index and the Dow Jones US Technology Hardware & Equipment Index for the five years ended June 30, 2017. The graph assumes that $100 was invested in our common stock at the close of market on June 29, 2012 and that all dividends were reinvested. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

TOTAL RETURN TO STOCKHOLDERS
(Assumes $100 investment on June 29, 2012)
Total Return Analysis

	June 29, 2012	June 28, 2013	June 27, 2014	July 3, 2015	July 1, 2016	June 30, 2017
Western Digital Corporation	$100.00	$208.29	$316.45	$280.92	$167.36	$326.27
S&P 500 Index	$100.00	$120.60	$150.32	$162.54	$168.23	$197.92
Dow Jones US Technology Hardware & Equipment Index	$100.00	$96.91	$137.92	$156.25	$144.23	$203.76

The stock performance graph shall not be deemed soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, nor shall it be incorporated by reference into any past or future filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically request that it be treated as soliciting material or specifically incorporate it by reference into a filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Table of Contents

Item 6. Selected Financial Data

Financial Highlights

This selected consolidated financial data should be read together with the Consolidated Financial Statements and related Notes contained in this Annual Report on Form 10 K, as well as the section of this Annual Report on Form 10 K entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

	June 30, 2017	July 1, 2016	July 3, 2015	June 27, 2014	June 28, 2013
	(in millions, except per share and employee data)				
Revenue, net	$19,093	$12,994	$14,572	$15,130	$15,351
Gross profit	6,072	3,435	4,221	4,360	4,363
Net income	397	242	1,465	1,617	980
Income per common share:					
Basic	$1.38	$1.01	$6.31	$6.88	$4.07
Diluted	$1.34	$1.00	$6.18	$6.68	$3.98
Cash dividends declared per common share	$2.00	$2.00	$1.80	$1.25	$1.00
Working capital	$6,712	$5,635	$5,275	$4,875	$3,625
Total assets	$29,860	$32,862	$15,170	$15,499	$14,036
Long-term debt	$12,918	$13,660	$2,149	$2,313	$1,725
Shareholders’ equity	$11,418	$11,145	$9,219	$8,842	$7,893
Number of employees [1]	67,629	72,878	76,449	84,072	85,777

[1] Excludes temporary employees and contractors.

Results for SanDisk, Amplidata NV, Virident Systems, Inc., sTec, Inc. and VeloBit, Inc., which were acquired on May 12, 2016, March 9, 2015, October 17, 2013, September 12, 2013 and July 9, 2013, respectively, are included in our operating results only after their respective dates of acquisition.

Table of Contents

Item 7. Management’s Discussion and Analysis of Financial Conditions and Results of Operations

Our Company

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

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Fiscal years 2017 and 2016, which ended on June 30, 2017 and July 1, 2016, respectively, both comprised 52 weeks, with all quarters presented consisting of 13 weeks. Fiscal year 2015, which ended on July 3, 2015, comprised 53 weeks, with the first quarter consisting of 14 weeks and the second, third and fourth quarters consisting of 13 weeks each.

Key Developments

Acquisition of SanDisk

On May 12, 2016 (the “SanDisk Closing Date”), we completed the acquisition of SanDisk (the “Merger”), a global leader in NAND-flash storage solutions, pursuant to the terms of the Agreement and Plan of Merger, dated October 21, 2015. The Merger is primarily intended to deepen our expertise in non-volatile memory and enable us to vertically integrate into NAND, securing long-term access to solid state technology at a lower cost. The aggregate purchase price of the Merger was $15.59 billion. This acquisition broadened our product portfolio, significantly increased our revenues in 2017 and enhanced our gross margins. Operating expenses also increased with the assumption of the SanDisk operations. For additional information on the acquisition, see Part II, Item 8, Note 15, Acquisitions, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Debt Facilities

In connection with the Merger, we entered into new debt facilities aggregating approximately $18.09 billion in principal to finance a portion of the purchase price related to the Merger. The proceeds were also used to refinance certain existing indebtedness of Western Digital and SanDisk, and pay certain transaction costs. This new debt significantly increased our interest expense in 2017. During 2017, we repaid a $3.00 billion short-term bridge loan, made a voluntary $750 million principal payment on one of the term loans and entered into several repricing transactions that significantly lowered the rate of interest on some of the new term loans. We also settled a substantial portion of the remaining assumed SanDisk convertible notes. The reductions in principal and the repricing transactions are expected to lower our interest expense going forward compared to 2017. For additional information, see Part II, Item 8, Note 6, Debt, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Ventures with Toshiba

Through Flash Ventures, we and Toshiba currently operate three business ventures in 300-millimeter NAND-flash manufacturing facilities in Yokkaichi, Japan, which provide us leading-edge, cost-competitive NAND wafers for our end products. Toshiba has announced significant losses related to its U.S. nuclear business and substantial doubt about its ability to continue as a going concern. Due to Toshiba’s financial condition, Toshiba’s working capital and access to credit and capital markets are severely limited. Toshiba could become unable to, or otherwise fail to, timely fund investments in Flash Ventures or our joint development efforts or fulfill its payment obligations to suppliers, which could harm Flash Ventures' operations, our joint technology roadmap and supplier relationships. We are committed to the success of Flash Ventures and we intend to, and have been engaged in discussions with Toshiba to, jointly invest in Fab 6 equipment with Toshiba. See Part I, Item I, Business: Ventures with Toshiba, for additional information. For a discussion of risks associated with our business ventures with Toshiba, see Part I, Item 1A, Risk Factors, of this Annual Report on Form 10 K.

Table of Contents

Results of Operations

Summary Comparison of 2017, 2016 and 2015

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

	2017		2016		2015	
	(in millions, except percentages)					
Revenue, net	$19,093	100.0 %	$12,994	100.0 %	$14,572	100.0 %
Cost of revenue	13,021	68.2	9,559	73.6	10,351	71.0
Gross profit	6,072	31.8	3,435	26.4	4,221	29.0
Operating expenses	4,118	21.6	2,969	22.8	2,610	17.9
Operating income	1,954	10.2	466	3.6	1,611	11.1
Total interest and other expense, net	(1,185)	(6.2)	(313)	(2.4)	(34)	(0.2)
Income before taxes	769	4.0	153	1.2	1,577	10.8
Income tax expense (benefit)	372	1.9	(89)	(0.7)	112	0.8
Net income	$397	2.1	$242	1.9	$1,465	10.1

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

	2017	2016	2015
	(in millions, except exabytes and percentages)		
Revenue, net	$19,093	$12,994	$14,572
Revenues by Geography (%)			
Americas	27 %	32 %	28 %
Europe, Middle East and Africa	17	21	22
Asia	56	47	50
Revenues by End Market (%)			
Client Devices	50 %	48 %	53 %
Data Center Devices & Solutions	29	38	34
Client Solutions	21	14	13
Exabytes Shipped	313	262	249

For 2017 and 2016, no customer accounted for 10% or more of our net revenue. For 2015, one customer, Hewlett-Packard Company, accounted for 11% of our net revenue. For 2017, 2016 and 2015, our top 10 customers accounted for 36%, 43% and 44%, of our net revenue, respectively.

Fiscal Year 2017 Net Revenue and Gross Margin Compared to Fiscal Year 2016 Net Revenue and Gross Margin

Net Revenue. Net revenue was $19.09 billion for 2017, an increase of $6.10 billion, or 47%, as compared to 2016, primarily due to a full year of revenue from the sale of NAND-flash products following the SanDisk Closing Date, compared to a partial year of such revenue in the prior year. This increase was partially offset by lower revenue related to lower PC and enterprise HDD shipments.

Table of Contents

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 2017 and 2016, these programs represented 12% and 13% of gross revenues, respectively. The decrease in sales incentive and marketing programs year-over-year reflects lower incentive programs offered on NAND-flash products as a result of the Merger. The amounts attributed to our sales incentive and marketing programs also generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of products. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue.

Net Revenue by Geography. Changes in the mix of net revenue by geography for 2017, as compared to 2016, reflect the additional revenues from the Merger which has comparatively higher revenue in Asia than our pre-acquisition business.

Net Revenue by End Market. Our end markets include Data Center Devices and Solutions (capacity and performance enterprise HDD, enterprise SSD, data center software and system solutions); Client Devices (mobile, desktop, gaming and digital video hard drives, client SSDs, embedded products and wafers); and Client Solutions (removable products, hard drive content solutions and flash content solutions).

Changes in the mix of net revenue by end market for 2017, as compared to 2016, reflect the full year increase in revenues from the Merger which has comparatively higher revenue in Client Devices and Client Solutions than our pre-acquisition business.

