

WESTERN DIGITAL CORP

Form 10-Q

October 28, 2011

Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

Or

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

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

Commission file number: 1-8703

**WESTERN DIGITAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**33-0956711**

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

**3355 Michelson Drive, Suite 100**

**Irvine, California**

(Address of principal executive offices)

**92612**

(Zip Code)

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

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting  
company ☐

(Do not check if a smaller  
reporting company)

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

As of the close of business on October 20, 2011, 233,790,441 shares of common stock, par value \$.01 per share, were outstanding.



**WESTERN DIGITAL CORPORATION  
INDEX**

**PAGE NO.**

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements (unaudited)

Condensed Consolidated Balance Sheets September 30, 2011 and July 1, 2011

Condensed Consolidated Statements of Income Three Months Ended September 30, 2011 and October 1, 2010

Condensed Consolidated Statements of Cash Flows Three Months Ended September 30, 2011 and October 1, 2010

Notes to Condensed Consolidated Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

**PART II. OTHER INFORMATION**

Item 1. Legal Proceedings

Item 1A. Risk Factors

Item 6. Exhibits

Exhibit 10.1

Exhibit 10.2

Exhibit 10.3

Exhibit 10.4

Exhibit 10.5

Exhibit 10.6

Exhibit 10.7

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

Exhibit 32.2

EX-101 INSTANCE DOCUMENT

EX-101 SCHEMA DOCUMENT

EX-101 CALCULATION LINKBASE DOCUMENT

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

EX-101 DEFINITION LINKBASE DOCUMENT

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every five years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Our fiscal first quarters ended

Edgar Filing: WESTERN DIGITAL CORP - Form 10-Q

September 30, 2011 and October 1, 2010 both consisted of 13 weeks. Fiscal year 2011 was comprised of 52 weeks and ended on July 1, 2011. Fiscal year 2012 will be comprised of 52 weeks and will end on June 29, 2012. Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms we, us, our, the Company and WD refer to Western Digital Corporation and its subsidiaries.

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

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

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

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS**

**WESTERN DIGITAL CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in millions, except par values; unaudited)

|                                                                                                               | <b>Sept. 30,<br/>2011</b> | <b>Jul. 1,<br/>2011</b> |
|---------------------------------------------------------------------------------------------------------------|---------------------------|-------------------------|
| <b>ASSETS</b>                                                                                                 |                           |                         |
| Current assets:                                                                                               |                           |                         |
| Cash and cash equivalents                                                                                     | \$ 3,675                  | \$ 3,490                |
| Accounts receivable, net                                                                                      | 1,356                     | 1,206                   |
| Inventories                                                                                                   | 645                       | 577                     |
| Other current assets                                                                                          | 250                       | 214                     |
| Total current assets                                                                                          | 5,926                     | 5,487                   |
| Property, plant and equipment, net                                                                            | 2,209                     | 2,224                   |
| Goodwill                                                                                                      | 151                       | 151                     |
| Other intangible assets, net                                                                                  | 67                        | 71                      |
| Other non-current assets                                                                                      | 114                       | 185                     |
| Total assets                                                                                                  | \$ 8,467                  | \$ 8,118                |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                   |                           |                         |
| Current liabilities:                                                                                          |                           |                         |
| Accounts payable                                                                                              | \$ 1,708                  | \$ 1,545                |
| Accrued expenses                                                                                              | 348                       | 349                     |
| Accrued warranty                                                                                              | 135                       | 132                     |
| Current portion of long-term debt                                                                             | 163                       | 144                     |
| Total current liabilities                                                                                     | 2,354                     | 2,170                   |
| Long-term debt                                                                                                | 100                       | 150                     |
| Other liabilities                                                                                             | 290                       | 310                     |
| Total liabilities                                                                                             | 2,744                     | 2,630                   |
| Commitments and contingencies (Note 4 and 5)                                                                  |                           |                         |
| Shareholders' equity:                                                                                         |                           |                         |
| Preferred stock, \$.01 par value; authorized 5 shares; issued and outstanding none                            |                           |                         |
| Common stock, \$.01 par value; authorized 450 shares; issued and outstanding 234 and 233 shares, respectively | 2                         | 2                       |
| Additional paid-in capital                                                                                    | 1,106                     | 1,091                   |
| Accumulated other comprehensive loss                                                                          | (24)                      | (5)                     |
| Retained earnings                                                                                             | 4,639                     | 4,400                   |
| Total shareholders' equity                                                                                    | 5,723                     | 5,488                   |
| Total liabilities and shareholders' equity                                                                    | \$ 8,467                  | \$ 8,118                |

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

Table of Contents

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

|                                             | <b>Three Months Ended</b> |                         |
|---------------------------------------------|---------------------------|-------------------------|
|                                             | <b>Sept. 30,<br/>2011</b> | <b>Oct. 1,<br/>2010</b> |
| Revenue, net                                | \$ 2,694                  | \$ 2,396                |
| Cost of revenue                             | 2,153                     | 1,959                   |
| Gross margin                                | 541                       | 437                     |
| Operating expenses:                         |                           |                         |
| Research and development                    | 193                       | 167                     |
| Selling, general and administrative         | 89                        | 59                      |
| Total operating expenses                    | 282                       | 226                     |
| Operating income                            | 259                       | 211                     |
| Other income (expense):                     |                           |                         |
| Interest income                             | 3                         | 2                       |
| Interest and other expense                  | (4)                       | (2)                     |
| Total other expense, net                    | (1)                       |                         |
| Income before income taxes                  | 258                       | 211                     |
| Income tax provision                        | 19                        | 14                      |
| Net income                                  | \$ 239                    | \$ 197                  |
| <b>Income per common share:</b>             |                           |                         |
| Basic                                       | \$ 1.03                   | \$ 0.86                 |
| Diluted                                     | \$ 1.01                   | \$ 0.84                 |
| <b>Weighted average shares outstanding:</b> |                           |                         |
| Basic                                       | 233                       | 230                     |
| Diluted                                     | 237                       | 234                     |

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

Table of Contents

**WESTERN DIGITAL CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in millions; unaudited)

|                                                                         | <b>Three Months Ended</b> |                |
|-------------------------------------------------------------------------|---------------------------|----------------|
|                                                                         | <b>Sept. 30,</b>          | <b>Oct. 1,</b> |
|                                                                         | <b>2011</b>               | <b>2010</b>    |
| <b>Cash flows from operating activities</b>                             |                           |                |
| Net income                                                              | \$ 239                    | \$ 197         |
| Adjustments to reconcile net income to net cash provided by operations: |                           |                |
| Depreciation and amortization                                           | 158                       | 150            |
| Stock-based compensation                                                | 17                        | 19             |
| Deferred income taxes                                                   | 9                         |                |
| Changes in:                                                             |                           |                |
| Accounts receivable, net                                                | (150)                     | (68)           |
| Inventories                                                             | (68)                      | (1)            |
| Accounts payable                                                        | 157                       | 162            |
| Accrued expenses                                                        | (17)                      | (52)           |
| Other assets and liabilities                                            | 7                         | (17)           |
| Net cash provided by operating activities                               | 352                       | 390            |
| <b>Cash flows from investing activities</b>                             |                           |                |
| Purchases of property, plant and equipment                              | (134)                     | (200)          |
| Cash used in investing activities                                       | (134)                     | (200)          |
| <b>Cash flows from financing activities</b>                             |                           |                |
| Issuance of stock under employee stock plans                            | 2                         | 2              |
| Taxes paid on vested stock awards under employee stock plans            | (5)                       | (4)            |
| Excess tax benefits from employee stock plans                           | 1                         | 11             |
| Repurchases of common stock                                             |                           | (50)           |
| Repayment of debt                                                       | (31)                      | (25)           |
| Net cash used in financing activities                                   | (33)                      | (66)           |
| Net increase in cash and cash equivalents                               | 185                       | 124            |
| Cash and cash equivalents, beginning of period                          | 3,490                     | 2,734          |
| Cash and cash equivalents, end of period                                | \$ 3,675                  | \$ 2,858       |
| <b>Supplemental disclosure of cash flow information:</b>                |                           |                |
| Cash paid for income taxes                                              | \$ 2                      | \$ 2           |
| Cash paid for interest                                                  | \$ 1                      | \$ 1           |

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



Table of Contents

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

**1. Basis of Presentation**

The accounting policies followed by Western Digital Corporation (the Company) are set forth in Part II, Item 8, Note 1 of the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended July 1, 2011. In the opinion of management, all adjustments necessary to fairly state the unaudited condensed consolidated financial statements have been made. All such adjustments are of a normal, recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended July 1, 2011. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year (see note 12).

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

**2. Supplemental Financial Statement Data***Inventories*

|                                   | Sept. 30,<br>2011 | Jul. 1,<br>2011 |
|-----------------------------------|-------------------|-----------------|
|                                   | (in millions)     |                 |
| Raw materials and component parts | \$ 170            | \$ 172          |
| Work-in-process                   | 275               | 263             |
| Finished goods                    | 200               | 142             |
| Total inventories                 | \$ 645            | \$ 577          |

*Warranty*

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

| Three Months<br>Ended |         |
|-----------------------|---------|
| Sept. 30,             | Oct. 1, |

|                                                        | <b>2011</b>   | <b>2010</b> |
|--------------------------------------------------------|---------------|-------------|
| Warranty accrual, beginning of period                  | \$ <b>170</b> | \$ 170      |
| Charges to operations                                  | <b>45</b>     | 44          |
| Utilization                                            | <b>(42)</b>   | (38)        |
| Changes in estimate related to pre-existing warranties |               | (3)         |
| Warranty accrual, end of period                        | \$ <b>173</b> | \$ 173      |

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

**Table of Contents****3. Income per Common Share**

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

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

|                                                 | <b>Three Months<br/>Ended</b> |                         |
|-------------------------------------------------|-------------------------------|-------------------------|
|                                                 | <b>Sept. 30,<br/>2011</b>     | <b>Oct. 1,<br/>2010</b> |
| Net income                                      | \$ 239                        | \$ 197                  |
| Weighted average shares outstanding:            |                               |                         |
| Basic                                           | 233                           | 230                     |
| Employee stock options and other                | 4                             | 4                       |
| Diluted                                         | 237                           | 234                     |
| Income per common share:                        |                               |                         |
| Basic                                           | \$ 1.03                       | \$ 0.86                 |
| Diluted                                         | \$ 1.01                       | \$ 0.84                 |
| Anti-dilutive potential common shares excluded* | 4                             | 4                       |

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

**4. Debt**

In February 2008, Western Digital Technologies, Inc. ( WDTI ), a wholly-owned subsidiary of the Company, entered into a five-year credit agreement that provided for a \$500 million term loan facility. As of September 30, 2011, the term loan facility had a variable interest rate of 1.50% and a remaining balance of \$263 million, which requires principal payments totaling \$113 million through the remainder of fiscal 2012 and \$150 million in fiscal 2013. The term loan facility has a maturity date of February 11, 2013. As of September 30, 2011, WDTI was in compliance with all covenants.

