

**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 January 3, 2020

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®
WESTERN DIGITAL CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

33-0956711

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

5601 Great Oaks Parkway San Jose, California
(Address of principal executive offices)

95119
(Zip Code)

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

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

<u>Title of each class</u>	<u>Trading symbol(s)</u>	<u>Name of each exchange on which registered</u>
Common Stock, \$.01 Par Value Per Share	WDC	The Nasdaq Stock Market LLC (Nasdaq Global Select Market)

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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Emerging growth company

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

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

As of the close of business on February 4, 2020, 298,931,536 shares of common stock, par value \$0.01 per share, were outstanding.

WESTERN DIGITAL CORPORATION
INDEX

PAGE NO.

PART I. FINANCIAL INFORMATION

Item 1.	Financial Statements (unaudited)	
	Condensed Consolidated Balance Sheets — As of January 3, 2020 and June 28, 2019	5
	Condensed Consolidated Statements of Operations — Three and Six Months Ended January 3, 2020 and December 28, 2018	6
	Condensed Consolidated Statements of Comprehensive Income (Loss) — Three and Six Months Ended January 3, 2020 and December 28, 2018	7
	Condensed Consolidated Statements of Cash Flows — Six Months Ended January 3, 2020 and December 28, 2018	8
	Condensed Consolidated Statements of Shareholders' Equity — Six Months Ended January 3, 2020 and December 28, 2018	9
	Notes to Condensed Consolidated Financial Statements	11
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	48
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	58
Item 4.	Controls and Procedures	58

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	59
Item 1A.	Risk Factors	59
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	75
Item 3.	Defaults Upon Senior Securities	75
Item 4.	Mine Safety Disclosures	75
Item 5.	Other Information	75
Item 6.	Exhibits	75

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

WDC, a Delaware corporation, is the parent company of our data storage business. Our principal executive offices are located at 5601 Great Oaks Parkway, San Jose, California 95119. Our telephone number is (408) 717-6000.

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

FORWARD-LOOKING STATEMENTS

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

- *expectations regarding our Flash Ventures joint venture with Kioxia Corporation, the flash industry and our flash wafer output plans;*
- *expectations regarding pricing conditions for flash products;*
- *the exit from our Storage Systems business;*
- *expectations regarding our product development and technology plans;*
- *expectations regarding the outcome of legal proceedings in which we are involved;*
- *our quarterly cash dividend policy and share repurchase program;*
- *expectations regarding the repatriation of funds from our foreign operations;*
- *our beliefs regarding tax benefits and the timing of future payments, if any, relating to the unrecognized tax benefits, and the adequacy of our tax provisions;*
- *expectations regarding capital investments and sources of funding for those investments; and*
- *our beliefs regarding the sufficiency of our available liquidity to meet our working capital, debt and capital expenditure needs as well as our dividend plans.*

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

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

	January 3, 2020	June 28, 2019
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,137	\$ 3,455
Accounts receivable, net	1,791	1,204
Inventories	3,122	3,283
Other current assets	577	535
Total current assets	8,627	8,477
Property, plant and equipment, net	2,722	2,843
Notes receivable and investments in Flash Ventures	2,321	2,791
Goodwill	10,069	10,076
Other intangible assets, net	1,311	1,711
Other non-current assets	810	472
Total assets	\$ 25,860	\$ 26,370
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,736	\$ 1,567
Accounts payable to related parties	364	331
Accrued expenses	1,559	1,296
Accrued compensation	537	347
Current portion of long-term debt	286	276
Total current liabilities	4,482	3,817
Long-term debt	9,547	10,246
Other liabilities	2,452	2,340
Total liabilities	16,481	16,403
Commitments and contingencies (Notes 9, 10, 12 and 15)		
Shareholders' equity:		
Preferred stock, \$0.01 par value; authorized — 5 shares; issued and outstanding — none	—	—
Common stock, \$0.01 par value; authorized — 450 shares; issued — 312 shares; outstanding — 299 shares and 295 shares, respectively	3	3
Additional paid-in capital	3,731	3,851
Accumulated other comprehensive loss	(110)	(68)
Retained earnings	6,717	7,449
Treasury stock — common shares at cost; 13 shares and 17 shares, respectively	(962)	(1,268)
Total shareholders' equity	9,379	9,967
Total liabilities and shareholders' equity	\$ 25,860	\$ 26,370

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

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

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
Revenue, net	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261
Cost of revenue	3,299	3,189	6,581	6,553
Gross profit	935	1,044	1,693	2,708
Operating expenses:				
Research and development	578	539	1,152	1,115
Selling, general and administrative	298	309	603	665
Employee termination, asset impairment, and other charges	9	20	17	66
Total operating expenses	885	868	1,772	1,846
Operating income (loss)	50	176	(79)	862
Interest and other income (expense):				
Interest income	8	15	20	30
Interest expense	(105)	(118)	(227)	(234)
Other income, net	7	8	9	6
Total interest and other expense, net	(90)	(95)	(198)	(198)
Income (loss) before taxes	(40)	81	(277)	664
Income tax expense	99	568	138	640
Net income (loss)	\$ (139)	\$ (487)	\$ (415)	\$ 24
Income (loss) per common share				
Basic	\$ (0.47)	\$ (1.68)	\$ (1.40)	\$ 0.08
Diluted	\$ (0.47)	\$ (1.68)	\$ (1.40)	\$ 0.08
Weighted average shares outstanding:				
Basic	298	290	297	291
Diluted	298	290	297	296
Cash dividends declared per share	\$ 0.50	\$ 0.50	\$ 1.00	\$ 1.00

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

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

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
Net income (loss)	\$ (139)	\$ (487)	\$ (415)	\$ 24
Other comprehensive income (loss), before tax:				
Actuarial pension gain	2	1	3	1
Foreign currency translation adjustment	(15)	31	(10)	(6)
Net unrealized gain (loss) on derivative contracts and available-for-sale securities	(6)	7	(39)	6
Total other comprehensive income (loss), before tax	(19)	39	(46)	1
Income tax benefit (expense) related to items of other comprehensive income (loss), before tax	(1)	2	4	3
Other comprehensive income (loss), net of tax	(20)	41	(42)	4
Total comprehensive income (loss)	<u>\$ (159)</u>	<u>\$ (446)</u>	<u>\$ (457)</u>	<u>\$ 28</u>

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

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

	Six Months Ended	
	January 3, 2020	December 28, 2018
Cash flows from operating activities		
Net income (loss)	\$ (415)	\$ 24
Adjustments to reconcile net income (loss) to net cash provided by operations:		
Depreciation and amortization	805	952
Stock-based compensation	154	158
Deferred income taxes	(42)	281
Loss (gain) on disposal of assets	(12)	1
Amortization of debt discounts	20	19
Other non-cash operating activities, net	(20)	37
Changes in:		
Accounts receivable, net	(587)	482
Inventories	155	(483)
Accounts payable	170	(256)
Accounts payable to related parties	33	51
Accrued expenses	327	254
Accrued compensation	191	(134)
Other assets and liabilities, net	(269)	(212)
Net cash provided by operating activities	<u>510</u>	<u>1,174</u>
Cash flows from investing activities		
Purchases of property, plant and equipment	(305)	(500)
Proceeds from the sale of property, plant and equipment	—	3
Acquisitions, net of cash acquired	(22)	—
Purchases of investments	—	(33)
Proceeds from sale of investments	—	13
Proceeds from maturities of investments	—	7
Notes receivable issuances to Flash Ventures	(224)	(508)
Notes receivable proceeds from Flash Ventures	690	312
Strategic investments and other, net	21	(19)
Net cash provided by (used in) investing activities	<u>160</u>	<u>(725)</u>
Cash flows from financing activities		
Issuance of stock under employee stock plans	72	61
Taxes paid on vested stock awards under employee stock plans	(54)	(69)
Repurchases of common stock	—	(563)
Dividends paid to shareholders	(296)	(292)
Repayment of debt	(707)	(75)
Repayment of revolving credit facility	—	(500)
Net cash used in financing activities	<u>(985)</u>	<u>(1,438)</u>
Effect of exchange rate changes on cash	(3)	(3)
Net decrease in cash and cash equivalents	(318)	(992)
Cash and cash equivalents, beginning of year	3,455	5,005
Cash and cash equivalents, end of period	<u>\$ 3,137</u>	<u>\$ 4,013</u>
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 181	\$ 264
Cash paid for interest	\$ 206	\$ 216