Gross Profit and Gross Margin. Gross profit was $6.07 billion for 2017, an increase of $2.64 billion, or 77%, as compared to 2016, largely driven by the increase in revenue mentioned above. Gross profit for 2017 was negatively impacted by amortization expense on acquired intangible assets, charges related to the implementation of cost-saving initiatives, stock-based compensation and acquisition related charges, which aggregated $1.14 billion, or 6.0% of revenue, for 2017, and $375 million, or 2.9% of revenue, for 2016. Gross margin increased to 31.8% for 2017, as compared to 26.4% for 2016. The increase in gross margin was primarily due to sales of NAND-flash products following the SanDisk Closing Date, as such products have comparatively higher gross margins than our pre-acquisition products, cost improvements across all products driven by manufacturing integration activities and cost improvements as NAND-flash technology transitions to more cost efficient designs.

Fiscal Year 2016 Net Revenue and Gross Margin Compared to Fiscal Year 2015 Net Revenue and Gross Margin

Net Revenue. Net revenue was $12.99 billion for 2016, a decrease of $1.58 billion, or 11%, as compared to 2015, primarily due to lower HDD unit shipments partially offset by an increase in HDD ASPs and partial year revenues from SanDisk of $793 million following the SanDisk Closing Date. The decrease in HDD unit shipments was primarily due to a softer demand environment. The increase in HDD ASPs was primarily due to a change in HDD product mix.

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 2016 and 2015, these programs represented 13% and 10% of gross revenues, respectively. These amounts generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of products. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue.

Net Revenue by Geography. Changes in the mix of net revenue by geography for 2016, as compared to 2015, reflect a decrease in Asia primarily due to reduced demand of client HDD shipments as a result of a decline in the desktop and notebook PC market and a decrease in Europe, Middle East and Africa due to lower demand for our client and retail HDD products primarily due to the continued decline of PC-related after-market sales.

Net Revenue by End Market. Changes in the mix of net revenue by end market for 2016, as compared to 2015, reflected lower Client Devices revenues primarily due to reduced demand for HDDs as a result of a decline in desktop and notebook PC market, partially offset by a partial year increase in revenues from the Merger, which has comparatively higher revenue in Client Devices and Client Solutions than our pre-acquisition business.

Table of Contents

Gross Profit and Gross Margin. Gross profit was $3.44 billion for 2016, a decrease of $786 million, or 19%, from 2015. Gross margin decreased to 26.4% in 2016, as compared to 29.0% in 2015. This decrease was primarily the result of lower HDD unit sales and the related absorption impact, and accelerated depreciation on assets related to both the closure of the Odawara, Japan facility and the restructuring plan (“Restructuring Plan 2016”) associated with the integration of substantial portions of our HGST and WD subsidiaries. This decrease in gross profit was partially offset by SanDisk’s gross profit following the SanDisk Closing Date.

Operating Expense

The following table sets forth operating expense information from our Consolidated Statement of Operations by dollar and percentage[(1)] of net revenue.

	2017		2016		2015	
	(in millions, except percentages)					
Research and development	$2,441	12.8%	$1,627	12.5%	$1,646	11.3%
Selling, general and administrative	1,445	7.6	997	7.7	788	5.4
Employee termination, asset impairment, and other charges	232	1.2	345	2.6	176	1.2
Total operating expenses	$4,118	21.6	$2,969	22.8	$2,610	17.9

(1) Percentages may not total due to rounding.

Fiscal Year 2017 Operating Expenses Compared to Fiscal Year 2016 Operating Expenses

Research and development (“R&D”) expense was $2.44 billion in 2017, an increase of $814 million, or 50%, from 2016, primarily due to the Merger and continued development of NAND-flash technology. Fiscal year 2017 also included aggregate charges of $199 million related to stock-based compensation expenses, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other discrete charges, compared to $106 million in 2016 related to such charges.

Selling, general and administrative (“SG&A”) expense was $1.45 billion in 2017, an increase of $448 million, or 45%, from 2016, primarily due to the Merger. Fiscal year 2017 also included aggregate charges of $404 million, related to stock-based compensation expenses, amortization expense on acquired intangible assets, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other discrete charges, compared to $379 million in 2016 related to such charges.

Employee termination and other charges were $232 million in 2017, a decrease of $113 million, or 33%, from 2016. These charges in 2017 primarily related to further actions under the Restructuring Plan 2016 associated with the integration and business realignment of substantial portions of our business. For additional information regarding employee termination, asset impairment and other charges, see Part II, Item 8, Note 16, Employee Termination, Asset Impairment and Other Charges, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Fiscal Year 2016 Operating Expenses Compared to Fiscal Year 2015 Operating Expenses

R&D expense was $1.63 billion in 2016, a decrease of $19 million, or 1%, from 2015. This slight decrease was primarily due to reductions in employee compensation expenses due to a reduction in headcount as a result of our business realignment initiatives, reduction in material spend due to the consolidation of our product roadmap in relation to the integration of our HGST and WD subsidiaries and an additional week in the prior year. These decreases were partially offset by SanDisk’s R&D expenses following the SanDisk Closing Date and expenses related to the integration of our HGST and WD subsidiaries.

SG&A expense was $997 million in 2016, an increase of $209 million, or 27%, from 2015. This increase was primarily due to SanDisk's SG&A expenses following the SanDisk Closing Date, acquisition charges and expenses related to the integration of our HGST and WD subsidiaries. These charges were partially offset by a reduction in employee compensation expenses due to a reduction in headcount as a result of our business realignment initiatives and an additional week in the prior year.

Employee termination, asset impairment and other charges was $345 million in 2016, an increase of $169 million, or 96%, from 2015 as we implemented our Restructuring Plan 2016 and initiated the closure of our hard component front-end wafer manufacturing facility in Odawara, Japan. For additional information, see Part II, Item 8, Note 16, Employee Termination, Asset Impairment and Other Charges, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Table of Contents

.

Interest and Other Income (Expense)

The following table sets forth interest and other income (expense) information from our Consolidated Statement of Operations by dollar and percentage[1] of net revenue.

	2017		2016		2015	
	(in millions, except percentages)					
Interest income	$26	0.1 %	$26	0.2 %	$14	0.1 %
Interest expense	(847)	(4.4)	(266)	(2.0)	(49)	(0.3)
Other income (expense), net	(364)	(1.9)	(73)	(0.6)	1	—
Total interest and other expense, net	$(1,185)	(6.2)	$(313)	(2.4)	$(34)	(0.2)

(1) Percentages may not total due to rounding.

Fiscal Year 2017 Interest and Other Expense, Net Compared to Fiscal Year 2016 Interest and Other Expense, Net

Total interest and other expense, net increased $872 million in 2017, primarily due to a full year of interest expense in 2017 resulting from the additional debt issued in connection with the Merger compared to only a partial year of such expense in 2016, as well as losses on the settlements of certain of our term loans (see Part II, Item 8, Note 6, Debt, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K) and impairment charges related to our cost-method investments.

Fiscal Year 2016 Interest and Other Income (Expense) Compared to Fiscal Year 2015 Interest and Other Income (Expense)

In 2016, Total interest and other expense, net increased $279 million over 2015, primarily due to interest expense resulting from the additional debt incurred in connection with the Merger, the loss on the settlement of convertible debt and write-off of debt issuance costs on settlement of other previously issued debt.

Table of Contents

Income Tax Expense (Benefit)

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

	2017	2016	2015
	(in millions, except percentages)		
Income tax expense (benefit)	$372	$(89)	$112
Effective tax rate	48 %	(58)%	7 %

Fiscal Year 2017 Income Tax Expense Compared to Fiscal Year 2016 Income Tax Benefit

Income tax expense was $372 million in 2017, as compared to an income tax benefit of $89 million in 2016. Income tax expense as a percentage of income before taxes was 48% in 2017, as compared to income tax benefit as a percentage of income before taxes of 58% in 2016. Income tax expense in 2017 reflects tax expense from the integration of SanDisk and a valuation allowance on both acquired tax attributes and net operating loss carryforwards from restructuring activities. The difference between the effective tax rate and the U.S. Federal statutory rate of 35% is primarily due to taxes on the integration of SanDisk and an increase in the valuation allowance for both acquired tax attributes and net operating loss carryforwards from restructuring activities, which are partially offset by the current year generation of tax credits and foreign income taxed at lower tax rates due to tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates from 2018 through 2030.

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

We believe that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax examinations cannot be predicted with certainty. If any issues addressed in our tax examinations are resolved in a manner not consistent with management's expectations, we could be required to adjust our provision for income taxes in the period such resolution occurs. As of June 30, 2017, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of our liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of our tax returns.