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

**5. Legal Proceedings**

When the Company becomes aware of a claim or potential claim, the Company assesses the likelihood of any loss or exposure. The Company discloses information regarding each material claim where the likelihood of a loss contingency is probable or reasonably possible. If a loss contingency is probable and the amount of the loss can be reasonably estimated, the Company records an accrual for the loss. In such cases, there may be an exposure to potential loss in excess of the amount accrued. Where a loss is not probable but is reasonably possible or where a loss

in excess of the amount accrued is reasonably possible, the Company discloses an estimate of the amount of the loss or range of possible losses for the claim if a reasonable estimate can be made, unless the amount of such reasonably possible losses is not material to the Company's financial position, results of operations or cash flows. For each of the matters described below, the Company has either recorded an accrual for losses that are probable and reasonably estimable or has determined that, while a loss is reasonably possible (including potential losses in excess of the amounts accrued by the Company), a reasonable estimate of the amount of loss or range of possible losses with respect to the claim or in excess of amounts already accrued by the Company cannot be made. The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

## **Table of Contents**

### *Intellectual Property Litigation*

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

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

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

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

On November 10, 2010, plaintiff Rembrandt Data Storage filed a complaint in the Western District of Wisconsin against the Company alleging infringement of U.S. Patent Nos. 5,995,342 and 6,195,232. Plaintiff is seeking injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to specific thin film heads having solenoid coils. The Company intends to defend itself vigorously in this matter.

On August 1, 2011, plaintiff Guzik Technical Enterprises filed a complaint in the Northern District of California against the Company and various of its subsidiaries alleging infringement of U.S. Patent Nos. 6,023,145 and 6,785,085, breach of contract and misappropriation of trade secrets. Plaintiff is seeking injunctive relief and unspecified monetary damages, fees and costs. The asserted patents allegedly relate to devices used to test hard disk drive heads and media. The Company intends to defend itself vigorously in this matter.

On September 6, 2011, plaintiff Powerline Innovations filed a complaint in the Eastern District of Texas against the Company alleging infringement of U.S. Patent No. 5,471,190. Plaintiff is seeking unspecified monetary damages, fees and costs. The asserted patent allegedly relates to power line Ethernet communications. The Company intends to defend itself vigorously in this matter.

On October 4, 2006, plaintiff Seagate Technology LLC ( Seagate ) filed a complaint against the Company and one of its employees formerly employed by Seagate in the Minnesota Fourth Judicial District Court. The complaint alleges claims based on supposed misappropriation of trade secrets and seeks injunctive relief and unspecified monetary damages, fees and costs. On June 19, 2007, the Company's employee filed a demand for arbitration with the American Arbitration Association. A motion to stay the litigation as against all defendants and to compel arbitration of all Seagate's claims was granted on September 19, 2007. On September 23, 2010, Seagate filed a motion to amend its claims and add allegations based on the supposed misappropriation of additional confidential information, and the

arbitrator granted Seagate's motion. The arbitration hearing commenced on May 23, 2011 and concluded on July 11, 2011. The parties filed post-arbitration briefs in August 2011. The arbitrator is expected to render a decision by November 30, 2011. The Company continues to defend itself vigorously in this matter.

**Table of Contents***Employment Litigation*

On March 20, 2009, plaintiff Ghazala H. Durrani, a former employee of the Company, filed a putative class action complaint in the Alameda County (California) Superior Court. The complaint alleged that certain of the Company's engineers had been misclassified as exempt employees under California state law and were, therefore, due unspecified amounts for unpaid hourly overtime wages and other amounts, as well as penalties for allegedly missed meal and rest periods. By court order dated April 24, 2009, the case was transferred to the Orange County (California) Superior Court. On or about June 16, 2009, the Company was dismissed from the case without prejudice by stipulation, leaving WDTI as the sole remaining defendant. On or about June 4, 2009, WDTI filed its answer to the complaint, denying the substantive allegations thereof and raising several affirmative defenses. The parties participated in a mediation of the case on June 3, 2010, which led to a proposed settlement of the case. The proposed settlement, which was ultimately approved by the court, resolved the case on a class-wide basis for an immaterial amount that was accrued by the Company in the fourth quarter of fiscal 2010. The court granted final approval of the settlement and entered judgment on February 7, 2011. A final accounting hearing took place on July 11, 2011, at which the court confirmed that the settlement amount was fully paid in accordance with the settlement agreement.

On February 26, 2010, and as thereafter amended on August 23, 2010 and December 22, 2010, plaintiff Tariq Sadaat, a former employee of the Company, filed a putative class action complaint in the Orange County (California) Superior Court against the Company, WDTI, Kelly Services, Inc., a Delaware corporation ( Kelly Services ), and certain other unnamed individuals. Plaintiff sought to represent certain hourly employees who were assigned to work at certain of the Company's facilities by Kelly Services, a temporary staffing agency. In this regard, the complaint alleged that the hourly employees were due unspecified sums for unpaid overtime wages and other amounts, as well as penalties for allegedly missed meal and rest periods. The complaint sought unspecified damages including lost wages, penalties under the California Labor Code and other statutes, compensatory and punitive damages, declaratory relief, injunctive relief, interest, attorneys' fees and costs. The Company's response to the complaint was filed and served in January 2011. The parties participated in a mediation of the case, which led to a proposed settlement of Sadaat's individual claims for an immaterial amount. The Court approved the proposed settlement on July 26, 2011, and dismissed the complaint in its entirety, with prejudice as to Sadaat's individual claims and without prejudice as to the alleged class claims.

*Other Matters*

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

**6. Income Taxes**

The Company's income tax provision for the three months ended September 30, 2011 was \$19 million as compared to \$14 million in the prior-year period. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, Singapore and Thailand that expire at various dates through 2023 and the current year generation of income tax credits.

In the three months ended September 30, 2011, the Company recorded a net decrease of \$14 million in its liability for unrecognized tax benefits. The decrease is due primarily to the resolution of the United States Internal Revenue Service ( IRS ) audit of Komag, Incorporated ( Komag ), which was acquired by the Company on September 5, 2007. As of September 30, 2011, the Company had a recorded liability for unrecognized tax benefits of approximately \$231 million. Interest and penalties recognized on such amounts were not material.

**Table of Contents**

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

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of September 30, 2011, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company's unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company's uncertain tax positions.

**7. Fair Value Measurements**

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

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

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

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

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

|                                   | Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level 1) | Fair Value Measurements at<br>Reporting Date Using        |                                                    | Total  |
|-----------------------------------|-------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|--------|
|                                   |                                                                                     | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |        |
| Assets:                           |                                                                                     |                                                           |                                                    |        |
| Cash equivalents                  |                                                                                     |                                                           |                                                    |        |
| Money market funds                | \$ 807                                                                              | \$                                                        | \$                                                 | \$ 807 |
| U.S. Treasury securities          |                                                                                     | 53                                                        |                                                    | 53     |
| U.S. Government agency securities |                                                                                     | 53                                                        |                                                    | 53     |
| Total cash equivalents            | 807                                                                                 | 106                                                       |                                                    | 913    |
| Auction-rate securities           |                                                                                     |                                                           | 15                                                 | 15     |
| Total assets at fair value        | \$ 807                                                                              | \$ 106                                                    | \$ 15                                              | \$ 928 |

Liabilities:

|                            |  |  |      |  |  |      |
|----------------------------|--|--|------|--|--|------|
| Foreign exchange contracts |  |  | (33) |  |  | (33) |
|----------------------------|--|--|------|--|--|------|

|                                 |    |    |      |    |    |      |
|---------------------------------|----|----|------|----|----|------|
| Total liabilities at fair value | \$ | \$ | (33) | \$ | \$ | (33) |
|---------------------------------|----|----|------|----|----|------|

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

## **Table of Contents**

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

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

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

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

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

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

## **8. Foreign Exchange Contracts**

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

If the derivative is designated as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially deferred in other comprehensive income (loss), net of tax. These amounts are subsequently recognized into earnings when the underlying cash flow being hedged is recognized into earnings. Recognized gains and losses on foreign exchange contracts entered into for manufacturing-related activities are reported in cost of revenue. Hedge effectiveness is measured by comparing the hedging instrument's cumulative change in fair value from inception to maturity to the underlying exposure's terminal value. As of September 30, 2011, the net amount of existing gains expected to be reclassified into earnings within the next 12 months was \$24 million. The Company determined the ineffectiveness associated with its cash flow hedges to be immaterial.



**Table of Contents**

A change in the fair value of fair value hedges is recognized in earnings in the period incurred and is reported as a component of operating expenses. All fair value hedges were determined to be effective. The fair value and the changes in fair value on these contracts were not material to the condensed consolidated financial statements.