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

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

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance at June 28, 2019	312	\$ 3	(17)	\$ (1,268)	\$ 3,851	\$ (68)	\$ 7,449	\$ 9,967
Net loss	—	—	—	—	—	—	(276)	(276)
Adoption of New Accounting Standard	—	—	—	—	—	—	(5)	(5)
Employee stock plans	—	—	3	181	(207)	—	—	(26)
Stock-based compensation	—	—	—	—	77	—	—	77
Dividends to shareholders	—	—	—	—	7	—	(156)	(149)
Actuarial pension gain	—	—	—	—	—	1	—	1
Foreign currency translation adjustment	—	—	—	—	—	4	—	4
Net unrealized loss on derivative contracts	—	—	—	—	—	(27)	—	(27)
Balance at October 4, 2019	312	\$ 3	(14)	(1,087)	3,728	(90)	7,012	9,566
Net loss	—	—	—	—	—	—	(139)	(139)
Employee stock plans	—	—	1	125	(81)	—	—	44
Stock-based compensation	—	—	—	—	77	—	—	77
Dividends to shareholders	—	—	—	—	7	—	(156)	(149)
Actuarial pension gain	—	—	—	—	—	1	—	1
Foreign currency translation adjustment	—	—	—	—	—	(13)	—	(13)
Net unrealized loss on derivative contracts	—	—	—	—	—	(8)	—	(8)
Balance at January 3, 2020	312	\$ 3	(13)	\$ (962)	\$ 3,731	\$ (110)	\$ 6,717	\$ 9,379

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

	Common Stock		Treasury Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance at June 29, 2018	312	\$ 3	(16)	\$ (1,444)	\$ 4,254	\$ (39)	\$ 8,757	\$ 11,531
Net income	—	—	—	—	—	—	511	511
Adoption of New Accounting Standards	—	—	—	—	—	—	56	56
Employee stock plans	—	—	1	198	(256)	—	—	(58)
Stock-based compensation	—	—	—	—	79	—	—	79
Repurchases of common stock	—	—	(8)	(563)	—	—	—	(563)
Dividends to shareholders	—	—	—	—	8	—	(152)	(144)
Foreign currency translation adjustment	—	—	—	—	—	(37)	—	(37)
Balance at September 28, 2018	312	3	(23)	(1,809)	4,085	(76)	9,172	11,375
Net loss	—	—	—	—	—	—	(487)	(487)
Employee stock plans	—	—	2	159	(109)	—	—	50
Stock-based compensation	—	—	—	—	79	—	—	79
Dividends to shareholders	—	—	—	—	7	—	(153)	(146)
Actuarial pension gain	—	—	—	—	—	1	—	1
Foreign currency translation adjustment	—	—	—	—	—	29	—	29
Net unrealized gain on derivative contracts	—	—	—	—	—	11	—	11
Balance at December 28, 2018	312	\$ 3	(21)	\$ (1,650)	\$ 4,062	\$ (35)	\$ 8,532	\$ 10,912

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

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

Note 1. Organization and Basis of Presentation

Western Digital Corporation (“Western Digital” or “the Company”) is a leading developer, manufacturer, and provider of data storage devices and solutions that address the evolving needs of the information technology (“IT”) industry and the infrastructure that enables the proliferation of data in virtually every other industry. The Company creates environments for data to thrive. The Company is driving the innovation needed to help customers capture, preserve, access and transform an ever-increasing diversity of data. Everywhere data lives, from advanced data centers to mobile sensors to personal devices, the Company’s industry-leading solutions deliver the possibilities of data.

The Company’s broad portfolio of technology and products address the following key end markets: Client Devices; Data Center Devices and Solutions; and Client Solutions. The Company also generates license and royalty revenue from its extensive intellectual property (“IP”), which is included in each of these three end market categories.

The accounting policies followed by the Company are set forth in Part II, Item 8, Note 1, *Organization and Basis of Presentation*, of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 28, 2019. In the opinion of management, all adjustments necessary to fairly state the 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 Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 28, 2019. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

Fiscal Year

The Company’s fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every five to six years, the Company reports a 53-week fiscal year to align the fiscal year with the foregoing policy. Fiscal year 2020, which ends on July 3, 2020, will be comprised of 53 weeks, with the first quarter consisting of 14 weeks and the remaining quarters consisting of 13 weeks each. Fiscal year 2019, which ended on June 28, 2019, was comprised of 52 weeks, with all quarters presented consisting of 13 weeks.

Use of Estimates

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

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

Note 2. Recent Accounting Pronouncements

Accounting Pronouncements Recently Adopted

In February 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”). ASU 2016-02 supersedes ASC 840 “Leases”. The amendments in this update require, among other things, that lessees recognize the following for all leases (unless a policy election is made by class of underlying asset to exclude short-term leases) at the commencement date: (1) a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee’s right to use, or the direct use of, a specified asset for the lease term. The FASB issued ASU 2018-11 on July 30, 2018, which allows entities to apply the provisions of ASC 842 at the effective date without adjusting comparative periods. The Company adopted this standard effective June 29, 2019, the first day of the fiscal year ending July 3, 2020, and has elected the transition method provided in ASU 2018-11 to apply Topic 842 as of the date of adoption without adjusting comparative periods. The Company has elected the package of practical expedients and did not reassess prior conclusions including (a) whether its contracts are or contain a lease, (b) lease classification and (c) capitalization of initial direct costs. The adoption of Topic 842 resulted in an increase in lease assets and a corresponding increase in lease liabilities on the Condensed Consolidated Balance Sheet of \$221 million as of June 29, 2019. The cumulative effect of adopting Topic 842 also included an after-tax decrease to opening retained earnings of \$5 million as of June 29, 2019, which was primarily related to previously recorded sublease proceed assumptions on lease exit liabilities for which there was no expected future economic benefit at transition. See Note 10, *Leases and Other Commitments*, for additional disclosures related to this standard.

In October 2018, the FASB issued ASU No. 2018-16, “Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes” (“ASU 2018-16”). ASU 2018-16 allows for the use of the OIS rate based on the SOFR as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, Derivatives and Hedging. The Company adopted this standard in the first quarter of 2020. The Company’s adoption of ASU 2018-16 did not have a material impact on its Condensed Consolidated Financial Statements.

Recently Issued Accounting Pronouncements Not Yet Adopted

In November 2018, the FASB issued ASU No. 2018-18, “Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606” (“ASU 2018-18”). ASU 2018-18 clarifies that certain transactions between collaborative arrangement participants should be accounted for as revenue when the collaborative arrangement participant is a customer in the context of a unit of account and precludes recognizing as revenue consideration received from a collaborative arrangement participant if the participant is not a customer. This ASU requires retrospective adoption to the date the Company adopted ASC 606 by recognizing a cumulative-effect adjustment to the opening balance of retained earnings of the earliest annual period presented. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, which for the Company is the first quarter of fiscal 2021. The Company does not expect this update to have a material impact on its Condensed Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). ASU 2016-13 seeks to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments, including trade receivables, and other commitments to extend credit held by a reporting entity at each reporting date. The amendments require an entity to replace the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects current expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, which for the Company is the first quarter of fiscal 2021. The Company is currently evaluating the impact this update will have on its Condensed Consolidated Financial Statements.