For additional information regarding income tax expense (benefit), see Part II, Item 8, Note 13, Income Tax Expense (Benefit), of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Fiscal Year 2016 Income Tax Benefit Compared to Fiscal Year 2015 Income Tax Expense

Income tax benefit was $89 million in 2016, as compared to a $112 million expense in 2015. Tax benefit as a percentage of income before taxes was 58.2% in 2016, as compared to tax expense of 7.1% in 2015. Fiscal year 2016 income tax benefit reflects tax benefits from expenses related to the Merger and from interest expense related to new debt facilities. The difference between the effective tax rate and the U.S. Federal statutory rate is primarily due to foreign income taxed at lower tax rates due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2016 through 2029, the current year generation of income tax credits and the tax deductible expenses related to the Merger.

Table of Contents

Liquidity and Capital Resources

The following table summarizes our statements of cash flows:

	2017	2016	2015
	(in millions)		
Net cash provided by (used in):			
Operating activities	$3,437	$1,983	$2,242
Investing activities	(636)	(9,608)	(953)
Financing activities	(4,595)	10,751	(1,069)
Effect of exchange rate changes on cash	(3)	1	—
Net increase (decrease) in cash and cash equivalents	$(1,797)	$3,127	$220

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

The indebtedness used to finance the Merger could cause us to place more reliance on cash generated from operations to pay principal and interest on our debt, thereby reducing the availability of our cash flow for working capital, capital expenditure needs, dividends, or to pursue other potential strategic plans.

During 2018, we expect cash used for purchases of property, plant and equipment and net activity in notes receivable and equity investments relating to Flash Ventures to be approximately $1.5 billion to $1.9 billion of our cash. The total expected cash to be used could vary depending on the timing and completion of various capital projects and the availability, timing and terms of related financing.

A total of $4.99 billion and $6.90 billion of our cash and cash equivalents was held outside of the U.S. as of June 30, 2017 and July 1, 2016, respectively. Our current plans anticipate we can meet our U.S. cash needs while continuing to permanently reinvest the undistributed earnings of our foreign subsidiaries. In the event the reinvested earnings of our foreign subsidiaries are distributed to the U.S., such a distribution could result in the accrual and payment of additional U.S. taxes.

Operating Activities

Cash flow from operating activities consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash provided by changes in working capital was $91 million for 2017, as compared to net cash provided by changes in working capital of $374 million for 2016 and net cash used for changes in working capital of $593 million for 2015.

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:

	2017	2016	2015
	(in days)		
Days sales outstanding	37	41	39
Days in inventory	65	81	49
Days payables outstanding	(66)	(78)	(67)
Cash conversion cycle	36	44	21

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

The working capital metrics in 2016 were notably impacted by the inclusion of SanDisk's accounts receivable, inventory and accounts payable balances as of July 1, 2016, but only including SanDisk's revenue and cost of sales following the SanDisk Closing Date. The Merger inflated DSO, DIO and DPO by 12 days, 32 days and 14 days, respectively. Excluding the impact of the Merger in 2016, DSO in 2017 increased by 8 days over 2016 and was 2 days lower than 2015, primarily reflecting timing of customer receipts in the prior year. Excluding the impact of the Merger in 2016, DIO in 2017 increased by 16 days over both 2016 and 2015. The increase in DIO primarily reflects short-term build-up of inventory to maintain supply as we close certain facilities and transition production. Excluding the impact of the Merger in 2016, DPO in 2017 increased by 2 days over 2016 and decreased by 1 day from 2015, primarily reflecting routine variations in timing purchases and payments during the period.

Investing Activities

During 2017, net cash used in investing activities primarily consisted of $578 million of capital expenditures and a net $277 million increase in notes receivable to and investments in Flash Ventures, partially offset by cash provided by a net $230 million decrease in our investments in marketable securities. During 2016, net cash used in investing activities primarily consisted of $9.84 billion related to the Merger, net of cash acquired, $632 million related to the purchase of investments, $584 million of capital expenditures, $90 million net increase in notes receivable to Flash Ventures and a net $76 million of other investing activities, partially offset by $1.20 billion of proceeds from sales of investments and $405 million of proceeds from maturities of investments. During 2015, net cash used in investing activities primarily consisted of $857 million related to the purchase of investments, $612 million of capital expenditures and $257 million related to acquisitions, net of cash acquired, partially offset by $505 million of proceeds from sales of investments and $263 million of proceeds from maturities of investments.

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

Financing Activities

During 2017, net cash used in financing activities primarily consisted of $11.70 billion to repay debt, $574 million to pay dividends on our common stock and $492 million to settle convertible debt, partially offset by $7.90 billion of proceeds from debt, net of issuance costs, a net $230 million provided by employee stock plans and $61 million of proceeds from call options. During 2016, net cash provided by financing activities consisted of $16.58 billion of proceeds from debt, net of issuance costs, $409 million of proceeds from call options, $125 million of proceeds from borrowings under our revolving credit facility and a net $74 million provided by employee stock plans, offset by a net $2.61 billion to settle convertible debt, $2.31 billion to repay debt, $613 million for payment upon settlement of warrants, $464 million to pay dividends on our common stock, $380 million to repay the revolving credit facility and $60 million to repurchase shares of our common stock. During 2015, net cash used in financing activities consisted of $970 million to repurchase shares of our common stock, $396 million to pay dividends on our common stock and $125 million to repay debt, partially offset by $255 million of proceeds from our revolving credit facility and a net $167 million provided by employee stock plans.

Off-Balance Sheet Arrangements

Other than the commitments related to Flash Ventures, facility lease commitments incurred in the normal course of business and certain indemnification provisions (see "Contractual Obligations and Commitments" below), we do not have any other material off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any other obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in the Consolidated Financial Statements. Additionally, we do not have an interest in, or relationships with, any special-purpose entities. For additional information regarding our off-balance sheet arrangements, see Part II, Item 8, Note 9, Commitments, Contingencies and Related Parties, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Table of Contents

Short and Long-term Liquidity

Contractual Obligations and Commitments

The following is a summary of our known contractual cash obligations and commercial commitments as of June 30, 2017:

	Total	1 Year (2018)	2-3 Years (2019-2020)	4-5 Years (2021-2022)	More than 5 Years (Beyond 2022)
	(in millions)				
Long-term debt, including current portion	$13,356	$246	$ 802	$ 3,312	$8,996
Interest on debt	4,467	769	1,513	1,347	838
Flash Ventures and other related commitments[1]	7,510	3,096	2,542	1,502	370
Operating leases	178	46	73	39	20
Purchase obligations	1,634	1,575	59	—	—
Total	$27,145	$5,732	$ 4,989	$ 6,200	$10,224

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

Debt

See Part II, Item 8, Note 6, Debt, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K for information regarding our indebtedness, including the principal repayment terms, interest rates, covenants and other key terms.

Interest Rate Swap

We have entered into interest rate swap agreements to moderate our exposure to fluctuations in interest rates underlying our variable rate debt. For a description of our current interest rate swaps, see Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk and Part II, Item 8, Note 5, Derivative Instruments and Hedging Activities, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Flash Ventures

Flash Ventures sells and leases back from a consortium of financial institutions a portion of its tools and has entered into equipment lease agreements of which we guarantee half of the total outstanding obligations. The lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the lease agreements contain acceleration clauses for certain events of default related to the guarantors, including us. As of June 30, 2017, we were in compliance with all covenants under these Japanese lease facilities.

See Part II, Item 8, Note 9, Commitments, Contingencies and Related Parties, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K for information regarding Flash Ventures.

Foreign Exchange Contracts

We purchase foreign exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. For a description of our current foreign exchange contract commitments, see Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk and Part II, Item 8, Note 5, Derivative Instruments and Hedging Activities, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Table of Contents

Indemnifications

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

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

Unrecognized Tax Benefits

As of June 30, 2017, the amount of unrecognized tax benefits, including related accrued interest and penalties, was $611 million, of which $493 million could result in potential cash payments. We are not able to provide a reasonable estimate of the timing of future tax payments related to these obligations. For additional information regarding our total tax liability for unrecognized tax benefits, see Part II, Item 8, Note 13, Income Tax Expense (Benefit), of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Cash Dividend

Since the first quarter of 2013, we have issued a quarterly cash dividend. On May 3, 2017, we declared a cash dividend of $0.50 per share of our common stock to our shareholders of record as of June 30, 2017. The cash dividend of $147 million was paid on July 17, 2017. On August 2, 2017, we declared a cash dividend of $0.50 per share of our common stock to our shareholders of record as of September 29, 2017. The cash dividend will be paid on October 16, 2017. We may modify, suspend, or cancel our cash dividend policy in any manner and at any time.