As of September 30, 2011, the Company did not have any foreign exchange contracts with credit-risk-related contingent features. The Company opened \$902 million and \$907 million, and closed \$836 million and \$727 million, in foreign exchange contracts in the three months ended September 30, 2011 and October 1, 2010, respectively. The fair value and balance sheet location of such contracts were as follows (in millions):

| Derivatives Designated as<br>Hedging Instruments | Asset Derivatives |       |              |       | Liability Derivatives |       |                     |       |
|--------------------------------------------------|-------------------|-------|--------------|-------|-----------------------|-------|---------------------|-------|
|                                                  | Sept. 30, 2011    |       | Jul. 1, 2011 |       | Sept. 30, 2011        |       | Jul. 1, 2011        |       |
|                                                  | Balance           |       | Balance      |       | Balance               |       | Balance             |       |
|                                                  | Sheet             | Fair  | Sheet        | Fair  | Sheet                 | Fair  | Sheet               | Fair  |
|                                                  | Location          | Value | Location     | Value | Location              | Value | Location            | Value |
| Foreign exchange contracts                       |                   |       |              |       | Accrued<br>Expenses   | \$ 33 | Accrued<br>Expenses | \$ 5  |

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

| Derivatives in Cash        | Amount of Gain (Loss) |                 | Location of Gain<br>(Loss) Reclassified<br>from Accumulated<br>OCI into Income | Amount of Gain (Loss) |                 |
|----------------------------|-----------------------|-----------------|--------------------------------------------------------------------------------|-----------------------|-----------------|
|                            | Recognized in         |                 |                                                                                | Reclassified from     |                 |
|                            | Accumulated OCI       |                 |                                                                                | Accumulated OCI into  |                 |
|                            | on Derivatives        |                 |                                                                                | Income                |                 |
| Flow Hedging Relationships | Sept. 30,<br>2011     | Oct. 1,<br>2010 |                                                                                | Sept. 30,<br>2011     | Oct. 1,<br>2010 |
| Foreign exchange contracts | \$ (8)                | \$ 55           | Cost of revenue                                                                | \$ 11                 | \$ 27           |

The total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements during the three months ended September 30, 2011 and October 1, 2010.

**9. Stock-Based Compensation**

During the three months ended September 30, 2011, the Company recognized in expense \$9 million for stock-based compensation related to the vesting of options issued under stock option plans and the ESPP, compared to \$11 million in the comparative prior-year period. As of September 30, 2011, total compensation cost related to unvested stock options and ESPP rights issued to employees but not yet recognized was \$80 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.5 years.

During the three months ended September 30, 2011 and the comparative prior-year period, the Company recognized in expense \$8 million related to the vesting of awards of restricted stock and restricted stock units ( RSUs ). As of September 30, 2011, the aggregate unamortized fair value of all unvested RSUs was \$60 million, which will be recognized on a straight-line basis over a weighted average vesting period of approximately 1.8 years.

**Table of Contents***Stock Option Activity*

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

|                                                             |                             | <b>Weighted<br/>Average</b>         | <b>Weighted<br/>Average</b> | <b>Remaining<br/>Contractual<br/>Life<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|-------------------------------------------------------------|-----------------------------|-------------------------------------|-----------------------------|----------------------------------------------------------|------------------------------------------|
|                                                             | <b>Number<br/>of Shares</b> | <b>Exercise Price<br/>Per Share</b> |                             |                                                          |                                          |
| <b>Options outstanding at July 1, 2011</b>                  | 10.2                        | \$ 22.49                            |                             |                                                          |                                          |
| Granted                                                     | 2.5                         | 29.64                               |                             |                                                          |                                          |
| Exercised                                                   | (0.2)                       | 7.99                                |                             |                                                          |                                          |
| Canceled or expired                                         |                             |                                     |                             |                                                          |                                          |
| <b>Options outstanding at September 30, 2011</b>            | 12.5                        | \$ 24.20                            |                             | 4.9                                                      | \$ 46                                    |
| <b>Exercisable at September 30, 2011</b>                    | 6.2                         | \$ 20.75                            |                             | 3.9                                                      | \$ 38                                    |
| <b>Vested and expected to vest after September 30, 2011</b> | 12.3                        | \$ 24.13                            |                             | 4.9                                                      | \$ 46                                    |

If an option has an exercise price that is less than the quoted price of the Company's common stock at the particular time, the aggregate intrinsic value of that option at that time is calculated based on the difference between the exercise price of the underlying options and the quoted price of the Company's common stock at that time. As of September 30, 2011, the Company had options outstanding to purchase an aggregate of 5.8 million shares with an exercise price below the quoted price of the Company's stock on that date resulting in an aggregate intrinsic value of \$46 million at that date. During the three months ended September 30, 2011, the aggregate intrinsic value of options exercised under the Company's stock option plans was \$5 million, determined as of the date of exercise, compared to \$2 million in the comparative prior-year period.

*Fair Value Disclosure – Binomial Model*

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

|                                          | <b>Three Months Ended</b> |                         |
|------------------------------------------|---------------------------|-------------------------|
|                                          | <b>Sept. 30,<br/>2011</b> | <b>Oct. 1,<br/>2010</b> |
| Suboptimal exercise factor               | <b>1.81</b>               | 1.81                    |
| Range of risk-free interest rates        | <b>0.13% to 1.43%</b>     | 0.26% to 1.90%          |
| Range of expected stock price volatility | <b>0.41 to 0.54</b>       | 0.42 to 0.59            |
| Weighted average expected volatility     | <b>0.48</b>               | 0.52                    |
| Post-vesting termination rate            | <b>2.63%</b>              | 2.42%                   |

Dividend yield

Fair value

**\$11.97**

\$11.26

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

*Fair Value Disclosure Black-Scholes-Merton Model*

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

**Table of Contents***RSU Activity*

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

|                                                  | Number<br>of Shares |    | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--------------------------------------------------|---------------------|----|-------------------------------------------------|
| <b>RSUs outstanding at July 1, 2011</b>          | 3.1                 | \$ | 28.85                                           |
| Granted                                          | 0.9                 |    | 29.64                                           |
| Vested                                           | (0.6)               |    | 23.94                                           |
| Canceled or expired                              |                     |    |                                                 |
| <b>RSUs outstanding at September 30, 2011</b>    | 3.4                 | \$ | 29.83                                           |
| <b>Expected to vest after September 30, 2011</b> | 3.3                 | \$ | 29.90                                           |

The fair value of each RSU is the market price of our stock at the date of grant. RSUs are generally payable in an equal number of shares of the Company's common stock at the time of vesting of the units. The grant-date fair value of the shares underlying the restricted stock awards at the date of grant was \$28 million for the three months ended September 30, 2011. These amounts are being recognized to expense over the corresponding vesting periods. For purposes of valuing these awards, the Company has assumed a forfeiture rate of 2.3%, based on a historical analysis indicating forfeitures for these types of awards.

**10. Planned Acquisition**

On March 7, 2011, the Company entered into a stock purchase agreement (the "Purchase Agreement") with Hitachi, Ltd. ("Hitachi"), Viviti Technologies Ltd., until recently known as Hitachi Global Storage Technologies Holdings Pte. Ltd., a wholly owned subsidiary of Hitachi ("HGST"), and Western Digital Ireland, Ltd., an indirect wholly owned subsidiary of the Company ("WDI"). Pursuant to the Purchase Agreement, WDI agreed to acquire all of the issued and outstanding paid-up share capital of HGST from Hitachi. The planned acquisition is intended to result in a more efficient and innovative customer-focused storage company, with significant operating scale, strong global talent and the industry's broadest product lineup backed by a rich technology portfolio. The aggregate purchase price of the planned acquisition is estimated to be approximately \$4.2 billion, due at closing, and is expected to be funded with existing cash, new debt, and 25 million newly issued shares of the Company's common stock. The Purchase Agreement contains certain termination rights for both the Company and Hitachi, including the right to terminate the Purchase Agreement if the planned acquisition has not closed by March 7, 2012. The Purchase Agreement does not contain a termination right for the benefit of the Company in the event it cannot obtain financing for the transaction. If the planned acquisition has not closed by March 7, 2012 due to the failure to receive any required antitrust or competition authority's consent, approval or clearance or any action by certain governmental entities to prevent the planned acquisition for antitrust or competition reasons, the Company will, concurrently with such termination, be required to pay Hitachi a fee of \$250 million in cash. During the three months ended September 30, 2011, the Company incurred \$11 million of expenses related to the planned acquisition of HGST, which are included within selling, general and administrative expense in the condensed consolidated statement of income.

On March 7, 2011, in connection with the planned acquisition of HGST, the Company, WDTI and WDI entered into a commitment letter with Bank of America, N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated regarding a new credit facility for an amount of \$2.5 billion, consisting of a \$500 million revolving credit facility and \$2.0 billion in term loans, to be entered into in connection with the closing of the planned acquisition (the "Senior Facility"). Since entering into the commitment letter, Bank of America N.A. and Merrill Lynch, Pierce, Fenner & Smith Incorporated led the effort to syndicate the Senior Facility for an amount of up to \$3.0 billion, consisting of a \$500 million revolving credit facility and up to \$2.5 billion in term loans. As a result of such effort, the Company, WDTI and WDI

have fully negotiated definitive loan documents for the Senior Facility with the syndicate members. The Company, WDTI and WDI expect all of these syndicate members to be part of the final lender group, subject to customary closing conditions, including completion of the acquisition in accordance with its terms, the receipt of antitrust approvals or the expiration of applicable waiting periods without any action being taken by an authority that would impose any material adverse condition on the Company, HGST or their respective subsidiaries taken as a whole, and there not having occurred for HGST, the Company or WDI a material adverse effect on their respective business, financial condition or operations. We are required to pay a commitment fee at the rate of 0.35%, per annum, of the aggregate unfunded amount committed to be borrowed under the Senior Facility. During the three months ended September 30, 2011, the Company incurred debt commitment fees of \$3 million related to the planned acquisition of HGST, which are included within interest and other expense in the condensed consolidated statement of income. The planned acquisition of HGST is subject to several closing conditions, including the receipt of antitrust approvals or the expiration of applicable waiting periods in the United States, the European Union, the People's Republic of China, Japan, Korea and Mexico. In certain jurisdictions, the Company has received requests for additional information and is engaged in more in-depth reviews of the pending acquisition. The Company has proposed a remedy to the European Commission intended to address the preliminary assessment of competitive effects of the transaction set out by the European Commission. This proposal remains under consideration by the European Union and there is no assurance that the proposal will be accepted or, if accepted, can be successfully implemented. The Company is cooperating fully with each of the regulatory authorities reviewing the proposed transaction. Subject to obtaining the required regulatory approvals or expiration of applicable waiting periods, the Company is targeting the transaction to close in its second quarter of fiscal 2012.

**Table of Contents****11. Recent Accounting Pronouncements**

In June 2011, the FASB issued ASU 2011-05 Presentation of Comprehensive Income ( ASU 2011-05 ). ASU 2011-05 requires that all non-owner changes in shareholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but continuous statements. If presented in two separate statements, the first statement should present total net income and its components followed immediately by a second statement of total other comprehensive income, its components and the total comprehensive income. ASU 2011-05 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, which for the Company is the first quarter of fiscal 2013. The Company is currently evaluating how it will report comprehensive income, but either method permitted will constitute a change in the Company's financial statement presentation.