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

Note 3. Revenues

Contract assets represent the Company's rights to consideration where performance obligations are completed but the customer payments are not due until another performance obligation is satisfied. The Company did not have any contract assets as of either January 3, 2020 or June 28, 2019.

The Company incurs sales commissions and other direct incremental costs to obtain sales contracts. The Company has applied the practical expedient to recognize the direct incremental costs of obtaining contracts as an expense when incurred if the amortization period is expected to be one year or less or the amount is not material, with these costs charged to Selling, general and administrative expenses. Direct incremental costs to obtain contracts that have an expected benefit of greater than one year are amortized over the period of expected cash flows from the related contracts, and the amortization expense is recorded as a reduction to revenue. Total capitalized contract costs as of January 3, 2020 and June 28, 2019 as well as the related amortization for the three and six months ended January 3, 2020 and December 28, 2018 were not material.

Contract liabilities relate to customers' payments in advance of performance under the contract and primarily relate to remaining performance obligations under support and maintenance contracts. As of January 3, 2020 and June 28, 2019, contract liabilities were not material.

The Company applies the practical expedients and does not disclose transaction price allocated to the remaining performance obligations for (i) arrangements that have an original expected duration of one year or less, which mainly consist of the support and maintenance contracts, and (ii) variable consideration amounts for sale-based or usage-based royalties for IP license arrangements, which typically range longer than one year. Remaining performance obligations are mainly attributed to right-to-access patent license arrangements and customer support and service contracts which will be recognized over the remaining contract period. The transaction price allocated to the remaining performance obligations as of January 3, 2020 was \$140 million, which is mainly attributable to the functional IP license and service arrangements. The Company expects to recognize this amount as revenue as follows: \$24 million during the remainder of fiscal 2020, \$43 million in fiscal 2021, \$40 million in fiscal 2022 and \$33 million thereafter.

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

The Company's disaggregated revenue information is as follows:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions)</i>			
Revenue by Product				
Hard disk drives ("HDD")	\$ 2,396	\$ 2,060	\$ 4,804	\$ 4,554
Flash-based	1,838	2,173	3,470	4,707
Total Revenue	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261
Revenue by End Market				
Client Devices	\$ 1,797	\$ 2,214	\$ 3,413	\$ 4,864
Data Center Devices & Solutions	1,489	1,074	3,021	2,520
Client Solutions	948	945	1,840	1,877
Total Revenue	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261
Revenue by Geography				
Americas	\$ 1,296	\$ 1,015	\$ 2,609	\$ 2,296
Europe, Middle East and Africa	811	817	1,590	1,701
Asia	2,127	2,401	4,075	5,264
Total Revenue	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261

The Company's top 10 customers accounted for 44% and 43% of its net revenue for the three and six months ended January 3, 2020, respectively, and 47% of its net revenue for both the three and six months ended December 28, 2018. For the three and six months ended January 3, 2020 and December 28, 2018, no single customer accounted for 10% or more of the Company's net revenue.

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

Note 4. Supplemental Financial Statement Data

Accounts receivable, net

From time to time, in connection with factoring agreements, the Company sells trade accounts receivable without recourse to third party purchasers in exchange for cash. During the six months ended January 3, 2020 and December 28, 2018, the Company sold trade accounts receivable and received cash proceeds of \$198 million and \$370 million, respectively. The discounts on the trade accounts receivable sold during the periods were not material and were recorded within Other income, net in the Condensed Consolidated Statements of Operations. As of January 3, 2020 and June 28, 2019, the amount of factored receivables that remained outstanding was \$113 million and \$318 million, respectively.

Inventories

	January 3, 2020	June 28, 2019
<i>(in millions)</i>		
Inventories:		
Raw materials and component parts	\$ 1,334	\$ 1,142
Work-in-process	847	968
Finished goods	941	1,173
Total inventories	\$ 3,122	\$ 3,283

Property, plant and equipment, net

	January 3, 2020	June 28, 2019
<i>(in millions)</i>		
Property, plant and equipment:		
Land	\$ 294	\$ 294
Buildings and improvements	1,806	1,743
Machinery and equipment	7,171	7,267
Computer equipment and software	447	441
Furniture and fixtures	55	56
Construction-in-process	184	202
Property, plant and equipment, gross	9,957	10,003
Accumulated depreciation	(7,235)	(7,160)
Property, plant and equipment, net	\$ 2,722	\$ 2,843

Goodwill

	Carrying Amount
<i>(in millions)</i>	
Balance at June 28, 2019	\$ 10,076
Goodwill recorded in connection with an acquisition	14
Reduction in goodwill in connection with disposition of business	(20)
Foreign currency translation adjustment	(1)
Balance at January 3, 2020	\$ 10,069

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

Acquisition

On September 10, 2019, the Company acquired substantially all the assets of Kazan Networks, Inc., an innovator in high-performance networking and non-volatile memory express over fabrics technology ("NVMe-oF"), and an industry leader in application-specific integrated circuit and adapter solutions to connect storage platforms and systems over ethernet fabrics. The purchase price of this acquisition was \$22 million in cash, with net assets acquired primarily consisting of in-process research and development ("IPR&D") of \$8 million and \$14 million allocated to Goodwill. Goodwill is primarily attributable to the benefits the Company expects to derive from diversifying product offerings in its Data Center Devices and Solutions and Client Solutions end markets as well as the acquired workforce. The expenses incurred by the Company related to the acquisition as well as the revenues and earnings related to the acquisition were not material to the Condensed Consolidated Financial Statements.

Dispositions

In September 2019, the Company announced the sale of its IntelliFlash business and intention to exit Storage Systems, which consists of IntelliFlash and ActiveScale. These actions will allow the Company to redirect investments to other high value priorities. In November 2019, the Company completed its sale of IntelliFlash for a price of \$28 million, to be collected over the next three years. The sale of the IntelliFlash business included an immaterial amount of inventory, other tangible and intangible assets, and goodwill and resulted in a gain of approximately \$17 million recorded in Employee termination, asset impairment, and other charges in the Condensed Consolidated Statements of Operations for both the three and six months ended January 3, 2020. Additionally, in February 2020, the Company entered into an agreement for the sale of ActiveScale. The net assets sold and the proceeds from the sale of ActiveScale were not material. The revenues and expenses related to these businesses were not material to the Condensed Consolidated Financial Statements and did not qualify to be reported as discontinued operations. The operating results of these businesses have and will be reflected in the Company's results from continuing operations in the Condensed Consolidated Statements of Operations for all periods presented through the date of disposition.

Intangible assets

	January 3, 2020	June 28, 2019
	<i>(in millions)</i>	
Finite-lived intangible assets	\$ 5,798	\$ 5,824
In-process research and development	80	72
Accumulated amortization	(4,567)	(4,185)
Intangible assets, net	\$ 1,311	\$ 1,711

As part of prior acquisitions, the Company recorded at the time of the acquisition acquired IPR&D for projects in progress that had not yet reached technological feasibility. IPR&D is initially accounted for as an indefinite-lived intangible asset. Once a project reaches technological feasibility, the Company reclassifies the balance to existing technology and begins to amortize the intangible asset over its estimated useful life.