Recently Issued Accounting Pronouncements Not Yet Adopted

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

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

Table of Contents

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

In August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments" ("ASU 2016-15"). ASU 2016-15 addresses certain cash flows issues regarding the classification of certain cash receipts and cash payments, which, among others, includes our disclosure requirement related to debt prepayment or extinguishment costs and distributions received from equity method investees. The new standard is effective for fiscal years beginning after December 15, 2017, which for us is the first quarter of 2019. Early adoption is permitted. We expect to adopt this standard in the first quarter of 2018. The adoption of this standard is not expected to have a material impact on our Consolidated Financial Statements.

In March 2016, the FASB issued ASU No. 2016-09, "Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for stock-based payment transactions and states that, among other things, all excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit in the income statement and an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur. We will adopt this standard in the first quarter of 2018 using the modified retrospective approach. This adoption will result in a one-time increase to beginning retained earnings for cumulative adjustments of $58 million for the unrecognized windfall tax benefits related to previous vesting and exercises of stock-based awards and $19 million related to the change in our accounting policy for estimated forfeitures and share cancellations. In addition, under the new standard, we will prospectively reflect the tax deficiencies and benefits as an operating activity, rather than as a financing activity under the previous standard, in our Consolidated Statements of Cash Flows.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). ASU 2016-02, among other things, requires lessees to recognize a right-of-use asset and a lease liability for leases. We expect to adopt this standard in the first quarter of 2020. We are currently evaluating the impact ASU 2016-02 will have on our Consolidated Financial Statements and related disclosures.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). ASU 2016-01 provides guidance related to accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017, which for us is the first quarter of 2019. Early adoption is not permitted. We are currently evaluating the impact ASU 2016-01 will have on our Consolidated Financial Statements.

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

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

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

Table of Contents

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

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

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

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

For a description of recently adopted accounting pronouncements, including the respective dates of adoption and effects on our results of operations and financial condition, see Part II, Item 8, Note 2, Recently Adopted Accounting Pronouncements, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Critical Accounting Policies and Estimates

We have prepared the accompanying Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States (“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 Consolidated Financial Statements may be material.

Revenue

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/or a right of return and we provide resellers and OEMs with other sales incentive programs. At the time we recognize revenue to resellers and OEMs, we record a reduction of revenue for estimated price protection and/or returns 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, historical and anticipated returns information and customer claim processing. If customer demand for our products or market conditions differ 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. 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. Total sales incentive and marketing programs have ranged from 8% to 14% of gross revenue and adjustments to revenue due to changes in accruals for these programs related to revenue reported in prior periods have generally averaged less than 1% of gross revenue over the last three fiscal years.

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

Inventories

We value inventories at the lower of cost (first-in, first-out) or net realizable value. 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. For additional information, see Part II, Item 8, Note 17, Legal Proceedings, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

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.

Goodwill and Other Long-Lived Assets

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 either use qualitative factors to determine whether goodwill is more likely than not impaired or we perform a two-step approach to quantify impairment. If we conclude from the qualitative assessment that goodwill is more likely than not impaired, we are required to 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. If our stock price decreases significantly, goodwill could become impaired, which could result in a material charge and adversely affect our results of operations.

In-process research and development ("IPR&D") is an intangible asset accounted as an indefinite-lived asset until the completion or abandonment of the associated R&D effort. During the development period, we conduct an IPR&D impairment test annually and whenever events or changes in facts and circumstances indicate that it is more likely than not that the IPR&D is impaired. Events which might indicate impairment include, but are not limited to, adverse cost factors, strategic decisions made in response to economic, market, and competitive conditions, the impact of the economic environment on us and our customer base. 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.

Table of Contents

Other long-lived intangible assets are amortized over their estimated useful lives based on the pattern in which the economic benefits are expected to be received. 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.

Table of Contents

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Disclosure About Foreign Currency Risk

Although the majority of our transactions are in U.S. dollars, some transactions are based in various foreign currencies. We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for product costs and operating expenses denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on our results of operations. The contract maturity dates do not exceed 12 months. We do not purchase foreign exchange contracts for speculative or trading purposes. For additional information, see Part II, Item 8, Note 4, Fair Value Measurements and Investments and Note 5, Derivative Instruments and Hedging Activities, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

As of June 30, 2017, we had outstanding the foreign exchange contracts presented in the following table. The changes in fair values of these foreign exchange contracts would be largely offset in other income (expense) by corresponding changes in the fair values of the foreign currency denominated monetary assets and liabilities.

	Contract Amount	Weighted-Average Contract Rate [1]	Unrealized Gain (Loss)
	(in millions, except weighted-average contract rate)		
British pound sterling	$24	0.78	$ —
Euro	1,100	0.87	3
Japanese yen	1,092	111.55	(1)
Malaysian ringgit	118	4.39	2
Philippine peso	117	50.26	(1)
Singapore dollar	49	1.39	1
Thai baht	286	34.37	4
Total forward contracts	$2,786		$ 8

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

During 2017 and 2016, total net realized transaction and foreign exchange contract currency gains and losses were not material to our Consolidated Financial Statements.

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

Table of Contents

Disclosure About Other Market Risks

Variable Interest Rate Risk

Borrowings under our Term Loan A and our revolving credit facility bear interest at a rate per annum, at our option, of either an adjusted LIBOR rate (subject to a 0.0% floor) plus an applicable margin of 2.00% or at a base rate plus an applicable margin of 1.0% (3.23% as of June 30, 2017). The applicable margin for the borrowings under our Term Loan A and our revolving credit facility will range, depending on our leverage, from 1.50% to 2.25% for LIBOR loans and from 0.50% to 1.25% for base rate loans.

Borrowings under the U.S. Term Loan B-2 tranche bear interest at a rate per annum, at our option, of an adjusted LIBOR rate, subject to a 0.75% floor, plus 2.75% or a base rate plus 1.75% (3.98% as of June 30, 2017). Borrowings under the Euro Term Loan B-2 tranche bear interest at a rate per annum, at our option, equal to an adjusted EURIBOR rate, subject to a 0.75% floor, plus 2.00% (2.75% as of June 30, 2017).

We have generally held a balance of fixed and variable rate debt. At June 30, 2017, 61% of the par value of our debt was at variable rates. To balance the portfolio, we entered into a pay-fixed interest rate swap on $1.00 billion notional amount, which effectively converts a portion of our term loan to fixed rates through May 2020. As of June 30, 2017, we had $8.10 billion of variable rate debt. After giving effect to the $1.00 billion of interest rate swaps, we effectively had $7.10 billion of long-term debt subject to variations in interest rates and a one percent increase in the variable rate of interest, subject to each loan's specific floor, would increase annual interest expense by $61 million.

For additional information regarding our term loans and our interest rate swaps, see Part II, Item 8, Note 6, Debt, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10 K.

Table of Contents

Item 8. Financial Statements and Supplementary Data

Index to Financial Statements and Financial Statement Schedule

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Western Digital Corporation:

We have audited the accompanying consolidated balance sheets of Western Digital Corporation and subsidiaries as of June 30, 2017 and July 1, 2016, and the related consolidated statements of operations, comprehensive income, cash flows, and shareholders' equity, for each of the years in the three-year period ended June 30, 2017. In connection with our audits of the consolidated financial statements, we have also audited the related financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Western Digital Corporation and subsidiaries as of June 30, 2017 and July 1, 2016, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2017, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Western Digital Corporation and subsidiaries' internal control over financial reporting as of June 30, 2017, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated August 28, 2017, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

August 28, 2017
Irvine, California

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders
Western Digital Corporation:

We have audited Western Digital Corporation and subsidiaries' internal control over financial reporting as of June 30, 2017, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Western Digital Corporation and subsidiaries' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Western Digital Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2017, based on criteria established in Internal Control — Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Western Digital Corporation and subsidiaries as of June 30, 2017 and July 1, 2016, the related consolidated statements of operations, comprehensive income, cash flows, and shareholders' equity for each of the years in the three-year period ended June 30, 2017, and the related financial statement schedule, and our report dated August 28, 2017, expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ KPMG LLP