**12. Subsequent Event**

The Company suspended production in all of its Thailand manufacturing facilities during the week of October 10, 2011 due to severe flooding in Thailand, and the flood waters have since inundated these facilities and submerged equipment located there. The flooded facilities in Thailand include the Company's magnetic head slider fabrication facilities, which supply a substantial majority of the Company's magnetic head requirements. The flooded facilities in Thailand also include the Company's hard drive, head gimbal assembly ( HGA ) and head stack assembly ( HSA ) facilities. Approximately 60% of the hard drives produced by the Company in the quarter ended September 30, 2011 came from its Thailand facilities. In addition to the suspension of the Company's Thailand hard drive assembly operations and the internal slider shortages, the Company is also experiencing other shortages of component parts from vendors located in several Thailand industrial parks that have been flooded or have been affected by protective plant shutdowns.

The Company is evaluating the Thailand situation on an ongoing basis and does not know, at this time, when it will recommence operations in Thailand, including the operation of its Thailand slider fabrication facility that also supports operations outside of Thailand. The Company is also uncertain about the timeline for recovery and commencement of production by suppliers in Thailand. The Company is pursuing its options so that it can safely begin working to accelerate the water removal and either extract and transfer equipment to clean rooms in another location or prepare the equipment for operation on-site. The Company expects the suspension of its operations in Thailand and that of some of its suppliers will continue into the March quarter and possibly beyond. During this time, the Company's operations outside Thailand will be impacted by a shortage of sliders that would otherwise be produced by the Company in Thailand and other shortages of components produced by some of its suppliers impacted by the floods. The Company is working with its suppliers to better understand the effect of the flooding on the supply chain and to locate alternative sources of supply, and is also pursuing all options to maximize existing capacity in other locations, including its Malaysian hard drive assembly facility and a third-party slider fabrication facility in the Philippines.

The flooding of the Company's Thailand facilities, combined with the flood damage to the supply chain in Thailand, will have a significant impact on the Company's overall operations and its ability to meet customer demand for its products in the December quarter and possibly beyond. While the Company expects industry unit demand in the December quarter will be flat to slightly down from the September quarter, it expects that its hard drive shipments during the December quarter will be between 22 million and 26 million units in contrast to the 58 million units shipped in the September quarter and that the overall hard drive industry unit shipments in the December quarter will also be supply constrained due to the flooding. In addition, while the Company's operations in Thailand remain suspended completely or in part, its costs will be impacted negatively by significant under-absorption of its assets and infrastructure, costs it will incur in restoring supply and increased costs of use of air freight and other charges to expedite the immediate availability of the Company's production for its customers. The Company also expects to incur significant unusual charges and expenses related to the flooding of its operations, including such items as fixed asset impairments, inventory write-downs, purchase order cancellations for excess materials that cannot be used near term, service charges for reclaim and recovery work and foreign exchange losses to settle a portion of its forward exchange contracts that exceed its current requirements. The Company is unable to estimate the amount of these charges and expenses at this time.



## **Table of Contents**

Given the lower expected product shipments, the Company anticipates its net revenue in the December quarter will be substantially lower than the quarter ended September 30, 2011. In addition, while the Company believes that supply constraint, relative to demand, will result in a higher average selling price ( ASP ) for the December quarter, the Company expects that the higher costs referenced above will result in negative gross margins and that it will incur a significant loss for the quarter before taking into account unusual charges and expenses the Company expects to incur related to the flooding. The Company's revenues, gross margins and operating results will continue to be negatively impacted in subsequent quarters until the Company and its supply sources affected by the Thailand flooding are able to substantially restore operations, the supply chain infrastructure is re-established and the Company is able to regain any lost market share.

The Company maintains insurance coverage that provides for reimbursement from losses resulting from flood damage. The Company anticipates the amount of flood damage incurred will exceed the policy's limit but cannot estimate by how much at this time. The Company also maintains insurance for business interruption losses, and is currently working with its insurance carrier to determine the amounts which may be recoverable under this policy.

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

This information should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended July 1, 2011.

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

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

#### **Forward-Looking Statements**

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

*the impact of the flooding in Thailand on the industry and our business in the December quarter and beyond, including our hard drive production capacity, the availability of components from our suppliers, our planned operations recovery efforts and the expected costs and expenses that we will incur in connection with these efforts, and our ability to complete recovery efforts and recommence normal operations in our Thailand facilities;*

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

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

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

## **Table of Contents**

*the terms of and our ability to syndicate the new credit facility to be entered into in connection with the planned acquisition of HGST;*  
*demand for hard drives and solid-state drives in the various markets and factors contributing to such demand;*  
*our plans to continue to develop new products and expand into new storage markets and into emerging economic markets;*  
*our entry into and position in the traditional enterprise market;*  
*emergence of new storage markets for hard drives;*  
*emergence of competing storage technologies;*  
*our share repurchase plans;*  
*our stock price volatility;*  
*expectations regarding the outcome of legal proceedings in which we are involved;*  
*our beliefs regarding the adequacy of our tax provisions and the timing of future payments, if any, relating to the unrecognized tax benefits; and*  
*our beliefs regarding the sufficiency of our cash and cash equivalents to meet our working capital, capital expenditure and other cash needs, and the expected impact of the flooding in Thailand and suspension of our Thailand operations on our liquidity.*

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

### **Our Company**

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

### **Severe Flooding in Thailand and Suspension of Thailand Operations**

We suspended production in all of our Thailand manufacturing facilities during the week of October 10, 2011 due to severe flooding in Thailand, and the flood waters have since inundated these facilities and submerged equipment located there. The flooded facilities in Thailand include our magnetic head slider fabrication facilities, which supply a substantial majority of our magnetic head requirements. The flooded facilities in Thailand also include our hard drive, head gimbal assembly ( HGA ) and head stack assembly ( HSA ) facilities. Approximately 60% of the hard drives we produced in the quarter ended September 30, 2011 came from our Thailand facilities. In addition to the suspension of our Thailand hard drive assembly operations and the internal slider shortages, we are also experiencing other shortages of component parts from vendors located in several Thailand industrial parks that have been flooded or have been affected by protective plant shutdowns.

**Table of Contents**

We are evaluating the Thailand situation on an ongoing basis and do not know, at this time, when we will recommence operations in Thailand, including the operation of our Thailand slider fabrication facility that also supports operations outside of Thailand. We are also uncertain about the timeline for recovery and commencement of production by suppliers in Thailand. We are pursuing our options so that we can safely begin working to accelerate the water removal and either extract and transfer equipment to clean rooms in another location or prepare the equipment for operation on-site. We expect the suspension of our operations in Thailand and that of some of our suppliers will continue into the March quarter and possibly beyond. During this time, our operations outside Thailand will be impacted by a shortage of sliders that would otherwise be produced by us in Thailand and other shortages of components produced by some of our suppliers impacted by the floods. We are working with our suppliers to better understand the effect of the flooding on the supply chain and to locate alternative sources of supply, and we are also pursuing all options to maximize existing capacity in other locations, including our Malaysian hard drive assembly facility and a third-party slider fabrication facility in the Philippines.

The flooding of our Thailand facilities, combined with the flood damage to the supply chain in Thailand, will have a significant impact on our overall operations and our ability to meet customer demand for our products in the December quarter and possibly beyond. While we expect industry unit demand in the December quarter will be flat to slightly down from the September quarter, we expect that our hard drive shipments during the December quarter will be between 22 million and 26 million units in contrast to the 58 million units we shipped in the September quarter and that the overall hard drive industry unit shipments in the December quarter will also be supply constrained due to the flooding. In addition, while our operations in Thailand remain suspended completely or in part, our costs will be impacted negatively by significant under-absorption of our assets and infrastructure, costs we will incur in restoring supply and increased costs of use of air freight and other charges to expedite the immediate availability of our production for our customers. We also expect to incur significant unusual charges and expenses related to the flooding of our operations, including such items as fixed asset impairments, inventory write-downs, purchase order cancellations for excess materials that cannot be used near term, service charges for reclaim and recovery work and foreign exchange losses to settle a portion of our forward exchange contracts that exceed our current requirements. We are unable to estimate the amount of these charges and expenses at this time.

Given the lower expected product shipments, we anticipate our net revenue in the December quarter will be substantially lower than the quarter ended September 30, 2011. In addition, while we believe that supply constraint, relative to demand, will result in a higher average selling price ( ASP ) for the December quarter, we expect that the higher costs referenced above will result in negative gross margins and that we will incur a significant loss for the quarter before taking into account unusual charges and expenses we expect to incur related to the flooding. Our revenues, gross margins and operating results will continue to be negatively impacted in subsequent quarters until we and our supply sources affected by the Thailand flooding are able to substantially restore operations, the supply chain infrastructure is re-established and we are able to regain any lost market share.

We maintain insurance coverage that provides for reimbursement from losses resulting from flood damage. We anticipate the amount of flood damage incurred will exceed the policy's limit but cannot estimate by how much at this time. We also maintain insurance for business interruption losses, and we are currently working with our insurance carrier to determine the amounts which may be recoverable under this policy.

**Planned Acquisition of Hitachi Global Storage Technologies**

On March 7, 2011, we entered into a stock purchase agreement (the Purchase Agreement ) with Hitachi, Ltd. ( Hitachi ), Viviti Technologies Ltd., until recently known as Hitachi Global Storage Technologies Holdings Pte. Ltd., a wholly owned subsidiary of Hitachi ( HGST ), and Western Digital Ireland, Ltd., our indirect wholly owned subsidiary ( WDI ). Pursuant to the Purchase Agreement, WDI agreed to acquire all of the issued and outstanding paid-up share capital of HGST from Hitachi. The planned acquisition is intended to result in a more efficient and innovative customer-focused storage company, with significant operating scale, strong global talent and the industry's broadest product lineup backed by a rich technology portfolio. The aggregate purchase price of the planned acquisition is estimated to be approximately \$4.2 billion, due at closing, and is expected to be funded with existing cash, new debt, and 25 million newly issued shares of our common stock. The Purchase Agreement contains certain termination rights for both us and Hitachi, including the right to terminate the Purchase Agreement if the planned acquisition has not closed by

March 7, 2012. The Purchase Agreement does not contain a termination right for the benefit of WD in the event we cannot obtain financing for the transaction. If the planned acquisition has not closed by March 7, 2012 due to the failure to receive any required antitrust or competition authority's consent, approval or clearance or any action by certain governmental entities to prevent the planned acquisition for antitrust or competition reasons, we will, concurrently with such termination, be required to pay Hitachi a fee of \$250 million in cash.