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

Product warranty liability

Changes in the warranty accrual were as follows:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions)</i>			
Warranty accrual, beginning of period	\$ 357	\$ 323	\$ 350	\$ 318
Charges to operations	50	47	99	81
Utilization	(35)	(42)	(83)	(68)
Changes in estimate related to pre-existing warranties	6	9	12	6
Warranty accrual, end of period	\$ 378	\$ 337	\$ 378	\$ 337

The current portion of the warranty accrual is classified in Accrued expenses and the long-term portion is classified in Other liabilities as noted below:

	January 3, 2020	June 28, 2019
		<i>(in millions)</i>
Warranty accrual		
Current portion (included in Accrued expenses)	\$ 193	\$ 188
Long-term portion (included in Other liabilities)	185	162
Total warranty accrual	\$ 378	\$ 350

Other liabilities

	January 3, 2020	June 28, 2019
		<i>(in millions)</i>
Other liabilities:		
Non-current net tax payable	\$ 839	\$ 928
Payables related to unrecognized tax benefits	708	699
Other non-current liabilities	905	713
Total other liabilities	\$ 2,452	\$ 2,340

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

Accumulated other comprehensive income (loss)

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

	Actuarial Pension Gains (Losses)	Foreign Currency Translation Adjustment	Unrealized Gains (Losses) on Derivative Contracts	Total Accumulated Comprehensive Income (Loss)
	<i>(in millions)</i>			
Balance at June 28, 2019	\$ (53)	\$ 4	\$ (19)	\$ (68)
Other comprehensive income (loss) before reclassifications	3	(10)	(20)	(27)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—	(19)	(19)
Income tax benefit (expense) related to items of other comprehensive income (loss)	(1)	1	4	4
Net current-period other comprehensive income (loss)	2	(9)	(35)	(42)
Balance at January 3, 2020	<u>\$ (51)</u>	<u>\$ (5)</u>	<u>\$ (54)</u>	<u>\$ (110)</u>

During the three and six months ended January 3, 2020 and December 28, 2018, the amounts reclassified out of AOCI related to derivative contracts were not material and substantially all were charged to Cost of revenue in the Condensed Consolidated Statements of Operations.

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

Note 5. Fair Value Measurements and Investments
Financial Instruments Carried at Fair Value

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

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

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

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

The following tables present information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of January 3, 2020 and June 28, 2019, and indicate the fair value hierarchy of the valuation techniques utilized to determine such values:

	January 3, 2020			
	Level 1	Level 2	Level 3	Total
	<i>(in millions)</i>			
Assets:				
Cash equivalents - Money market funds	\$ 1,051	\$ —	\$ —	\$ 1,051
Foreign exchange contracts	—	31	—	31
Total assets at fair value	\$ 1,051	\$ 31	\$ —	\$ 1,082
Liabilities:				
Foreign exchange contracts	\$ —	\$ 14	\$ —	\$ 14
Interest rate swap contract	—	69	—	69
Total liabilities at fair value	\$ —	\$ 83	\$ —	\$ 83

	June 28, 2019			
	Level 1	Level 2	Level 3	Total
	<i>(in millions)</i>			
Assets:				
Cash equivalents:				
Money market funds	\$ 1,388	\$ —	\$ —	\$ 1,388
Certificates of deposit	—	17	—	17
Total cash equivalents	1,388	17	—	1,405
Foreign exchange contracts	—	44	—	44
Interest rate swap contracts	—	2	—	2
Total assets at fair value	\$ 1,388	\$ 63	\$ —	\$ 1,451
Liabilities:				
Foreign exchange contracts	\$ —	\$ 40	\$ —	\$ 40
Interest rate swap contract	—	65	—	65
Total liabilities at fair value	\$ —	\$ 105	\$ —	\$ 105

During the three and six months ended January 3, 2020, the Company had no transfers of financial assets and liabilities between levels and there were no changes in valuation techniques and the inputs used in the fair value measurement.

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

Financial Instruments Not Carried at Fair Value

The carrying value of the Company's revolving credit facility approximates its fair value given the revolving nature of the balance and the variable market interest rate. For financial instruments where the carrying value (which includes principal adjusted for any unamortized issuance costs, and discounts or premiums) differs from fair value (which is based on quoted market prices), the following table represents the related carrying value and fair value for each of the Company's outstanding financial instruments. Each of the financial instruments presented below was categorized as Level 2 for all periods presented, based on the frequency of trading immediately prior to the end of the second quarter of 2020 and the fourth quarter of 2019, respectively.

	January 3, 2020		June 28, 2019	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	<i>(in millions)</i>			
0.50% convertible senior notes due 2020	\$ 33	\$ 33	\$ 33	\$ 31
Variable interest rate Term Loan A-1 maturing 2023	4,700	4,720	4,824	4,780
Variable interest rate U.S. Term Loan B-4 maturing 2023	1,843	1,857	2,424	2,370
1.50% convertible notes due 2024	973	1,085	958	986
4.75% senior unsecured notes due 2026	2,284	2,419	2,283	2,263
Total	\$ 9,833	\$ 10,115	\$ 10,522	\$ 10,430

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

Note 6. Derivative Instruments and Hedging Activities

As of January 3, 2020, the Company had outstanding foreign exchange forward contracts that were designated as either cash flow hedges or non-designated hedges. Substantially all of the contract maturity dates of these foreign exchange forward contracts do not exceed 12 months. In addition, the Company had outstanding pay-fixed interest rate swaps that were designated as cash flow hedges of variable rate interest payments on a portion of its term loans through February 2023.

As of January 3, 2020, the amount of existing net losses related to cash flow hedges recorded in AOCI included \$51 million related to the Company's interest rate swaps that is expected to be reclassified to earnings after twelve months. In addition, as of January 3, 2020, the Company did not have any foreign exchange forward contracts with credit-risk-related contingent features.

Changes in fair values of the non-designated foreign exchange contracts are recognized in Other income, net and are largely offset by corresponding changes in the fair values of the foreign currency denominated monetary assets and liabilities. For each of the three and six months ended January 3, 2020 and December 28, 2018, total net realized and unrealized transaction and foreign exchange contract currency gains and losses were not material to the Company's Condensed Consolidated Financial Statements.

Netting Arrangements

Under certain provisions and conditions within agreements with counterparties to the Company's foreign exchange forward contracts, subject to applicable requirements, the Company has the right of offset associated with the Company's foreign exchange forward contracts and is allowed to net settle transactions of the same currency with a single net amount payable by one party to the other. As of January 3, 2020 and June 28, 2019, the effect of rights of offset was not material and the Company did not offset or net the fair value amounts of derivative instruments in its Condensed Consolidated Balance Sheets.

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

Note 7. Debt

Debt consisted of the following as of January 3, 2020 and June 28, 2019:

	January 3, 2020	June 28, 2019
	<i>(in millions)</i>	
0.50% convertible senior notes due 2020	\$ 35	\$ 35
Variable interest rate Term Loan A-1 maturing 2023	4,708	4,834
Variable interest rate U.S. Term Loan B-4 maturing 2023	1,843	2,425
1.50% convertible notes due 2024	1,100	1,100
4.75% senior unsecured notes due 2026	2,300	2,300
Total debt	9,986	10,694
Issuance costs and debt discounts	(153)	(172)
Subtotal	9,833	10,522
Less current portion of long-term debt	(286)	(276)
Long-term debt	\$ 9,547	\$ 10,246

The credit agreement governing the revolving credit facility and Term Loan A-1 requires the Company to comply with certain financial covenants, consisting of a leverage ratio and an interest coverage ratio. As of January 3, 2020, the Company was in compliance with these financial covenants.