August 28, 2017

Irvine, California

64

Table of Contents

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

	June 30, 2017	July 1, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$6,354	$8,151
Short-term investments	24	227
Accounts receivable, net	1,948	1,461
Inventories	2,341	2,129
Other current assets	389	616
Total current assets	11,056	12,584
Property, plant and equipment, net	3,033	3,503
Notes receivable and investments in Flash Ventures	1,340	1,171
Goodwill	10,014	9,951
Other intangible assets, net	3,823	5,034
Other non-current assets	594	619
Total assets	$29,860	$32,862
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,144	$1,888
Accounts payable to Flash Ventures	206	168
Accrued expenses	1,069	995
Accrued compensation	506	392
Accrued warranty	186	172
Bridge loan	—	2,995
Current portion of long-term debt	233	339
Total current liabilities	4,344	6,949
Long-term debt	12,918	13,660
Other liabilities	1,180	1,108
Total liabilities	18,442	21,717
Commitments and contingencies (Notes 6, 9, 13 and 17)		
Shareholders' equity:		
Preferred stock, $0.01 par value; authorized — 5 shares; issued and outstanding — none	—	—
Common stock, $0.01 par value; authorized — 450 shares; issued — 312 shares in 2017 and 2016; outstanding — 294 shares in 2017 and 284 shares in 2016	3	3
Additional paid-in capital	4,506	4,429
Accumulated other comprehensive income (loss)	(58)	103
Retained earnings	8,633	8,848
Treasury stock — common shares at cost; 18 shares in 2017 and 28 shares in 2016	(1,666)	(2,238)
Total shareholders' equity	11,418	11,145
Total liabilities and shareholders' equity	$29,860	$32,862

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

Table of Contents

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

	Year Ended		
	June 30, 2017	July 1, 2016	July 3, 2015
Revenue, net	$19,093	$12,994	$14,572
Cost of revenue	13,021	9,559	10,351
Gross profit	6,072	3,435	4,221
Operating expenses:			
Research and development	2,441	1,627	1,646
Selling, general and administrative	1,445	997	788
Employee termination, asset impairment, and other charges	232	345	176
Total operating expenses	4,118	2,969	2,610
Operating income	1,954	466	1,611
Interest and other income (expense):			
Interest income	26	26	14
Interest expense	(847)	(266)	(49)
Other income (expense), net	(364)	(73)	1
Total interest and other expense, net	(1,185)	(313)	(34)
Income before taxes	769	153	1,577
Income tax expense (benefit)	372	(89)	112
Net income	$397	$242	$1,465
Income per common share			
Basic	$1.38	$1.01	$6.31
Diluted	$1.34	$1.00	$6.18
Weighted average shares outstanding:			
Basic	288	239	232
Diluted	296	242	237
Cash dividends declared per share	$2.00	$2.00	$1.80

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

Table of Contents

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

	Year Ended		
	June 30, 2017	July 1, 2016	July 3, 2015
Net income	$397	$242	$1,465
Other comprehensive income (loss), before tax:			
Actuarial pension gain (loss)	39	(73)	(2)
Foreign currency translation adjustment	(115)	74	—
Net unrealized gain (loss) on derivative contracts	(77)	99	(30)
Net unrealized gain on available-for-sale securities	2	—	—
Total other comprehensive income (loss), before tax	(151)	100	(32)
Income tax benefit (expense) related to items of other comprehensive income (loss), before tax	(10)	23	—
Other comprehensive income (loss), net of tax	(161)	123	(32)
Total comprehensive income	$236	$365	$1,433

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

Table of Contents

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

	Year Ended		
	June 30, 2017	July 1, 2016	July 3, 2015
Cash flows from operating activities			
Net income	$397	$242	$1,465
Adjustments to reconcile net income to net cash provided by operations:			
Depreciation and amortization	2,128	1,154	1,114
Stock-based compensation	394	191	162
Deferred income taxes	12	(149)	28
Loss on disposal of assets	18	22	17
Write-off of issuance costs and amortization of debt discounts	285	39	—
Loss on convertible debt and related instruments	5	58	—
Non-cash portion of employee termination, asset impairment and other charges	13	41	86
Other non-cash operating activities, net	94	11	(37)
Changes in:			
Accounts receivable, net	(487)	466	458
Inventories	(204)	306	(143)
Accounts payable	223	(299)	(148)
Accounts payable to related parties	38	(115)	—
Accrued arbitration award	—	—	(758)
Accrued expenses	231	102	35
Accrued compensation	115	(94)	(134)
Other assets and liabilities, net	175	8	97
Net cash provided by operations	3,437	1,983	2,242
Cash flows from investing activities			
Purchases of property, plant and equipment	(578)	(584)	(612)
Proceeds from the sale of property, plant and equipment	21	—	—
Acquisitions, net of cash acquired	—	(9,835)	(257)
Purchases of investments	(281)	(632)	(857)
Proceeds from sale of investments	94	1,204	505
Proceeds from maturities of investments	417	405	263
Investments in Flash Ventures	(20)	—	—
Notes receivable issuances to Flash Ventures	(549)	(106)	—
Notes receivable proceeds from Flash Ventures	292	16	—
Strategic investments and other, net	(32)	(76)	5
Net cash used in investing activities	(636)	(9,608)	(953)
Cash flows from financing activities			
Issuance of stock under employee stock plans	235	117	212
Taxes paid on vested stock awards under employee stock plans	(124)	(50)	(64)
Excess tax benefits from employee stock plans	119	7	19
Proceeds from acquired call option	61	409	—
Settlement of convertible debt	(492)	(2,611)	—
Repurchases of common stock	—	(60)	(970)
Proceeds from revolving credit facility	—	125	—
Repayment of revolving credit facility	—	(380)	—
Dividends paid to shareholders	(574)	(464)	(396)

Settlement of debt hedge contracts	(21)	—	—
Repayment of debt	(11,697)	(2,313)	(125)
Proceeds from debt	7,908	17,108	255
Debt issuance costs	(10)	(524)	—
Payment upon settlement of acquired warrants	—	(613)	—
Net cash provided by (used in) financing activities	(4,595)	10,751	(1,069)
Effect of exchange rate changes on cash	(3)	1	—
Net increase (decrease) in cash and cash equivalents	(1,797)	3,127	220
Cash and cash equivalents, beginning of year	8,151	5,024	4,804
Cash and cash equivalents, end of year	$6,354	$8,151	$5,024
Supplemental disclosure of cash flow information:			
Cash paid for income taxes	$184	$26	$47
Cash paid for interest	$777	$113	$45
Supplemental disclosure of non-cash investing and financing activities:			
Common stock issued and equity awards assumed in connection with acquisition	$—	$1,822	$—
Shares issued in conjunction with settlement of convertible notes	$16	$94	$—
Shares received in conjunction with assumed call options	$(11)	$(70)	$—
Accrual of cash dividend declared	$147	$142	$116

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

Table of Contents

WESTERN DIGITAL CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in millions)

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance at June 27, 2014	261	$ 3	(27)	$(1,570)	$ 2,331	$ 12	$ 8,066	$ 8,842
Net income	—	—	—	—	—	—	1,465	1,465
Employee stock plans	—	—	6	241	(93)	—	—	148
Stock-based compensation	—	—	—	—	162	—	—	162
Stock awards assumed in acquisition	—	—	—	—	3	—	—	3
Increase in excess tax benefits from employee stock plans	—	—	—	—	19	—	—	19
Repurchases of common stock	—	—	(10)	(970)	—	—	—	(970)
Dividends to shareholders	—	—	—	—	6	—	(424)	(418)
Actuarial pension loss	—	—	—	—	—	(2)	—	(2)
Net unrealized loss on derivative contracts	—	—	—	—	—	(30)	—	(30)
Balance at July 3, 2015	261	3	(31)	(2,299)	2,428	(20)	9,107	9,219
Net income	—	—	—	—	—	—	242	242
Employee stock plans	—	—	5	191	(124)	—	—	67
Stock-based compensation	—	—	—	—	191	—	—	191
Common stock issued in connection with acquisition	49	—	—	—	1,764	—	—	1,764
Stock awards assumed in acquisition	—	—	—	—	58	—	—	58
Increase in excess tax benefits from employee stock plans	—	—	—	—	7	—	—	7
Shares issued in conjunction with settlement of convertible notes	2	—	—	—	94	—	—	94
Shares received in conjunction with assumed call options	—	—	(1)	(70)	—	—	—	(70)
Repurchases of common stock	—	—	(1)	(60)	—	—	—	(60)
Dividends to shareholders	—	—	—	—	11	—	(501)	(490)
Actuarial pension loss	—	—	—	—	—	(50)	—	(50)
Foreign currency translation adjustment	—	—	—	—	—	74	—	74
Net unrealized gain on derivative contracts	—	—	—	—	—	99	—	99
Balance at July 1, 2016	312	3	(28)	(2,238)	4,429	103	8,848	11,145
Net income	—	—	—	—	—	—	397	397
Employee stock plans	—	—	10	583	(472)	—	—	111
Stock-based compensation	—	—	—	—	394	—	—	394
Increase in excess tax benefits from employee stock plans	—	—	—	—	104	—	—	104
Shares issued in conjunction with settlement of convertible notes	—	—	—	—	16	—	—	16
Shares received in conjunction with assumed call options	—	—	—	(11)	—	—	—	(11)
Dividends to shareholders	—	—	—	—	35	—	(612)	(577)
Actuarial pension gain	—	—	—	—	—	27	—	27

Foreign currency translation adjustment	—	—	—	—	—	(113)	—	(113)
Net unrealized gain on available-for-sale securities	—	—	—	—	—	2	—	2
Net unrealized loss on derivative contracts	—	—	—	—	—	(77)	—	(77)
Balance at June 30, 2017	312	$ 3	(18)	$(1,666)	$ 4,506	$ (58)	$ 8,633	$ 11,418

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

69

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Basis of Presentation

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

Basis of Presentation

The Company has prepared its Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and has adopted accounting policies and practices which are generally accepted in the industry in which it operates. The Company's significant accounting policies are summarized below.