## **Table of Contents**

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

The planned acquisition of HGST is subject to several closing conditions, including the receipt of antitrust approvals or the expiration of applicable waiting periods in the United States, the European Union, the People's Republic of China, Japan, Korea and Mexico. In certain jurisdictions, we have received requests for additional information and are engaged in more in-depth reviews of the pending acquisition. We have proposed a remedy to the European Commission intended to address the preliminary assessment of competitive effects of the transaction set out by the European Commission. This proposal remains under consideration by the European Union and there is no assurance that the proposal will be accepted or, if accepted, can be successfully implemented. We are cooperating fully with each of the regulatory authorities reviewing the proposed transaction. Subject to obtaining the required regulatory approvals or expiration of applicable waiting periods, we are targeting the transaction to close in our second quarter of fiscal 2012.

### **First Quarter Overview**

For the September quarter, we believe that overall hard drive industry shipments totaled approximately 176 million units, up 7% from the prior-year period and up 6% sequentially from the June quarter. We also believe that the industry growth in the September quarter compared to the June quarter was muted by historical standards as a result of global economic uncertainties, the slow growth being experienced in many mature markets and the PC industry's continued shift to a higher rate of sea freight versus more expensive air freight, which has time-shifted typical seasonal linearity.

**Table of Contents**

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

|                          | <b>Three Months Ended</b> |        |                         |        |
|--------------------------|---------------------------|--------|-------------------------|--------|
|                          | <b>Sept. 30,<br/>2011</b> |        | <b>Oct. 1,<br/>2010</b> |        |
| Net revenue              | \$ 2,694                  | 100.0% | \$ 2,396                | 100.0% |
| Gross margin             | 541                       | 20.1   | 437                     | 18.2   |
| Total operating expenses | 282                       | 10.5   | 226                     | 9.4    |
| Operating income         | 259                       | 9.6    | 211                     | 8.8    |
| Net income               | 239                       | 8.9    | 197                     | 8.2    |

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

Consolidated net revenue totaled \$2.7 billion.

36% of our hard drive revenue was derived from non-compute and enterprise markets, which include CE products, enterprise applications, and WD®-branded products, as compared to 37% in the prior-year period.

Hard drive unit shipments increased by 14% over the prior-year period to 57.8 million units.

Gross margin increased to 20.1%, compared to 18.2% for the prior-year period.

Operating income, including \$11 million of acquisition-related expenses and \$7 million of accruals for unrelated litigation contingencies, was \$259 million, an increase of \$48 million from the prior-year period.

We generated \$352 million in cash flow from operations in the first quarter of 2012, and we finished the quarter with \$3.7 billion in cash and cash equivalents.

**Results of Operations****Net Revenue**

|                                                                    | <b>Three Months Ended</b> |                         |                          |
|--------------------------------------------------------------------|---------------------------|-------------------------|--------------------------|
| <b>(in millions, except percentages and average selling price)</b> | <b>Sept. 30,<br/>2011</b> | <b>Oct. 1,<br/>2010</b> | <b>Percentage Change</b> |
| Net revenue                                                        | \$ 2,694                  | \$ 2,396                | 12%                      |
| Average selling price (per unit)*                                  | \$ 46                     | \$ 46                   |                          |
| <b>Revenues by Geography (%)</b>                                   |                           |                         |                          |
| Americas                                                           | 19%                       | 23%                     |                          |
| Europe, Middle East and Africa                                     | 22                        | 23                      |                          |
| Asia                                                               | 59                        | 54                      |                          |
| <b>Revenues by Channel (%)</b>                                     |                           |                         |                          |
| OEM                                                                | 53%                       | 50%                     |                          |
| Distributors                                                       | 29                        | 32                      |                          |
| Retailers                                                          | 18                        | 18                      |                          |
| <b>Unit Shipments*</b>                                             |                           |                         |                          |
| Compute                                                            | 41.2                      | 37.5                    |                          |
| Non-compute                                                        | 14.2                      | 10.9                    |                          |
| Enterprise                                                         | 2.4                       | 2.3                     |                          |
| Total Units Shipped                                                | 57.8                      | 50.7                    | 14%                      |

\* Based on sales of hard drive units only.

For the quarter ended September 30, 2011, net revenue was \$2.7 billion, an increase of 12% from the prior-year period. Total hard drive shipments increased to 57.8 million units for the quarter ended September 30, 2011 as

compared to 50.7 million units in the prior-year period. The increase in net revenue resulted primarily from an increase in hard drive shipments. For the three months ended September 30, 2011 and October 1, 2010, our average selling price ( ASP ) remained at \$46.

Changes in revenue by geography and channel generally reflect normal fluctuations in market demand and competitive dynamics. For the three months ended September 30, 2011, no single customer accounted for 10%, or more, of our revenue.

**Table of Contents**

In accordance with standard industry practice, we have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. For the three months ended September 30, 2011, these programs represented 9% of gross revenues compared to 11% in the comparative prior-year period. These amounts generally vary according to several factors, including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product.

***Gross Margin***

|                                          | <b>Three Months Ended</b> |                     | <b>Percentage Change</b> |
|------------------------------------------|---------------------------|---------------------|--------------------------|
|                                          | <b>Sept. 30, 2011</b>     | <b>Oct. 1, 2010</b> |                          |
| <b>(in millions, except percentages)</b> |                           |                     |                          |
| Net revenue                              | \$ 2,694                  | \$ 2,396            | 12%                      |
| Gross margin                             | 541                       | 437                 | 24%                      |
| Gross margin %                           | 20.1%                     | 18.2%               |                          |

For the three months ended September 30, 2011, gross margin as a percentage of revenue increased to 20.1% as compared to 18.2% for the prior-year period. This increase was primarily a result of an improved product mix.

***Operating Expenses***

|                                          | <b>Three Months Ended</b> |                     | <b>Percentage Change</b> |
|------------------------------------------|---------------------------|---------------------|--------------------------|
|                                          | <b>Sept. 30, 2011</b>     | <b>Oct. 1, 2010</b> |                          |
| <b>(in millions, except percentages)</b> |                           |                     |                          |
| R&D expense                              | \$ 193                    | \$ 167              | 16%                      |
| SG&A expense                             | 89                        | 59                  | 51%                      |
| Total operating expenses                 | \$ 282                    | \$ 226              |                          |

Research and development ( R&D ) expense was \$193 million for the three months ended September 30, 2011, an increase of \$26 million over the prior-year period. As a percentage of net revenue, R&D expense increased to 7.2% in the three months ended September 30, 2011, compared to 7.0% in the prior-year period. The increase was primarily due to increased investments in new product and technology development.

Selling, general and administrative ( SG&A ) expense was \$89 million for the three months ended September 30, 2011, an increase of \$30 million over the prior-year period. SG&A expense as a percentage of net revenue increased to 3.3% in the three months ended September 30, 2011, compared to 2.5% in the prior-year period. The increase was primarily due to \$11 million of acquisition-related expenses and \$7 million of accruals for unrelated litigation contingencies, with the remainder of the increase related to the expansion of sales and marketing to support new products and growing markets.

***Other Income (Expense)***

Interest income for the three months ended September 30, 2011 was \$3 million, an increase of \$1 million compared to the prior-year period. The increase was primarily due to higher average daily invested cash balances for the periods. Interest and other expense for the three months ended September 30, 2011 increased by \$2 million as compared to the prior-year period, primarily due to \$3 million of debt commitment fees related to the planned acquisition of HGST, offset by a \$1 million decrease in our term loan interest expense due to a lower principal balance.

***Income Tax Provision***

Our income tax provision for the three months ended September 30, 2011 was \$19 million as compared to \$14 million in the prior-year period. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, Singapore and Thailand that expire at various dates through 2023 and the current year generation of income tax credits.



**Table of Contents**

In the three months ended September 30, 2011, we recorded a net decrease of \$14 million in our liability for unrecognized tax benefits. The decrease is due primarily to the resolution of the United States Internal Revenue Service ( IRS ) audit of Komag, Incorporated ( Komag ), which we acquired on September 5, 2007. As of September 30, 2011, we had a recorded liability for unrecognized tax benefits of approximately \$231 million. Interest and penalties recognized on such amounts were not material.

The IRS has completed its field examination of the federal income tax returns for fiscal years 2006 and 2007 for the Company and calendar years 2005 and 2006 for Komag. In September 2011, we received a final Revenue Agent Report ( RAR ) and Closing Agreement with respect to the years under examination for Komag. This agreement resulted in an immaterial benefit to our income tax provision. We have also received RARs from the IRS that seek adjustments to income before income taxes of approximately \$970 million in connection with unresolved issues related primarily to transfer pricing and certain other intercompany transactions. We disagree with the proposed adjustments. In May 2011, we filed a protest with the IRS Appeals Office regarding the proposed adjustments.

We believe that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in our tax audits are resolved in a manner not consistent with management's expectations, we could be required to adjust our provision for income taxes in the period such resolution occurs. As of September 30, 2011, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of our unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of our uncertain tax positions.

**Liquidity and Capital Resources**

We ended the first quarter of fiscal 2012 with total cash and cash equivalents of \$3.7 billion. The following table summarizes our statements of cash flows (in millions):

|                                           | <b>Three Months Ended</b> |                         |
|-------------------------------------------|---------------------------|-------------------------|
|                                           | <b>Sept. 30,<br/>2011</b> | <b>Oct. 1,<br/>2010</b> |
| Net cash flow provided by (used in):      |                           |                         |
| Operating activities                      | \$ 352                    | \$ 390                  |
| Investing activities                      | (134)                     | (200)                   |
| Financing activities                      | (33)                      | (66)                    |
| Net increase in cash and cash equivalents | \$ 185                    | \$ 124                  |

Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing return through the full investment of available funds. We expect that our cash position will be adversely impacted by the suspension of our operations in Thailand and expenditures related to the recovery from the flooding of our Thailand facilities. Specifically, we expect our cash flow for the quarter ending December 30, 2011, and possibly beyond, to be negative. We expect to incur significant unusual charges and expenses related to the flooding and some of these will be cash charges and expenses. We further anticipate that we will need to repair and replace equipment that has been submerged as a result of the flooding, and our capital expenditures to do so are expected to be significantly in excess of our business model range of between 7 and 8 percent of revenue. Notwithstanding the foregoing, we believe our current cash, cash equivalents and cash generated from operations will be sufficient to meet our working capital and capital expenditure needs for the next 12 months as well as to pay the portion of the purchase price for our planned acquisition of HGST that will be funded with existing cash. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

We had cash and cash equivalents of \$3.7 billion at September 30, 2011 and \$3.5 billion at July 1, 2011, of which \$3.0 billion at September 30, 2011 and July 1, 2011 was held outside of the United States. Substantially all of the amounts held outside of the United States are intended to be indefinitely reinvested in foreign operations. We are

assessing the impact the Thailand floods will have on our U.S. cash flows. In the event funds from foreign operations are needed in the United States, any repatriation could result in the accrual and payment of additional U.S. income tax.