On October 4, 2019 and January 3, 2020, the Company made voluntary prepayments of \$250 million and \$325 million, respectively, on its U.S. Term Loan B-4, which were applied toward the remaining scheduled amortization and the remainder towards the principal due at maturity. As of January 3, 2020, there are no longer any scheduled amortization payments due under the U.S. Term Loan B-4 prior to its maturity on April 29, 2023. On January 31, 2020, the Company made an incremental voluntary prepayment of \$150 million on its Term Loan B-4.

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

Note 8. Pension and Other Post-Retirement Benefit Plans

The Company has pension and other post-retirement benefit plans in various countries. The Company's principal pension plans are in Japan. All pension and other post-retirement benefit plans outside of the Company's Japanese defined benefit pension plan (the "Japanese Plan") are immaterial to the Condensed Consolidated Financial Statements. The expected long-term rate of return on the Japanese Plan assets is 2.5%.

Obligations and Funded Status

The following table presents the unfunded status of the benefit obligations for the Japanese Plan:

	January 3, 2020	June 28, 2019
	<i>(in millions)</i>	
Benefit obligation at end of period	\$ 278	\$ 280
Fair value of plan assets at end of period	210	208
Unfunded status	<u>\$ 68</u>	<u>\$ 72</u>

The following table presents the unfunded amounts related to the Japanese Plan as recognized on the Company's Condensed Consolidated Balance Sheets:

	January 3, 2020	June 28, 2019
	<i>(in millions)</i>	
Current liabilities	\$ 1	\$ 1
Non-current liabilities	67	71
Net amount recognized	<u>\$ 68</u>	<u>\$ 72</u>

Net periodic benefit costs were not material for either the three or six months ended January 3, 2020.

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

Note 9. Related Parties and Related Commitments and Contingencies

Flash Ventures

The Company's business ventures with Kioxia Corporation ("Kioxia") consist of three separate legal entities: Flash Partners Ltd. ("Flash Partners"), Flash Alliance Ltd. ("Flash Alliance"), and Flash Forward Ltd. ("Flash Forward"), collectively referred to as "Flash Ventures".

The following table presents the notes receivable from, and equity investments in, Flash Ventures as of January 3, 2020 and June 28, 2019:

	January 3, 2020	June 28, 2019
	<i>(in millions)</i>	
Notes receivable, Flash Partners	\$ 412	\$ 551
Notes receivable, Flash Alliance	625	878
Notes receivable, Flash Forward	663	743
Investment in Flash Partners	200	200
Investment in Flash Alliance	297	296
Investment in Flash Forward	124	123
Total notes receivable and investments in Flash Ventures	\$ 2,321	\$ 2,791

During the three and six months ended January 3, 2020 and during the three and six months ended December 28, 2018, the Company made net payments to Flash Ventures of \$648 million and \$1.33 billion, and \$1.12 billion and \$1.86 billion respectively, for purchased flash-based memory wafers and net loans and investments.

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

As of January 3, 2020 and June 28, 2019, the Company had Accounts payable balances due to Flash Ventures of \$364 million and \$331 million, respectively.

The Company's maximum reasonably estimable loss exposure (excluding lost profits) as a result of its involvement with Flash Ventures, based upon the Japanese yen to U.S. dollar exchange rate at January 3, 2020, is presented below. Investments in Flash Ventures are denominated in Japanese yen, and the maximum estimable loss exposure excludes any cumulative translation adjustment due to revaluation from the Japanese yen to the U.S. dollar.

	January 3, 2020
Notes receivable	\$ 1,700
Equity investments	621
Operating lease guarantees	1,746
Inventory and prepayments	462
Maximum estimable loss exposure	\$ 4,529

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

The Company is obligated to pay for variable costs incurred in producing its share of Flash Ventures' flash-based memory wafer supply, based on its three-month forecast, which generally equals 50% of Flash Ventures' output. In addition, the Company is obligated to pay for half of Flash Ventures' fixed costs regardless of the output the Company chooses to purchase. The Company is not able to estimate its total wafer purchase commitment obligation beyond its rolling three-month purchase commitment because the price is determined by reference to the future cost of producing the semiconductor wafers. In addition, the Company is committed to fund 49.9% to 50.0% of each Flash Ventures entity's capital investments to the extent that each Flash Ventures entity's operating cash flow is insufficient to fund these investments.

In June 2019, an unexpected power outage incident occurred at the flash-based memory manufacturing facilities operated by Flash Ventures in Yokkaichi, Japan. The power outage incident impacted the facilities and process tools and resulted in the damage of flash wafers in production and a reduction in the Company's flash wafer availability. As a result of this incident, the Company incurred charges of \$68 million in its fiscal 2020, all incurred in the three months ended October 4, 2019, which were recorded in Cost of revenue and primarily consisted of unabsorbed manufacturing overhead costs. The Company is pursuing recovery of its losses associated with this event; however, the amount of any recovery cannot be estimated at this time.

In May 2019, the Company entered into additional agreements with Kioxia to extend Flash Ventures to a new wafer fabrication facility, known as "K1," located in Kitakami, Japan. The primary purpose of K1 is to provide clean room space to continue the transition of existing flash-based wafer capacity to newer technology nodes. Output from the initial production line at K1 began in the second half of fiscal year 2020, although meaningful output from K1 is not expected to begin until the first half of fiscal year 2021. The Company's share of the initial commitment for K1 will result in equipment investments, relocation and other start-up costs which are expected to be incurred primarily through the second half of fiscal year 2020. The Company also agreed to prepay an aggregate of approximately \$360 million over a 3-year period beginning in the first half of fiscal year 2020 toward K1 building depreciation, to be credited against future wafer charges. As of January 3, 2020, remaining committed prepayments totaled \$265 million.

Inventory Purchase Commitments with Flash Ventures. Purchase orders placed under Flash Ventures for up to three months are binding and cannot be canceled.

Research and Development Activities. The Company participates in common Research and development ("R&D") activities with Kioxia and is contractually committed to a minimum funding level. R&D commitments are immaterial to the Condensed Consolidated Financial Statements.

Off-Balance Sheet Liabilities

Flash Ventures sells to and leases back from a consortium of financial institutions a portion of its tools and has entered into equipment lease agreements of which the Company guarantees half or all of the outstanding obligations under each lease agreement. The lease agreements are subject to customary covenants and cancellation events related to Flash Ventures and each of the guarantors. The occurrence of a cancellation event could result in an acceleration of Flash Ventures' obligations and a call on the Company's guarantees.

The following table presents the Company's portion of the remaining guarantee obligations under the Flash Ventures' lease facilities in both Japanese yen and U.S. dollar-equivalent, based upon the Japanese yen to U.S. dollar exchange rate as of January 3, 2020.

	Lease Amounts	
	(Japanese yen, in billions)	(U.S. dollar, in millions)
Total guarantee obligations	¥ 189	\$ 1,746

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

The following table details the breakdown of the Company’s remaining guarantee obligations between the principal amortization and the purchase option exercise price at the end of the term of the Flash Ventures lease agreements, in annual installments as of January 3, 2020 in U.S. dollars, based upon the Japanese yen to U.S. dollar exchange rate as of January 3, 2020:

Annual Installments	Payment of Principal Amortization	Purchase Option Exercise Price at Final Lease Terms <i>(in millions)</i>	Guarantee Amount
Remaining six months of 2020	\$ 239	\$ 35	\$ 274
2021	406	108	514
2022	323	49	372
2023	215	67	282
2024	98	120	218
Thereafter	12	74	86
Total guarantee obligations	\$ 1,293	\$ 453	\$ 1,746

The Company and Kioxia have agreed to mutually contribute to, and indemnify each other and Flash Ventures for, environmental remediation costs or liability resulting from Flash Ventures’ manufacturing operations in certain circumstances. The Company has not made any indemnification payments, nor recorded any indemnification receivables, under any such agreements. As of January 3, 2020, no amounts have been accrued in the Condensed Consolidated Financial Statements with respect to these indemnification agreements.