Fiscal Year

The Company's fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, the Company reports a 53-week fiscal year to align the fiscal year with the foregoing policy. Fiscal years 2017 and 2016, which ended on June 30, 2017 and July 1, 2016, respectively, both comprised 52 weeks, with all quarters consisting of 13 weeks. Fiscal year 2015, which ended on July 3, 2015, comprised 53 weeks, with the first quarter consisting of 14 weeks and the second, third and fourth quarters consisting of 13 weeks each.

Basis of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The functional currency of most of the Company's foreign subsidiaries is the U.S. dollar. The accounts of these foreign subsidiaries have been remeasured using the U.S. dollar as the functional currency. Gains or losses resulting from remeasurement of these accounts from local currencies into U.S. dollars were immaterial to the Consolidated Financial Statements. Financial statements of the Company's foreign subsidiaries for which the functional currency is the local currency are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities and a weighted average exchange rate for each period for statement of operations items. Translation adjustments are recorded in accumulated other comprehensive income, a component of stockholders' equity.

Reclassifications

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

Use of Estimates

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.

Cash Equivalents

The Company’s cash equivalents represent highly liquid investments in money market funds, which are invested in U.S. Treasury securities and U.S. Government agency securities as well as bank certificates of deposit with original maturities at purchase of three months or less. Cash equivalents are carried at cost plus accrued interest, which approximates fair value.

Table of Contents

Available-for-Sale Securities

The Company invests in U.S. Treasury securities, U.S. and International Government agency securities, certificates of deposit, asset-backed securities, and corporate and municipal notes and bonds, with original maturities at purchase of more than three months. These investments are classified as available-for-sale securities and included within short-term investments and other non-current assets in the Consolidated Balance Sheets. Available-for-sale securities are stated at fair value with unrealized gains and losses included in accumulated other comprehensive income (loss), which is a component of shareholders' equity. Gains and losses on available-for-sale securities are recorded based on the specific identification method. The Company evaluates the available-for-sale securities in an unrealized loss position for other-than-temporary impairment. The amortized cost of available-for-sale securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion are included in total other expense, net in the consolidated statements of operations. In addition, realized gains and losses are included in total other expense, net in the consolidated statements of operations.

Equity Investments

The Company enters into certain strategic investments for the promotion of business and strategic objectives. The equity method of accounting is used if the Company's ownership interest is greater than or equal to 20% but less than a majority or where the Company has the ability to exercise significant influence over operating and financial policies. The Company's equity in the earnings or losses in equity-method investments is recognized in Other income (expense), net, in the Consolidated Statement of Operations.

The Company accounts for investments in equity securities of other entities under the cost method of accounting if the Company's ownership interest is less than 20% and the Company does not have the ability to exercise significant influence over operating and financial policies of the investee. Investments accounted for under the cost method of accounting are recorded within Other non-current assets in the Consolidated Balance Sheets and are also periodically analyzed to determine whether or not there are indicators of impairment.

Variable Interest Entities

The Company evaluates its investments and other significant relationships to determine whether any investee is a variable interest entity ("VIE"). If the Company concludes that an investee is a VIE, the Company evaluates its power to direct the activities of the investee, its obligation to absorb the expected losses of the investee and its right to receive the expected residual returns of the investee to determine whether the Company is the primary beneficiary of the investee. If the Company is the primary beneficiary of a VIE, the Company consolidates such entity and reflects the non-controlling interest of other beneficiaries of that entity. The Company does not consolidate any cost method investment or equity method investment entities.

Fair Value of Financial Instruments

The carrying amounts of cash equivalents, 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 fair value of investments that are not accounted for under the equity method is based on appropriate market information.

Inventories

The Company values inventories at the lower of cost (first-in, first out and weighted-average methods) or net realizable value. The first-in, first-out ("FIFO") method is used to value the cost of the majority of the Company's inventories, while the weighted-average method is used to value precious metal inventories. Weighted-average cost is calculated based upon the cost of precious metals at the time they are received by the Company. The Company has determined that it is not practicable to assign specific costs to individual units of precious metals and, as such, precious metals are relieved from 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 the FIFO method. Inventory write-downs are recorded 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.

Table of Contents

The Company evaluates inventory balances for excess quantities and obsolescence on a regular basis by analyzing estimated demand, inventory on hand, sales levels and other information and reduces 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 the Company’s products, which may require a write down of inventory that could materially affect operating results.

Property, Plant and Equipment

Property and equipment are carried at cost less accumulated depreciation and amortization. The cost of property, plant and equipment is depreciated over the estimated useful lives of the respective assets. The Company’s buildings are depreciated over periods ranging from fifteen to thirty-five years. The majority of the Company’s machinery and equipment, software, and furniture and fixtures, are depreciated on a straight-line basis over a period of two to seven years. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the related lease terms.

Business Combinations

The application of acquisition accounting to a business combination requires that the Company identify the individual assets acquired and liabilities assumed and estimate the fair value of each. The fair value of assets acquired and liabilities assumed in a business acquisition are recognized at the acquisition date using a combination of valuation techniques, with the purchase price exceeding the fair values being recognized as goodwill. Determining fair value of identifiable assets, particularly intangibles, liabilities acquired and contingent obligations assumed requires management to make estimates. In certain circumstances, the allocations of the excess purchase price are based upon preliminary estimates and assumptions and subject to revision when the Company receives final information, including appraisals and other analyses. Accordingly, the measurement period for such purchase price allocations will end when the information, or the facts and circumstances, becomes available, but will not exceed twelve months. The Company will recognize measurement-period adjustments during the period of resolution, including the effect on earnings of any amounts that would have been recorded in previous periods if the accounting had been completed at the acquisition date.

Goodwill and intangible assets often represent a significant portion of the assets acquired in a business combination. The Company recognizes the fair value of an acquired intangible apart from goodwill whenever the intangible arises from contractual or other legal rights, or when it can be separated or divided from the acquired entity and sold, transferred, licensed, rented or exchanged, either individually or in combination with a related contract, asset or liability. Intangible assets consist primarily of technology, customer relationships, and trade name and trademarks acquired in business combinations and in-process research and development (“IPR&D”). The Company’s assessment of IPR&D also includes consideration of the risk of the projects not achieving technological feasibility.

Goodwill and Other Long-Lived Assets

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. The Company performs an annual impairment test as of the first day of its fiscal fourth quarter. The Company either uses qualitative factors to determine whether goodwill is more likely than not impaired or performs a two-step approach to quantify impairment. If the Company concludes from the qualitative assessment that goodwill is more likely than not impaired, the Company is required to follow a two-step approach to quantify the impairment. The Company is required to use judgment when applying the goodwill impairment test, including the identification of reporting units, assignment of assets, liabilities and 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 reporting units may change based on results of operations, macroeconomic conditions or other factors. Changes in these estimates could materially affect the Company’s assessment of the fair value and goodwill impairment. If the Company’s stock price decreases significantly, goodwill could become impaired, which could result in a material charge and adversely affect the Company’s results of operations.

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

IPR&D is an intangible asset accounted as an indefinite-lived asset until the completion or abandonment of the associated research and development effort. During the development period, the Company conducts an IPR&D impairment test annually and whenever events or changes in facts and circumstances indicate that it is more likely than not that the IPR&D is impaired. Events which might indicate impairment include, but are not limited to, adverse cost factors, strategic decisions made in response to economic, market, and competitive conditions, and the impact of the economic environment the Company and on its customer base. 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.