**Table of Contents*****Operating Activities***

Net cash provided by operating activities during the three months ended September 30, 2011 was \$352 million as compared to \$390 million during the three months ended October 1, 2010. Cash flow from operating activities consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash used to fund working capital changes was \$71 million for the three months ended September 30, 2011 as compared to \$24 million provided by working capital changes for the prior-year period.

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

|                           | <b>Three Months Ended</b> |                         |
|---------------------------|---------------------------|-------------------------|
|                           | <b>Sept. 30,<br/>2011</b> | <b>Oct. 1,<br/>2010</b> |
| Days sales outstanding    | <b>46</b>                 | 50                      |
| Days in inventory         | <b>27</b>                 | 26                      |
| Days payables outstanding | <b>(72)</b>               | (79)                    |
| Cash conversion cycle     | <b>1</b>                  | (3)                     |

For the three months ended September 30, 2011, our days sales outstanding ( DSOs ) decreased by 4 days, days in inventory ( DIOs ) increased by 1 day, and days payable outstanding ( DPOs ) decreased by 7 days as compared to the prior-year period. Changes in average DSOs are generally related to linearity of shipments throughout the quarter. The increase in DIOs was primarily due to an increase in our finished goods inventory as a result of increasing our utilization of ocean shipments which has longer lead times compared to air freight. Changes in DPOs are generally related to production volume and the timing of purchases during the period. From time to time, we modify the timing of payments to our vendors. We make modifications primarily to manage our vendor relationships and to manage our cash flows, including our cash balances. Generally, we make the payment modifications through negotiations with our vendors or by granting to, or receiving from, our vendors payment term accommodations.

***Investing Activities***

Cash used in investing activities for the three months ended September 30, 2011 was \$134 million as compared to \$200 million for the prior-year period and consisted of capital expenditures.

Our cash equivalents are invested in highly liquid money market funds that are invested in U.S. Treasury securities, U.S. Treasury bills and U.S. Government agency securities. We also have \$15 million of auction-rate securities, which are classified as available-for-sale securities.

***Financing Activities***

Net cash used in financing activities for the three months ended September 30, 2011 was \$33 million as compared to \$66 million in the prior-year period. Net cash used in financing activities for the three months ended September 30, 2011 consisted of \$31 million used to repay long-term debt and a net \$2 million related to employee stock plans. Net cash used in financing activities for the three months ended October 1, 2010 consisted of \$50 million used to repurchase shares of our common stock and \$25 million used to repay long-term debt, partially offset by a net \$9 million related to employee stock plans.

***Off-Balance Sheet Arrangements***

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



## **Table of Contents**

### ***Contractual Obligations and Commitments***

**Long-Term Debt** In February 2008, WDTI, entered into a five-year credit agreement that provided for a \$500 million term loan facility. As of September 30, 2011, the remaining balance of the term loan facility was \$263 million, which requires principal payments totaling \$113 million through the remainder of 2012 and \$150 million in 2013. See Part I, Item 1, Note 4 in the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

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

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

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

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

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

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



## **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, or from intellectual property infringement claims made by third parties. In addition, we have entered into indemnification agreements with our directors and certain of our officers that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We maintain director and officer insurance, which may cover certain liabilities arising from our obligation to indemnify our directors and officers in certain circumstances.

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

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

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

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

### **Critical Accounting Policies and Estimates**

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with U.S. GAAP. The preparation of the financial statements requires the use of judgments and estimates that affect the reported amounts of revenues, expenses, assets, liabilities and shareholders' equity. We have adopted accounting policies and practices that are generally accepted in the industry in which we operate. We believe the following are our most critical accounting policies that affect significant areas and involve judgment and estimates made by us. If these estimates differ significantly from actual results, the impact to the consolidated financial statements may be material.

### **Revenue and Accounts Receivable**

In accordance with standard industry practice, we provide distributors and retailers (collectively referred to as resellers) with limited price protection for inventories held by resellers at the time of published list price reductions, and we provide resellers and OEMs with other sales incentive programs. At the time we recognize revenue to resellers and OEMs, we record a reduction of revenue for estimated price protection until the resellers sell such inventory to their customers and we also record a reduction of revenue for the other programs in effect. We base these adjustments on several factors including anticipated price decreases during the reseller holding period, resellers' sell-through and inventory levels, estimated amounts to be reimbursed to qualifying customers, historical pricing information and customer claim processing. If customer demand for hard drives or market conditions differs from our expectations, our operating results could be materially affected. 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. Since the first quarter of fiscal 2011, total sales incentive and marketing programs have ranged from 9% to 12% of gross revenues per quarter. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue from the

current range. Adjustments to revenues due to changes in accruals for these programs related to revenues reported in prior periods have averaged 0.2% of quarterly gross revenue since the first quarter of fiscal 2011. Customer sales incentive and marketing programs are recorded as a reduction of revenue.

## **Table of Contents**

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

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

### ***Warranty***

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

### ***Inventory***

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

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

**Table of Contents*****Litigation and Other Contingencies***

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

***Income Taxes***

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

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

***Stock-based Compensation***

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

***Recent Accounting Pronouncements***

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operations and financial condition, refer to Part I, Item I, Note 11 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated by reference in response to this item.

**Table of Contents****Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Disclosure About Foreign Currency Risk**

Although the majority of our transactions are in U.S. dollars, some transactions are based in various foreign currencies. We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, revenue, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on our results of operations. The contract maturity dates do not exceed 12 months. We do not purchase foreign exchange contracts for trading or speculative purposes. Currently, we focus on hedging our foreign currency risk related to the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling. Thai Baht contracts are designated as either cash flow or fair value hedges. Malaysian Ringgit contracts are designated as cash flow hedges. Euro and British Pound Sterling contracts are designated as fair value hedges. See Part I, Item 1, Note 8 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. As of September 30, 2011, we had outstanding the following purchased foreign exchange contracts (in millions, except weighted average contract rate):

|                                          | <b>Contract<br/>Amount</b> | <b>Weighted<br/>Average<br/>Contract Rate*</b> | <b>Unrealized<br/>Loss</b> |
|------------------------------------------|----------------------------|------------------------------------------------|----------------------------|
| <b>Foreign exchange contracts:</b>       |                            |                                                |                            |
| Thai Baht cash flow hedges               | \$ 1,070                   | 30.78                                          | \$ 16                      |
| Thai Baht fair value hedges              | \$ 108                     | 31.16                                          |                            |
| Malaysian Ringgit cash flow hedges       | \$ 320                     | 3.09                                           | \$ 8                       |
| Euro fair value hedges                   | \$ 12                      | 0.75                                           |                            |
| British Pound Sterling fair value hedges | \$ 7                       | 0.64                                           |                            |

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

During the three months ended September 30, 2011, total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements. Due to the suspension of production in our Thailand facilities as a result of the flooding in Thailand, we expect to recognize unrealized gains or losses in earnings in the December quarter for any foreign exchange contracts that exceed our current foreign currency requirements.

**Disclosure About Other Market Risks*****Variable Interest Rate Risk***

Borrowings under the term loan facility bear interest at a rate equal to, at the option of WDTI, either (a) a LIBOR rate determined by reference to the cost of funds for Eurodollar deposits for the interest period relevant to such borrowing, adjusted for certain additional costs (the Eurocurrency Rate) or (b) a base rate determined by reference to the higher of (i) the federal funds rate plus 0.50% and (ii) the prime rate as announced by JPMorgan Chase Bank, N.A. (the Base Rate); in each case plus an applicable margin. The applicable margin for borrowings under the term loan facility ranges from 1.25% to 1.50% with respect to borrowings at the Eurocurrency Rate and 0.0% to 0.125% with respect to borrowings at the Base Rate. The applicable margins for borrowings under the term loan facility are determined based upon a leverage ratio of the Company and its subsidiaries calculated on a consolidated basis. If the federal funds rate, prime rate or LIBOR rate increase, our interest payments could also increase. A one percent increase in the variable rate of interest on the term loan facility would increase interest expense by approximately \$3 million annually.

**Item 4. CONTROLS AND PROCEDURES**

As required by SEC Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period

covered by this Quarterly Report on Form 10-Q.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective. There has been no change in our internal control over financial reporting during the first fiscal quarter ended September 30, 2011, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

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

**Item 1A. RISK FACTORS**

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

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

The recent severe flooding in Thailand, and the suspension of production in all of our Thailand manufacturing facilities, will adversely affect our near-term business, results of operations and financial condition. Material risks and uncertainties we face as a result of flooding in Thailand include the following:

*Recommencement of Operations.* Our ability and the time required to recommence operations following the flooding of our Thailand facilities will be affected by the time necessary for the flood waters to recede, the extent of damage to our facilities and equipment caused by the floods, the time required to repair or replace damaged equipment and complete customer qualification of any replaced equipment and our ability to access freight lanes and transportation routes. At this time, we are not able to estimate when we will recommence full operations. While we expect to transfer a portion of our production capacity to our Malaysian manufacturing facility, the extent of additional capacity we can achieve from this facility may be limited by the space available there and our ability to extract and transfer equipment to this facility and reconfigure it to support the production of our full array of products. Until we are able to recommence production at normal capacity, our costs will be impacted negatively by significant under-absorption of our assets and infrastructure, our ability to assemble and supply hard drives will be constrained and our business and results of operations will be adversely affected.