Unis Venture

The Company has a joint venture with Unisplendour Corporation Limited and Unisoft (Wuxi) Group Co. Ltd. (“Unis”), referred to as the “Unis Venture”, to market and sell the Company’s products in China and to develop data storage systems for the Chinese market in the future. The Unis Venture is 49% owned by the Company and 51% owned by Unis. The Company accounts for its investment in the Unis Venture under the equity method of accounting. Revenue on products distributed by the Unis Venture is recognized upon sell through to third-party customers. For both the three and six months ended January 3, 2020 and December 28, 2018, the Company recognized approximately 1% of its consolidated revenue on products distributed by the Unis Venture. The outstanding accounts receivable due from and investment in the Unis Venture were not material to the Condensed Consolidated Financial Statements as of January 3, 2020 or June 28, 2019.

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

Note 10. Leases and Other Commitments
Leases

The Company leases certain domestic and international facilities and data center space under long-term, non-cancelable operating leases that expire at various dates through 2034. These leases include no material variable or contingent lease payments. Operating lease assets and liabilities are recognized based on the present value of the remaining lease payments discounted using the Company's incremental borrowing rate. Operating lease assets also include prepaid lease payments minus any lease incentives. Extension or termination options present in the Company's lease agreements are included in determining the right-of-use asset and lease liability when it is reasonably certain the Company will exercise that option. Lease expense is recognized on a straight-line basis over the lease term. The following table summarizes supplemental balance sheet information related to operating leases as of January 3, 2020:

	Lease Amounts
	<i>(in millions)</i>
Minimum lease payments by fiscal year:	
Remaining six months of 2020	\$ 26
2021	45
2022	30
2023	25
2024	27
Thereafter	168
Total future minimum lease payments	321
Less: Imputed Interest	(63)
Present value of lease liabilities	258
Less: Current portion (included in Accrued expenses)	41
Long-term operating lease liabilities (included in Other liabilities)	\$ 217
Operating lease right-of-use assets (included in Other non-current assets)	\$ 242
Weighted average remaining lease term in years	9.4
Weighted average discount rate	4.2%

The following table summarizes supplemental disclosures of operating cost and cash flow information related to operating leases for the three and six months ended January 3, 2020:

	Three Months Ended	Six Months Ended
	January 3,	January 3,
	2020	2020
	<i>(in millions)</i>	
Cost of operating leases	\$ 18	\$ 30
Cash paid for operating leases	13	29
Operating lease assets obtained in exchange for operating lease liabilities	1	50

Purchase Agreements and Other Commitments

In the normal course of business, the Company enters into purchase orders with suppliers for the purchase of components used to manufacture its 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. The Company also enters into long-term agreements with suppliers that contain fixed future commitments, which are contingent on certain conditions such as performance, quality and technology of the vendor's components. As of January 3, 2020, the Company had the following minimum long-term commitments:

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

	<u>Long-term commitments</u>
	<i>(in millions)</i>
Fiscal year:	
Remaining six months of 2020	\$ 123
2021	304
2022	390
2023	407
2024	180
Thereafter	338
Total	<u>\$ 1,742</u>

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

Note 11. Shareholders' Equity
Stock-based Compensation Expense

The following tables present the Company's stock-based compensation for equity-settled awards by type and financial statement line as well as the related tax benefit included in the Company's Condensed Consolidated Statements of Operations:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions)</i>			
Options	\$ 2	\$ 4	\$ 4	\$ 9
Restricted and performance stock units	70	70	136	137
Employee stock purchase plan	5	5	14	12
Total	\$ 77	\$ 79	\$ 154	\$ 158

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions)</i>			
Cost of revenue	\$ 13	\$ 13	\$ 25	\$ 24
Research and development	41	42	82	81
Selling, general and administrative	23	24	47	53
Subtotal	77	79	154	158
Tax benefit	(11)	(14)	(23)	(25)
Total	\$ 66	\$ 65	\$ 131	\$ 133

Windfall tax benefits related to the vesting and exercise of stock-based awards, which are recognized as a component of the Company's Income tax expense, were immaterial for the periods presented.

Compensation cost related to unvested stock options, restricted stock units ("RSUs"), performance-based stock units ("PSUs"), and rights to purchase shares of common stock under the Company's Employee Stock Purchase Plan ("ESPP") will generally be amortized on a straight-line basis over the remaining average service period. The following table presents the unamortized compensation cost and weighted average service period of all unvested outstanding awards as of January 3, 2020:

	Unamortized Compensation Costs	Weighted Average Service Period
	<i>(in millions)</i>	<i>(years)</i>
Options	\$ 3	0.6
RSUs and PSUs ⁽¹⁾	640	2.7
ESPP	50	1.4
Total unamortized compensation cost	\$ 693	

⁽¹⁾ Weighted average service period assumes the performance metrics are met for the PSUs.

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

Plan Activities
Stock Options

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

	Number of Shares <i>(in millions)</i>	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life <i>(in years)</i>	Aggregate Intrinsic Value <i>(in millions)</i>
Options outstanding at June 28, 2019	3.9	\$ 65.72		
Exercised	(0.6)	43.48		\$ 8
Canceled or expired	(0.3)	93.23		
Options outstanding at January 3, 2020	3.0	67.85	2.6	\$ 28
Exercisable at January 3, 2020	2.7	70.60	2.5	\$ 22

RSUs and PSUs

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

	Number of Shares <i>(in millions)</i>	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value at Vest Date <i>(in millions)</i>
RSUs and PSUs outstanding at June 28, 2019	11.6	\$ 62.07	
Granted	5.8	58.13	
Vested	(3.3)	63.15	\$ 186
Forfeited	(0.8)	63.37	
RSUs and PSUs outstanding at January 3, 2020	13.3	60.88	

RSUs and PSUs are generally settled in an equal number of shares of the Company's common stock at the time of vesting of the units.

Stock Repurchase Program

The Company's Board of Directors has authorized a stock repurchase program for the repurchase of up to \$5.00 billion of the Company's common stock, which authorization is effective through July 25, 2023. For the six months ended January 3, 2020, the Company did not make any stock repurchases. The remaining amount available to be repurchased under the Company's current stock repurchase program as of January 3, 2020 was \$4.50 billion. Repurchases under the stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan. The Company expects stock repurchases to be funded principally by operating cash flows.

Dividends to Shareholders

Since the first quarter of 2013, the Company has issued a quarterly cash dividend. During the six months ended January 3, 2020, the Company declared aggregate cash dividends of \$1.00 per share on its outstanding common stock totaling \$298 million, of which \$149 million was paid on January 21, 2020. The Company may modify, suspend or cancel its cash dividend policy in any manner and at any time.

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

Note 12. Income Tax Expense

The Tax Cuts and Jobs Act (the “2017 Act”), enacted on December 22, 2017, includes a broad range of tax reform proposals affecting businesses. The Company completed its accounting for the tax effects of the enactment of the 2017 Act during the second quarter of fiscal 2019. However, the U.S. Treasury and the Internal Revenue Service (“IRS”) have issued tax guidance on certain provisions of the 2017 Act since the enactment date, and the Company anticipates the issuance of additional regulatory and interpretive guidance. The Company applied a reasonable interpretation of the 2017 Act along with the then-available guidance in finalizing its accounting for the tax effects of the 2017 Act. Any additional regulatory or interpretive guidance would constitute new information, which may require further refinements to the Company’s estimates in future periods.