Other long-lived intangible assets are amortized over their estimated useful lives based on the pattern in which the economic benefits are expected to be received. 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. The Company recorded impairments to certain long-lived assets in 2017, 2016 and 2015. See Note 4, Fair Value Measurements and Investments, Note 7, Goodwill and Other Intangible Assets and Note 15, Acquisitions, for additional disclosures related to the Company’s other intangible assets.

Revenue and Accounts Receivable

Revenue is recognized when the title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, delivery has occurred, or services have been rendered, the sales price is fixed or determinable and collectability is reasonably assured. The Company establishes provisions against revenue and cost of revenue for estimated sales returns in the same period that the related revenue is recognized based 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.

In accordance with standard industry practice, the Company provides 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/or a right of return and the Company provides resellers and original equipment manufacturers (“OEMs”) with other sales incentive programs. At the time the Company recognizes revenue to resellers and OEMs, a reduction of revenue is recorded for estimated price protection and/or returns until the resellers sell such inventory to their customers and the Company also records a reduction of revenue for the other programs in effect. The Company bases these adjustments on several factors including anticipated price decreases during the reseller holding period, reseller’s sell-through and inventory levels, estimated amounts to be reimbursed to qualifying customers, historical pricing information, historical and anticipated returns information and customer claim processing. If customer demand for the Company’s products or market conditions differ from the Company’s expectations, the Company’s operating results could be materially affected. The Company also has programs under which it reimburses qualified distributors and retailers for certain marketing expenditures, which are recorded as a reduction of revenue.

Revenue from patent licensing arrangements is recognized when earned, estimable and realizable. The timing of revenue recognition is dependent on the terms of each license agreement and on the timing of sales of licensed products. The Company generally recognizes royalty revenue when it is reported to the Company by its licensees, which is generally one quarter in arrears from the licensees’ sales of licensed products. For licensing fees that are not determined by the licensees’ sales, the Company generally recognizes license fee revenue on a straight-line basis over the life of the license.

Some of the Company's revenue arrangements are multiple-element arrangements because they are generally comprised of product, software and support services or multiple distinct licenses. For multiple-element arrangements, the Company evaluates whether each deliverable should be accounted for as a separate unit of accounting. For multiple-element arrangements that include support or software elements, the Company analyzes whether tangible products containing software and non-software components function together and therefore should be excluded from industry-specific software revenue recognition guidance. For all multiple-element arrangements, the Company allocates revenue to each element, or the software elements as a group, based on the relative selling price determined in accordance with the Company's normal pricing and discounting practices for the specific element when sold separately. For multiple-element license agreements that include more than one license to distinct technology that are separate units of accounting, the Company allocates revenue to each license based on the relative selling price of each deliverable. License fees related to existing technology with no continuing performance obligations are generally recognized upon license commencement and other license fees are generally recognized on a straight-line basis over the life of the license. The Company primarily uses an estimate of selling price to allocate revenue for multiple-element license agreements based upon similar licenses, historical and estimated future sales volume, duration and market conditions.

The Company records 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, the Company routinely analyzes the different receivable aging categories and establishes reserves based on a combination of past due receivables and expected future losses based primarily on its 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 the Company's overall loss history changes significantly, an adjustment in the Company's allowance for doubtful accounts would be required, which could materially affect operating results.

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, with a small number of products having a warranty ranging up to ten years or more. 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. For warranties ten years or greater, including lifetime warranties, the Company uses the estimated useful life of the product to calculate the warranty exposure. 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 product reliability, such as factory test data, historical field return rates and costs to repair by product type. Management's judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base warranty estimates. Management reviews the warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross profit and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. If actual product return trends, costs to repair returned products or costs of customer compensatory claims differ significantly from estimates, future results of operations could be materially affected.

Litigation and Other Contingencies

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. 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. See Note 17, Legal Proceedings, for additional disclosures related to the Company's litigation.

Advertising Expense

Advertising costs are expensed as incurred and amounted to $89 million, $60 million and $71 million in 2017, 2016 and 2015, respectively. These expenses are included in Selling, general and administrative ("SG&A") in the

Consolidated Statements of Operations.

Research and Development Expense

Research and development ("R&D") expenditures are expensed as incurred.

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

Income Taxes

The Company accounts 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 assets and liabilities and expected benefits of utilizing net operating loss (“NOL”) and tax credit carryforwards. The Company records a valuation allowance when it is more likely than not that the deferred tax assets will not be realized. Each quarter, the Company evaluates the need for a valuation allowance for its deferred tax assets and adjusts the valuation allowance so that the Company records net deferred tax assets only to the extent that it has concluded it is more likely than not that these deferred tax assets will be realized.

The Company recognizes 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 in liabilities recorded for uncertain tax positions and are recorded in the provision for income taxes. The actual liability for unrealized tax benefits in any such contingency may be materially different from the Company’s 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 may materially affect the Company’s operating results.

Income per Common Share

The Company computes basic income per common share using net income and the weighted average number of common shares outstanding during the period. Diluted income per common share is computed using net income and the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include dilutive outstanding employee stock options, restricted stock unit awards (“RSUs”), performance-based restricted stock unit awards (“PSUs”), rights to purchase shares of common stock under the Company’s Employee Stock Purchase Plan (“ESPP”) and shares issuable in connection with convertible debt.

Stock-based Compensation

The Company accounts for all stock-based compensation at fair value. Stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. The fair values of all stock options granted are estimated using a binomial option-pricing model, and the fair values of all ESPP purchase rights are estimated using the Black-Scholes-Merton option-pricing model. The Company accounts for stock appreciation rights (“SARs”) as liability awards based upon management’s intention to settle such awards in cash. All SARs issued to employees were fully vested, and the fair values are now solely subject to market price fluctuations. Both the binomial and the Black-Scholes-Merton option-pricing models require the input of highly subjective assumptions. The Company is 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 the results of operations could be materially affected. PSUs are granted to certain employees and vest only after the achievement of pre-determined performance metrics. Once the performance metrics are met, vesting of PSUs is subject to continued service by the employee. At the end of each reporting period, the Company evaluates the probability that PSUs will be earned. The Company records stock-based compensation expense based on the probability that the performance metrics will be achieved over the vesting period.

Other Comprehensive Income (Loss), Net of Tax

Other comprehensive income (loss), net of tax refers to revenue, expenses, gains and losses that are recorded as an element of shareholders’ equity but are excluded from net income. The Company’s other comprehensive income (loss), net of tax is comprised of unrealized gains or losses on foreign exchange contracts and interest rate swap agreements designated as cash flow hedges, available-for-sale securities, foreign currency translation, and actuarial gains or losses related to pensions.

Derivative Contracts

The majority of the Company's transactions are in U.S. dollars; however, some transactions are based in various foreign currencies. The Company purchases foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedging transactions is to minimize the impact of foreign currency fluctuations on the Company's results of operations. These contract maturity dates do not exceed 12 months. All foreign exchange contracts are for risk management purposes only. The Company does not purchase foreign exchange contracts for speculative or trading purposes. The Company had foreign exchange contracts with commercial banks for British Pound Sterling, European Euro, Japanese yen, Malaysian ringgit, Philippine peso, Singapore dollar and Thai baht, which had an aggregate notional amount of $2.79 billion and $3.07 billion at June 30, 2017 and July 1, 2016, respectively.

If the derivative is designated as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially deferred in other comprehensive income (loss), net of tax. These amounts are subsequently recognized into earnings when the underlying cash flow being hedged is recognized into earnings. Recognized gains and losses on foreign exchange contracts are reported in cost of revenue and operating expenses, and presented within cash flows from operating activities. 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 Consolidated Financial Statements for all years presented.

A change in the fair value of undesignated hedges is recognized in earnings in the period incurred and is reported in Other income (expense), net. See Note 4, Fair Value Measurements and Investments, and Note 5, Derivative Instruments and Hedging Activities, for additional disclosures related to the Company's foreign exchange contracts.

The Company accounts for its interest rate swap as a designated cash flow hedge to mitigate variations in interest payments under a portion of its LIBOR-based term loans due to variations in the LIBOR index. The Company pays interest monthly at a fixed rate and receives interest monthly at the LIBOR rate on the notional amount of the contract. The effective portion of the change in fair value of this designated cash flow hedge is deferred in other comprehensive income (loss), net of tax, with any ineffective portion recognized in Other income (expense), net. See Note 5, Derivative Instruments and Hedging Activities, and Note 6, Debt, for further discussion on interest rate swaps.