*Availability of Components.* Our flooded facilities in Thailand include our magnetic head slider fabrication facilities, which supplies a substantial majority of our magnetic head requirements, as well as our assembly facilities for hard drives, head gimbal assemblies ( HGAs ) and head stack assemblies ( HSAs ). Due to the flooding and the suspension of our operations in Thailand, the availability of sliders for our hard drives has been significantly constrained. In addition, we are also experiencing other shortages of components from vendors located in several Thailand industrial parks that have already been inundated by the floods or have been affected by protective plant shut downs. We are engaging in efforts to increase our slider production in a third-party slider fabrication facility located in the Philippines, although we will be limited in our ability to source our slider needs from that facility. We are also working with our suppliers to understand the extent of their capacity constraints, if any, and to find alternative sources for our component materials, including sliders. Some of these suppliers may fail to remain in business as a result of liquidity issues caused by the flooding. We cannot assure you that we will be able to successfully, or on a timely basis, find alternative sources of quality component materials at acceptable prices or at all. In addition, due to supply constraints, the cost of certain component materials is expected to increase, which may further adversely affect our results of operations.

**Table of Contents**

*Recovery and Related Charges and Expenses.* We expect to incur significant charges and expenses related to the recovery from the flooding of our Thailand facilities and its impact on our operations, including items such as fixed asset impairments, inventory write-downs, charges related to cancellation of purchase orders for excess materials, charges for restoration and recovery work and foreign currency losses to settle forward exchange contracts that exceed current requirements. The amount of these charges and expenses cannot currently be estimated and is dependent on a number of factors, including our ability to extract water from our facilities, the extent of damage to our facilities, existing inventories and equipment caused by the flooding, the time and effort required to restore or replace damaged equipment, our ability to extract existing equipment from our Thailand facilities and successfully transfer such equipment to alternative locations and bring it up to operation and the time required to recommence production at normal capacity. We expect to incur a significant amount of these charges and expenses during our second fiscal quarter ending December 30, 2011; however, the ultimate timing of the incurrence of these charges and expenses is dependent on the time required to complete our recovery efforts and recommence production at normal capacity.

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

*Insurance.* We maintain insurance coverage that provides for reimbursement from losses resulting from flood damage. The magnitude of the flood damage we will incur is dependent on a number of factors, including those described above, and currently cannot be estimated; however, we expect that our flood damage losses will exceed our policy limit. We also maintain insurance for business interruption losses, and we are currently working with our insurance carrier to determine the amounts which may be recoverable under this policy. We cannot assure you that we will be covered for the business interruption losses we incur in connection with the flooding of our Thailand facilities, and it is reasonably possible that the final losses that we incur in connection with the flood damage and our business interruption will significantly exceed the limits of our insurance policies. We also cannot estimate the timing of the proceeds we will ultimately receive under our insurance policies, and there may be a substantial delay between our incurrence of losses and our recovery under our insurance policies.

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

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

## **Table of Contents**

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

*Required Government Approvals.* Completion of our planned acquisition of HGST is conditioned upon, among other things, obtaining required governmental approvals. While certain governmental approvals have been obtained, the transaction remains conditioned upon the receipt of approval from the United States, the European Union, the People's Republic of China, Japan, Korea and Mexico. There is no assurance that we will obtain such approvals or, if obtained, the timing of the approvals. We agreed to take any and all actions to obtain the requisite governmental approvals in specified jurisdictions unless such action would reasonably be expected to materially impair the business operations of the combined company absent such imposed condition. For example, we have proposed a remedy to the European Commission intended to address the preliminary assessment of competitive effects of the transaction set out by the European Commission. This proposal remains under consideration by the European Union and there is no assurance that the proposal will be accepted or, if accepted, can be successfully implemented. There also can be no assurance that conditions or changes will not be imposed and any such conditions or changes could have the effect of jeopardizing or delaying completion of the planned acquisition or reducing the anticipated benefits of the planned acquisition. If we agree to any material conditions in order to obtain any approvals required to complete the planned acquisition, the business and results of operations of the combined company may be adversely affected.

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

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

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

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

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

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

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

- difficulties entering new markets or manufacturing in new geographies where we have no or limited direct prior experience;
- difficulties in coordinating geographically separate organizations, which may be subject to additional complications resulting from being geographically distant from our other operations;
- failure to identify or assess the magnitude of certain liabilities we are assuming in the acquisition, which could result in unexpected litigation or regulatory exposure, unfavorable accounting treatment, unexpected

increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, operating results or financial condition;

## **Table of Contents**

failure to realize the anticipated increase in our revenues due to the acquisition if customers adjust their purchasing decisions and allocate more market share to our competitors;  
 difficulties or delays in incorporating acquired technologies or products with our existing product lines and maintaining uniform standards, controls, processes and policies;  
 failure to successfully manage relationships with our combined supplier and customer base;  
 the impact of the March 2011 earthquakes, tsunami and related events in Japan on HGST's business, component supply or Japan facilities;  
 the impact of the recent flooding in Thailand on HGST's business, component supply or Thailand facilities;  
 difficulties integrating and harmonizing business systems;  
 difficulties in modifying HGST's existing accounting and internal control systems to comply with Section 404 of the Sarbanes-Oxley Act of 2002, to which HGST is not currently subject, which could adversely impact the effectiveness of internal control over financial reporting for the combined company;  
 and  
 the loss of key employees.

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

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

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

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

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

## Table of Contents

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

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

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

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

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

*Impairment Charges.* Negative or uncertain global economic conditions could result in circumstances, such as a sustained decline in our stock price and market capitalization or a decrease in our forecasted cash flows such that they are insufficient, indicating that the carrying value of our long-lived assets or goodwill may be impaired. If we are required to record a significant charge to earnings in our consolidated financial statements because an impairment of our long-lived assets or goodwill is determined, our results of operations will be adversely affected.

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

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



## 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 is based in part on these forecasts. Accurately forecasting demand has become increasingly difficult for us, our customers and our suppliers in light of the volatility in global economic conditions and a recent shift from air to ocean freight in response to increased transportation costs, which requires additional lead times. In addition, because hard drives are designed to be largely interchangeable with competitors products, our demand forecasts may be impacted significantly by the strategic actions of our competitors. As forecasting demand becomes more difficult, the risk that our forecasts are not in line with demand increases. If our forecasts exceed actual market demand, then we could experience periods of product oversupply and price decreases, which could impact our financial performance. If market demand increases significantly beyond our forecasts or beyond our ability to add manufacturing capacity, then we may not be able to satisfy customer product needs, which could result in a loss of market share if our competitors are able to meet customer demands.

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

Sales of computer systems, storage subsystems and consumer electronics tend to be seasonal and cyclical, and therefore we expect to continue to experience seasonality and cyclical in our business as we respond to variations in our customers demand for hard drives. In the desktop, mobile, CE and retail markets, seasonality is partially attributable to the increase in sales of PCs and CE devices during the back-to-school and winter holiday seasons. As such, we anticipate that sales of our products will continue to be lower during the second half of our fiscal year. However, recently we have experienced a muting of typical seasonal demand patterns partially driven by the increased adoption of sea freight in the PC supply chain, which requires additional lead times, and the increased importance of emerging markets, which may have different seasonal demand patterns. In the enterprise market our sales are seasonal because of the capital budgeting and purchasing cycles of our end users. However, changes in seasonal and cyclical patterns have made it, and could continue to make it, more difficult for us to forecast demand, especially in the current macroeconomic environment. Changes in the product or channel mix of our business can also impact seasonal and cyclical patterns, adding complexity in forecasting demand. Seasonality and cyclical also may lead to higher volatility in our stock price. It is difficult for us to evaluate the degree to which seasonality and cyclical may affect our stock price or business in future periods because of the rate and unpredictability of product transitions and new product introductions and macroeconomic conditions.

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

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

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

*Cloud Computing.* Consumers traditionally have stored their data on their PC, often supplemented with personal external storage devices. Most businesses also include similar local storage as a primary or secondary storage location. This storage is typically provided by hard disk drives. Recently, cloud computing has emerged whereby applications and data are hosted, accessed and processed through a third-party provider over a broadband Internet connection, potentially reducing or eliminating the need for, among other things, significant storage inside the accessing computer. This trend could cause the market for disk drives in computers to decline over time, which could harm our business to the extent this decline is not offset by the sale of our products to customers who provide cloud computing services.



## **Table of Contents**

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

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

Selling branded products is an important part of our business, and as our branded products revenue increases as a portion of our overall revenue, our success in the retail market becomes increasingly important to our operating results. Our success in the retail market depends in large part on our ability to maintain our brand image and corporate reputation and to expand into and gain market acceptance of our products in multiple channels. Adverse publicity, whether or not justified, or allegations of product quality issues, even if false or unfounded, could tarnish our reputation and cause our customers to choose products offered by our competitors. In addition, the proliferation of new methods of mass communication facilitated by the Internet makes it easier for false or unfounded allegations to adversely affect our brand image and reputation. If customers no longer maintain a preference for WD®-brand products, our operating results may be adversely affected.

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

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

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

During the quarter ended September 30, 2011, a large percentage of our revenue, 49%, came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, which often results in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship, our operating results would likely be harmed.

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

## **Table of Contents**

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

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

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

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

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

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

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

negatively impacting our operating results.

## Table of Contents

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

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

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

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

*Further industry consolidation could provide competitive advantages to our competitors.*

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

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

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

*If we fail to qualify our products with our customers or if product life cycles lengthen, it may have a significant adverse impact on our sales and margins.*

We regularly engage in new product qualification with our customers. Once a product is accepted for qualification testing, failures or delays in the qualification process can result in delayed or reduced product sales, reduced product margins caused by having to continue to offer a more costly current generation product, or lost sales to that customer until the next generation of products is introduced. The effect of missing a product qualification opportunity is magnified by the limited number of high volume OEMs, which continue to consolidate their share of the storage markets. Likewise, if product life cycles lengthen, we may have a significantly longer period to wait before we have an opportunity to qualify a new product with a customer, which could reduce our profits because we expect declining gross margins on our current generation products as a result of competitive pressures.

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

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

defective product. Moreover, there is a risk that product defects may trigger an epidemic failure clause in a customer agreement. If an epidemic failure occurs, we may be required to replace or refund the value of the defective product and to cover certain other costs associated with the consequences of the epidemic failure. In addition, a product recall or epidemic failure may damage our reputation or customer relationships, and may cause us to lose market share with our customers, including our OEM and ODM customers.