The following table presents the Company’s Income tax expense and the effective tax rate:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions)</i>			
Income (loss) before taxes	\$ (40)	\$ 81	\$ (277)	\$ 664
Income tax expense	99	568	138	640
Effective tax rate	(248)%	701%	(50)%	96%

The primary drivers of the difference between the effective tax rate for the three and six months ended January 3, 2020 and the U.S. Federal statutory rate of 21% are the relative mix of earnings and losses by jurisdiction, the deduction for foreign derived intangible income, credits and tax holidays in Malaysia, Philippines and Thailand that will expire at various dates during fiscal years 2020 through 2030. In addition, the effective tax rate for the six months ended January 3, 2020 includes the discrete effect of a de-recognition of \$33 million for certain deferred tax assets associated with the Company’s creditable foreign withholding taxes due to the issuance of final regulatory guidance. The regulatory guidance does not preclude the Company from potentially claiming these creditable taxes as a period benefit when paid.

The primary drivers of the difference between the effective tax rate for the three and six months ended December 28, 2018 and the U.S. Federal statutory rate of 21% is the discrete effect of the finalization of the accounting for the tax effects of the enactment of the 2017 Act. For the three months ended December 28, 2018, these discrete effects consist of \$230 million related to the mandatory deemed repatriation tax and \$134 million related to the Company’s decision to change its indefinite reinvestment assertion. For the six months ended December 28, 2018, these discrete effects consist of \$178 million related to the mandatory deemed repatriation tax and \$144 million related to the Company’s decision to change its indefinite reinvestment assertion. For both periods, the remaining difference is attributable primarily to the changes in the relative mix of our U.S. earnings compared to foreign earnings.

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

The IRS previously completed its field examination of the Company's federal income tax returns for fiscal years 2008 through 2012 and proposed certain adjustments. As previously disclosed, the Company received Revenue Agent Reports from the IRS for fiscal years 2008 through 2009, proposing adjustments relating to transfer pricing with the Company's foreign subsidiaries and intercompany payable balances. The Company disagrees with the proposed adjustments and in September 2015, filed a protest with the IRS Appeals Office and received the IRS rebuttal in July 2016. The Company and the IRS Appeals Office did not reach a settlement on the disputed matters. On June 28, 2018, the IRS issued a statutory notice of deficiency with respect to the disputed matters for fiscal years 2008 through 2009, seeking to increase the Company's U.S. taxable income by an amount that would result in additional federal tax through fiscal year 2009 totaling approximately \$516 million, subject to interest. The Company filed a petition with the U.S. Tax Court in September 2018. On December 10, 2018, the IRS issued a statutory notice of deficiency with respect to fiscal years 2010 through 2012, seeking to increase the Company's U.S. taxable income by an amount that would result in additional federal tax for fiscal years 2010 through 2012 totaling approximately \$549 million, subject to interest. Approximately \$535 million of the total additional federal tax for fiscal years 2010 through 2012 relates to proposed adjustments for transfer pricing with the Company's foreign subsidiaries, intercompany payable balances and the utilization of certain tax attributes. The Company filed a petition with the U.S. Tax Court in March 2019. The U.S. Tax Court consolidated the case for fiscal years 2008 through 2009 with the case for fiscal years 2010 through 2012. The Company believes that its tax positions are properly supported and will vigorously contest the position taken by the IRS.

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax examinations cannot be predicted with certainty. If any issues addressed in the Company's tax examinations are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of January 3, 2020, it was not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company's liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company's tax returns.

As of January 3, 2020, the liability for unrecognized tax benefits (excluding accrued interest and penalties) was approximately \$696 million. Accrued interest and penalties related to unrecognized tax benefits as of January 3, 2020 was approximately \$131 million. Of these amounts, approximately \$708 million could result in potential cash payments. The Company is not able to provide a reasonable estimate of the timing of future tax payments related to these obligations.

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

Note 13. Net Income (Loss) Per Common Share

The following table presents the computation of basic and diluted income (loss) per common share:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions, except per share data)</i>			
Net income (loss)	\$ (139)	\$ (487)	\$ (415)	\$ 24
Weighted average shares outstanding:				
Basic	298	290	297	291
Employee stock options, RSUs, PSUs and ESPP	—	—	—	5
Diluted	298	290	297	296
Income (loss) per common share				
Basic	\$ (0.47)	\$ (1.68)	\$ (1.40)	\$ 0.08
Diluted	\$ (0.47)	\$ (1.68)	\$ (1.40)	\$ 0.08
Anti-dilutive potential common shares excluded	15	19	15	8

The Company computes basic income (loss) per common share using Net income (loss) and the weighted average number of common shares outstanding during the period. Diluted income (loss) per common share is computed using Net income (loss) and the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include dilutive outstanding employee stock options, RSUs and PSUs, and rights to purchase shares of common stock under the Company's ESPP. For the six months ended December 28, 2018, the Company excluded common shares subject to outstanding equity awards from the calculation of diluted shares because their impact would have been anti-dilutive based on the Company's average stock price during the period. For the three and six months ended January 3, 2020, and the three months ended December 28, 2018, the Company recorded net losses, and all shares subject to outstanding equity awards have been excluded for those periods because including them would be anti-dilutive.

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

Note 14. Employee Termination, Asset Impairment and Other Charges

The Company recorded the following charges related to employee terminations benefits, asset impairment, and other charges:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions)</i>			
Employee termination and other charges:				
Closure of Foreign Manufacturing Facilities	\$ —	\$ 7	\$ 4	\$ 11
Business Realignment	26	13	30	55
Total employee termination and other charges	26	20	34	66
Gain on disposition of assets:				
Business Realignment	(17)	—	(17)	—
Total gain on disposition of assets	(17)	—	(17)	—
Total employee termination, asset impairment, and other charges	\$ 9	\$ 20	\$ 17	\$ 66

Closure of Foreign Manufacturing Facilities

In July 2018, the Company announced the closing of its HDD manufacturing facility in Kuala Lumpur, Malaysia, in order to reduce its manufacturing costs and consolidate HDD operations into Thailand. The Company substantially completed the closure in fiscal year 2019.

The following table presents an analysis of the components of the restructuring charges, payments and adjustments made against the reserve during the six months ended January 3, 2020:

	Employee Termination Benefits	Contract Termination and Other	Total
		<i>(in millions)</i>	
Accrual balance at June 28, 2019	\$ 30	\$ 2	\$ 32
Charges	2	2	4
Cash payments	(21)	(4)	(25)
Accrual balance at January 3, 2020	\$ 11	\$ —	\$ 11

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

Business Realignment

The Company periodically incurs charges as part of the integration process of recent acquisitions and to realign its operations with anticipated market demand, primarily consisting of organization rationalization designed to streamline its business, reduce its cost structure and focus its resources. In addition to the amounts recognized under Business Realignment as presented above, the Company recognized \$5 million of accelerated depreciation on facility assets in Cost of revenue and Operating expenses in the Condensed Consolidated Statements of Operations for the six months ended January 3, 2020.

The following table presents an analysis of the components of the activity against the reserve during the six months ended January 3, 2020:

	Employee Termination Benefits	Contract Termination and Other	Total
	<i>(in millions)</i>		
Accrual balance at June 28, 2019	\$ 37	\$ 8	\$ 45
Charges	26	4	30
Cash payments	(35)	(11)	(46)
Accrual balance at January 3, 2020	<u>\$ 28</u>	<u>\$ 1</u>	<u>\$ 29</u>

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

Note 15. Legal Proceedings

Tax

For disclosures regarding statutory notices of deficiency issued by the IRS on June 28, 2018 and December 10, 2018, and petitions filed by the Company with the U.S. Tax Court in September 2018 and March 2019, see Note 12, *Income Tax Expense*.