Pensions and Other Post-Retirement Benefit Plans

The Company has defined benefit pension plans and other post-retirement plans covering certain employees in various countries. The benefits are based on the employees' years of service and compensation. The plans are funded in conformity with the funding requirements of applicable government authorities. The Company amortizes unrecognized actuarial gains and losses and prior service costs on a straight-line basis over the remaining estimated average service life of the participants. The measurement date for the plans is the Company's fiscal year-end. The Company recognizes the funded status of its defined benefit pension and post-retirement plans in the Consolidated Balance Sheets, with changes in the funded status recognized through accumulated other comprehensive income (loss) in the year in which such changes occur. See Note 8, Pension and Other Post-Retirement Benefit Plans, for additional disclosures related to the Company's pensions and other post-retirement benefit plans.

Table of Contents

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

Note 2. Recently Adopted Accounting Pronouncements

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

Table of Contents

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

Note 3. Supplemental Financial Statement Data

Accounts receivable, net

From time to time, in connection with factoring agreements, the Company sells trade accounts receivable without recourse to third party purchasers in exchange for cash. During 2017, the Company did not sell any trade accounts receivable. During 2016, the Company sold trade accounts receivable and received cash proceeds of $225 million. The discounts on the trade accounts receivable sold during 2016 were not material and were recorded within Other income (expense), net in the Consolidated Financial Statements.

Inventories

	June 30, 2017	July 1, 2016
	(in millions)	
Inventories:		
Raw materials and component parts	$646	$569
Work-in-process	632	589
Finished goods	1,063	971
Total inventories	$2,341	$2,129

Property, plant, and equipment, net

	June 30, 2017	July 1, 2016
	(in millions)	
Property, plant, and equipment:		
Land and buildings	$1,855	$1,900
Machinery and equipment	6,868	6,915
Software	284	155
Furniture and fixtures	116	110
Leasehold improvements	259	307
Construction-in-process	144	245
Property, plant, and equipment, gross	9,526	9,632
Accumulated depreciation	(6,493)	(6,129)
Property, plant, and equipment, net	$3,033	$3,503

Depreciation expense of property, plant, and equipment totaled $960 million, $888 million and $809 million in 2017, 2016 and 2015, respectively.

Table of Contents

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

Product warranty liability

Changes in the warranty accrual were as follows:

	2017	2016	2015
	(in millions)		
Warranty accrual, beginning of period	$279	$221	$182
Warranty liabilities assumed as a result of acquisitions	—	45	1
Charges to operations	177	162	187
Utilization	(151)	(178)	(190)
Changes in estimate related to pre-existing warranties	6	29	41
Warranty accrual, end of period	$311	$279	$221

The long-term portion of the warranty accrual classified in Other liabilities was $125 million and $107 million as of June 30, 2017 and July 1, 2016, respectively.

Accumulated other comprehensive income

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

	Actuarial Pension Gains (Losses)	Foreign Currency Translation Gains (Losses)	Unrealized Gains (Losses) on Available for Sale Securities	Unrealized Gains (Losses) on Derivative Contracts	Total Accumulated Comprehensive Income (Loss)
	(in millions)				
Balance at July 3, 2015	$5	$ —	$ —	$ (25)	$ (20)
Other comprehensive income (loss) before reclassifications	(73)	74	—	48	49
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	—	51	51
Income tax benefit related to items of other comprehensive income (loss)	23	—	—	—	23
Net current-period other comprehensive income (loss)	(50)	74	—	99	123
Balance at July 1, 2016	(45)	74	—	74	103
Other comprehensive income (loss) before reclassifications	39	(115)	2	(47)	(121)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	—	(30)	(30)
Income tax benefit (expense) related to items of other comprehensive income (loss)	(12)	2	—	—	(10)
Net current-period other comprehensive income (loss)	27	(113)	2	(77)	(161)
Balance at June 30, 2017	$(18)	$ (39)	$ 2	$ (3)	$ (58)

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

The following table illustrates the significant amounts of each component reclassified out of AOCI to the Consolidated Statements of Operations:

AOCI Component	2017	2016	2015	Statement of Operations Line Item
	(in millions)			
Unrealized holding gain (loss) on cash flow hedging activities:				
Foreign exchange contracts	$ 33	$ (17)	$ (44)	Cost of revenue
Foreign exchange contracts	(3)	(34)	—	Research and development
Total reclassifications for the period	$ 30	$ (51)	$ (44)	

Table of Contents

Note 4. Fair Value Measurements and Investments

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

	June 30, 2017	July 1, 2016
	(in millions)	
Cash and cash equivalents	$6,354	$8,151
Short-term marketable securities	24	227
Long-term marketable securities	94	119
Total cash, cash equivalents and marketable securities	$6,472	$8,497

Financial Instruments Carried at Fair Value

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

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

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

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

Table of Contents

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

The following tables present information about the Company’s financial assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2017 and July 1, 2016, and indicate the fair value hierarchy of the valuation techniques utilized to determine such values:

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

Table of Contents

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

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

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

Certificates of Deposit. The Company’s certificates of deposit are investments which are held in custody by a third party. Certificates of deposit are valued using fixed interest rates.

Asset-Backed Securities, and Corporate and Municipal Notes and Bonds. The Company’s asset-backed securities, and Corporate and Municipal notes and bonds securities are investments issued by corporations and U.S. state municipalities which are held in custody by a third party. Asset-backed securities, and Corporate and Municipal notes and bonds are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

U.S. Treasury Securities. The Company’s U.S. Treasury securities are direct obligations of the U.S. federal government and are held in custody by a third party. U.S. Treasury securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

83

Table of Contents

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

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

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 valued using an income approach that is based on a present value of future cash flows model. The market-based observable inputs for the model include forward rates and credit default swap rates. For more information on the Company’s foreign exchange contracts, see Note 5, Derivative Instruments and Hedging Activities.

Interest Rate Swaps. The Company’s interest rate swaps are long-term contracts to hedge the Company’s variable rate debt risk. Interest rate swaps are valued based on estimated present value of future cash flows model. The market-based observable inputs for the model include interest rate curves and credit valuation adjustments.

During 2017 and 2016, the Company had no transfers of financial assets and liabilities between Level 1 and Level 2.

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

Call Options. The call options are derivative instruments classified as an asset that result in the Company receiving cash and shares that partially offset the Company’s obligation upon conversion of its convertible notes.

Exchange Options. The Company’s convertible notes were bifurcated into a debt host and exchange option for accounting purposes. The exchange options are accounted for as derivative liabilities because they are predominantly settled in cash.

The fair value measurement of the call options and exchange options arising from the Company’s Convertible Notes (as defined in Note 6, Debt), which are not actively traded, is determined using unobservable inputs (Level 3). These inputs include (i) the estimated amount and timing of settlement of the underlying debt; (ii) the probability of the achievement of the factor(s) on which the settlement is based; (iii) the risk-adjusted discount rate based on the expected term to maturity of the debt; and (iv) the economic incentive for holders to exercise their exchange option. Significant increases or decreases in any of those inputs in isolation could result in a significantly lower or higher fair value measurement.

There were no transfers of call options or exchange options out of Level 3 for 2017.

The following table illustrates the changes in the balances of the call options reported in Other current assets and Other non-current assets in the Company’s Consolidated Balance Sheets:

	2017 Call Options	2020 Call Options	Total
	(in millions)		
Initial estimate upon acquisition	$501	$ —	$501
Redemptions	(437)	—	(437)
Net unrealized gain	6	1	7

Fair value as of July 1, 2016	70	1	71
Net realized gain (loss)	2	(1)	1
Redemptions	(72)	—	(72)
Fair value as of June 30, 2017	$—	$ —	$—

84

Table of Contents

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

The following table illustrates the changes in the balances of the exchange options reported in Accrued expenses and Other liabilities in the Company’s Consolidated Balance Sheets:

	2017 Exchange Options	2020 Exchange Options	Total
	(in millions)		
Initial estimate upon acquisition	$610	$ 357	$967
Net realized loss	8	8	16
Redemptions	(531)	(283)	(814)
Net unrealized gain	—	(14)	(14)
Fair value as of July 1, 2016	87	68	155
Net realized gain	(3)	(31)	(34)
Redemptions	(83)	(46)	(129)
Net unrealized loss	—	9	9
Fair value as of June 30, 2017	$1	$ —	$1

Available-for-Sale Securities

The cost basis of the Company’s investments classified as available-for-sale securities, individually and in the aggregate, approximated its fair value as of June 30, 2017 and July 1, 2016. The cost basis and fair value of the Company’s investments classified as available-for-sale securities as of June 30, 2017, by remaining contractual maturity, were as follows:

	Cost Basis	Fair Value
	(in millions)	
Due in less than one year (short-term investments)	$ 22	$