**Table of Contents**

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

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

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

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

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

- an unwillingness of a supplier to supply such components or equipment to us;
- consolidation of key suppliers;
- failure of a key supplier's business process;
- a key supplier's or sub-supplier's inability to access credit necessary to operate its business; or
- failure of a key supplier to remain in business, to remain an independent merchant supplier, or to adjust to market conditions.

## **Table of Contents**

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

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

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

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

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

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

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

If product life cycles lengthen, we may need to develop new technologies or programs to reduce our costs on any particular product to maintain competitive pricing for that product. If product life cycles shorten, it may result in an increase in our overall expenses and a decrease in our gross margins, both of which could adversely affect our

operating results. In addition, shortening of product life cycles also makes it more difficult to recover the cost of product development before the product becomes obsolete. Our failure to recover the cost of product development in the future could adversely affect our operating results.

**Table of Contents**

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

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

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

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

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

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

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

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

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

**Table of Contents**

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

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

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

As a result of our cost structure and strategy of vertical integration, we conduct our manufacturing operations at large, high volume, purpose-built facilities. For example, a substantial majority of our overall requirement for heads is satisfied by wafers fabricated in our Fremont, California facility. Also, we manufacture the majority of our substrates for magnetic media in our Johor, Malaysia facility, and we finish a majority of our magnetic media in our facilities in Penang, Malaysia and Tuas, Singapore. A majority of our high volume hard drive manufacturing operations are conducted in our two facilities in Thailand, with the balance conducted in our Kuala Lumpur, Malaysia facility and the facilities of our contract manufacturers in Asia, Brazil, Europe and the United States. As part of our planned acquisition of HGST, we will also acquire manufacturing facilities located in Japan, China and the Philippines (as well as additional factories in Singapore, Thailand and Malaysia). The manufacturing facilities of many of our customers, our suppliers and our customers' suppliers are also concentrated in certain geographic locations in Asia and elsewhere. A localized health risk affecting our employees at these facilities or the staff of our or our customers' other suppliers, such as the spread of the Influenza A (H1N1) or a new pandemic influenza, could impair the total volume of hard drives that we are able to manufacture and/or sell, which would result in substantial harm to our operating results. Similarly, a fire, flood, earthquake, tsunami or other disaster, condition or event such as political instability, civil unrest or a power outage that adversely affects any of these facilities, including access to or from these facilities by employees or logistics operations, would significantly affect our ability to manufacture and/or sell hard drives, which would result in a substantial loss of sales and revenue and a substantial harm to our operating results.

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

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

- obtaining requisite governmental permits and approvals;
- currency exchange rate fluctuations or restrictions;
- political instability and civil unrest;
- limited transportation availability, delays, and extended time required for shipping, which risks may be compounded in periods of price declines;

- higher freight rates;
- labor challenges;
- trade restrictions or higher tariffs;

copyright levies or similar fees or taxes imposed in European and other countries;  
exchange, currency and tax controls and reallocations;

## **Table of Contents**

increasing labor and overhead costs; and

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

*Terrorist attacks may adversely affect our business and operating results.*

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

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

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

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

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

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

As part of our growth strategy, we may pursue acquisitions of, investment opportunities in or other significant transactions with companies that are complementary to our business. In order to pursue this strategy successfully, we must identify attractive acquisition or investment opportunities, successfully complete the transaction, some of which may be large and complex, and manage post-closing issues such as integration of the acquired company or employees. We may not be able to identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. Even if we identify and complete suitable corporate transactions, we may not be able to successfully address any integration challenges in a timely manner, or at all. If we fail to successfully integrate an acquisition, we may not realize all or any of the anticipated benefits of the acquisition, and our future results of operations could be adversely affected.

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

Our success depends upon the continued contributions of our key staff and skilled employees, many of whom would be extremely difficult to replace. Global competition for skilled employees in the data storage industry is intense and, as we attempt to move to a position of technology leadership in the storage industry, our business success becomes increasingly dependent on our ability to retain our key staff and skilled employees as well as attract, integrate and retain new skilled employees. Volatility or lack of positive performance in our stock price and the overall markets may adversely affect our ability to retain key staff or skilled employees who have received equity compensation. Additionally, because a substantial portion of our key employees' compensation is placed at risk and linked to the performance of our business, when our operating results are negatively impacted by global economic conditions, we are at a competitive disadvantage for retaining and hiring key staff and skilled employees versus other companies that pay a relatively higher fixed salary. If we are unable to retain our existing key staff or skilled employees, or hire and integrate new key staff or skilled employees, or if we fail to implement succession plans for our key staff, our operating results would likely be harmed.

## **Table of Contents**

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

The data storage industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may result in adverse rulings or decisions. We may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on our business, financial condition or operating results.

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

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

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

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

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

## **Table of Contents**

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

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

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

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

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

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

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

We have attempted to manage the impact of foreign currency exchange rate changes by, among other things, entering into short-term, foreign exchange contracts. However, these contracts do not cover our full exposure and can be canceled by the counterparty if currency controls are put in place. Currently, we hedge the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling with foreign exchange contracts.

## Table of Contents

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

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

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

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

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

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

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

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

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

**Table of Contents**

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

*The market price of our common stock is volatile.*

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

actual or anticipated fluctuations in our operating results, including those resulting from the seasonality of our business;  
announcements of technological innovations by us or our competitors which may decrease the volume and profitability of sales of our existing products and increase the risk of inventory obsolescence;  
new products introduced by us or our competitors;  
periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures or industry consolidation;  
developments with respect to patents or proprietary rights;  
conditions and trends in the hard drive, computer, data and content management, storage and communication industries;  
contraction in our operating results or growth rates that are lower than our previous high growth-rate periods;  
changes in financial estimates by securities analysts relating specifically to us or the hard drive industry in general;  
macroeconomic conditions that affect the market generally; and  
uncertainties regarding our planned acquisition of HGST.

In addition, general economic conditions may cause the stock market to experience extreme price and volume fluctuations from time to time that particularly affect the stock prices of many high technology companies. These fluctuations often appear to be unrelated to the operating performance of the companies.

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

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

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

**Table of Contents**

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

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

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

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

**Table of Contents****Item 6. EXHIBITS**

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

| <b>Exhibit No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1                | Stock Purchase Agreement, dated March 7, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on May 2, 2011)                   |
| 2.2                | First Amendment to Stock Purchase Agreement, dated May 21, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd. and Viviti Technologies Ltd. (Incorporated by reference to the Company's Annual Report on Form 10-K (File No. 1-08703), as filed with the Securities and Exchange Commission on August 12, 2011) |
| 3.1                | Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on February 8, 2006)                                                                      |
| 3.2                | Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 5, 2007 (Incorporated by reference to the Company's Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on November 8, 2007)                                                                      |
| 10.1               | Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors *                                                                                                                                                                                                                                     |
| 10.2               | Form of Notice of Grant of Stock Option and Option Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan *                                                                                                                                                                             |
| 10.3               | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan *                                                                                                                                                                    |
| 10.4               | Form of Notice of Grant of Long-Term Cash Award and Long-Term Cash Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan *                                                                                                                                                       |
| 10.5               | Form of Notice of Grant of Stock Option and Stock Option Agreement between Western Digital Corporation and John Coyne *                                                                                                                                                                                                                           |
| 10.6               | Form of Notice of Stock Units and Stock Unit Award Agreement between Western Digital Corporation and John Coyne *                                                                                                                                                                                                                                 |

|      |                                                                                                                                                   |
|------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.7 | Form of Notice of Long-Term Cash Award and Long-Term Cash Award Agreement between Western Digital Corporation and John Coyne *                    |
| 31.1 | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                            |
| 31.2 | Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                            |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

**Table of Contents**

**Exhibit No.      Description**

|         |                                                          |
|---------|----------------------------------------------------------|
| 101.INS | XBRL Instance Document**                                 |
| 101.SCH | XBRL Taxonomy Extension Schema Document**                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document**  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document**        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document** |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document**   |

Filed with this report.

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

\*\* Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.

**Table of Contents**

**SIGNATURES**

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

WESTERN DIGITAL CORPORATION  
Registrant

/s/ Wolfgang U. Nickl

Wolfgang U. Nickl  
Senior Vice President and Chief Financial Officer  
(Principal Financial Officer)

/s/ Joseph R. Carrillo

Joseph R. Carrillo  
Vice President and Chief Accounting Officer  
(Principal Accounting Officer)

Date: October 28, 2011

**Table of Contents****Item 6. EXHIBITS**

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

| <b>Exhibit No.</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1                | Stock Purchase Agreement, dated March 7, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd., and Viviti Technologies Ltd. (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on May 2, 2011)                   |
| 2.2                | First Amendment to Stock Purchase Agreement, dated May 21, 2011, among Western Digital Corporation, Western Digital Ireland, Ltd., Hitachi, Ltd. and Viviti Technologies Ltd. (Incorporated by reference to the Company's Annual Report on Form 10-K (File No. 1-08703), as filed with the Securities and Exchange Commission on August 12, 2011) |
| 3.1                | Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on February 8, 2006)                                                                      |
| 3.2                | Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 5, 2007 (Incorporated by reference to the Company's Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on November 8, 2007)                                                                      |
| 10.1               | Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors *                                                                                                                                                                                                                                     |
| 10.2               | Form of Notice of Grant of Stock Option and Option Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan *                                                                                                                                                                             |
| 10.3               | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan *                                                                                                                                                                    |
| 10.4               | Form of Notice of Grant of Long-Term Cash Award and Long-Term Cash Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan *                                                                                                                                                       |
| 10.5               | Form of Notice of Grant of Stock Option and Stock Option Agreement between Western Digital Corporation and John Coyne *                                                                                                                                                                                                                           |
| 10.6               | Form of Notice of Stock Units and Stock Unit Award Agreement between Western Digital Corporation and John Coyne *                                                                                                                                                                                                                                 |

|      |                                                                                                                                                   |
|------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.7 | Form of Notice of Long-Term Cash Award and Long-Term Cash Award Agreement between Western Digital Corporation and John Coyne *                    |
| 31.1 | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                            |
| 31.2 | Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                            |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

**Table of Contents**

**Exhibit No.      Description**

|         |                                                          |
|---------|----------------------------------------------------------|
| 101.INS | XBRL Instance Document**                                 |
| 101.SCH | XBRL Taxonomy Extension Schema Document**                |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document**  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document**        |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document** |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document**   |

Filed with this report.

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

\*\* Furnished herewith. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.