Other Matters

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

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

Note 16. Separate Financial Information of Guarantor Subsidiaries

The Company's 4.750% senior unsecured notes due 2026 (the "2026 Senior Unsecured Notes") are fully and unconditionally guaranteed, jointly and severally, on a senior unsecured basis, subject to certain customary guarantor release conditions, by certain 100% owned material domestic subsidiaries of the Company (or the "Guarantor Subsidiaries"). The guarantee by a Guarantor Subsidiary will be released in the event of (i) the release of a Guarantor Subsidiary from its guarantee of indebtedness under the credit agreement governing the revolving credit facility and term loans or other indebtedness that would have required the Guarantor Subsidiary to guarantee the 2026 Senior Unsecured Notes, (ii) the sale, issuance or other disposition of capital stock of a Guarantor Subsidiary such that it is no longer a restricted subsidiary under the indenture governing the 2026 Senior Unsecured Notes, (iii) the sale of all or substantially all of a Guarantor Subsidiary's assets, (iv) the Company's exercise of its defeasance options under the indenture governing the 2026 Senior Unsecured Notes, (v) the dissolution or liquidation of a Guarantor Subsidiary or (vi) the sale of all the equity interest in a Guarantor Subsidiary. The Company's other domestic subsidiaries and its foreign subsidiaries (collectively, the "Non-Guarantor Subsidiaries") do not guarantee the 2026 Senior Unsecured Notes. The following condensed consolidating financial information reflects the summarized financial information of Western Digital Corporation ("Parent"), the Guarantor Subsidiaries on a combined basis, and the Non-Guarantor Subsidiaries on a combined basis.

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

Condensed Consolidating Balance Sheet
As of January 3, 2020

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 11	\$ 786	\$ 2,340	\$ —	\$ 3,137
Accounts receivable, net	—	1,172	619	—	1,791
Intercompany receivables	2,617	7,840	2,839	(13,296)	—
Inventories	—	716	2,472	(66)	3,122
Loans due from consolidated affiliates	—	—	258	(258)	—
Other current assets	—	364	213	—	577
Total current assets	2,628	10,878	8,741	(13,620)	8,627
Property, plant and equipment, net	—	820	1,902	—	2,722
Notes receivable and investments in Flash Ventures	—	—	2,321	—	2,321
Goodwill	—	374	9,695	—	10,069
Other intangible assets, net	—	10	1,301	—	1,311
Investments in consolidated subsidiaries	20,637	15,471	—	(36,108)	—
Loans due from consolidated affiliates	—	1,626	—	(1,626)	—
Other non-current assets	56	255	499	—	810
Total assets	\$ 23,321	\$ 29,434	\$ 24,459	\$ (51,354)	\$ 25,860
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Accounts payable	\$ —	\$ 153	\$ 1,583	\$ —	\$ 1,736
Accounts payable to related parties	—	364	—	—	364
Intercompany payables	2,285	4,953	6,058	(13,296)	—
Accrued expenses	206	837	516	—	1,559
Accrued compensation	—	356	181	—	537
Loans due to consolidated affiliates	—	258	—	(258)	—
Current portion of long-term debt	251	—	35	—	286
Total current liabilities	2,742	6,921	8,373	(13,554)	4,482
Long-term debt	9,547	—	—	—	9,547
Loans due to consolidated affiliates	1,603	—	23	(1,626)	—
Other liabilities	50	1,843	559	—	2,452
Total liabilities	13,942	8,764	8,955	(15,180)	16,481
Total shareholders' equity	9,379	20,670	15,504	(36,174)	9,379
Total liabilities and shareholders' equity	\$ 23,321	\$ 29,434	\$ 24,459	\$ (51,354)	\$ 25,860

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

Condensed Consolidating Balance Sheet
As of June 28, 2019

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 8	\$ 985	\$ 2,462	\$ —	\$ 3,455
Accounts receivable, net	—	779	425	—	1,204
Intercompany receivables	2,409	5,808	1,581	(9,798)	—
Inventories	—	990	2,438	(145)	3,283
Loans due from consolidated affiliates	—	—	50	(50)	—
Other current assets	2	251	282	—	535
Total current assets	2,419	8,813	7,238	(9,993)	8,477
Property, plant and equipment, net	—	873	1,970	—	2,843
Notes receivable and investments in Flash Ventures	—	—	2,791	—	2,791
Goodwill	—	388	9,688	—	10,076
Other intangible assets, net	—	23	1,688	—	1,711
Investments in consolidated subsidiaries	20,772	16,355	—	(37,127)	—
Loans due from consolidated affiliates	—	674	—	(674)	—
Other non-current assets	60	51	361	—	472
Total assets	\$ 23,251	\$ 27,177	\$ 23,736	\$ (47,794)	\$ 26,370
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Accounts payable	\$ —	\$ 195	\$ 1,372	\$ —	\$ 1,567
Accounts payable to related parties	—	—	331	—	331
Intercompany payables	1,871	3,515	4,412	(9,798)	—
Accrued expenses	195	522	579	—	1,296
Accrued compensation	—	214	133	—	347
Loans due to consolidated affiliates	—	50	—	(50)	—
Current portion of long-term debt	276	—	—	—	276
Total current liabilities	2,342	4,496	6,827	(9,848)	3,817
Long-term debt	10,213	—	33	—	10,246
Loans due to consolidated affiliates	674	—	—	(674)	—
Other liabilities	55	1,795	490	—	2,340
Total liabilities	13,284	6,291	7,350	(10,522)	16,403
Total shareholders' equity	9,967	20,886	16,386	(37,272)	9,967
Total liabilities and shareholders' equity	\$ 23,251	\$ 27,177	\$ 23,736	\$ (47,794)	\$ 26,370

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

Condensed Consolidating Statement of Operations
For the three months ended January 3, 2020

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Revenue, net	\$ —	\$ 3,304	\$ 4,041	\$ (3,111)	\$ 4,234
Cost of revenue	—	2,881	3,643	(3,225)	3,299
Gross profit	—	423	398	114	935
Operating expenses:					
Research and development	—	362	216	—	578
Selling, general and administrative	—	196	102	—	298
Intercompany operating expense (income)	4	(397)	393	—	—
Employee termination, asset impairment, and other charges	—	(5)	14	—	9
Total operating expenses	4	156	725	—	885
Operating income (loss)	(4)	267	(327)	114	50
Interest and other income (expense):					
Interest income	—	16	5	(13)	8
Interest expense	(118)	—	—	13	(105)
Other income, net	—	—	7	—	7
Total interest and other income (expense), net	(118)	16	12	—	(90)
Income (loss) before taxes	(122)	283	(315)	114	(40)
Equity in earnings from subsidiaries	(42)	(384)	—	426	—
Income tax expense (benefit)	(25)	55	69	—	99
Net loss	\$ (139)	\$ (156)	\$ (384)	\$ 540	\$ (139)

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

Condensed Consolidating Statement of Operations
For the six months ended January 3, 2020

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Revenue, net	\$ —	\$ 6,665	\$ 8,025	\$ (6,416)	\$ 8,274
Cost of revenue	—	5,833	7,333	(6,585)	6,581
Gross profit	—	832	692	169	1,693
Operating expenses:					
Research and development	—	726	426	—	1,152
Selling, general and administrative	1	399	203	—	603
Intercompany operating expense (income)	7	(822)	815	—	—
Employee termination, asset impairment, and other charges	—	(5)	22	—	17
Total operating expenses	8	298	1,466	—	1,772
Operating income (loss)	(8)	534	(774)	169	(79)
Interest and other income (expense):					
Interest income	—	28	15	(23)	20
Interest expense	(249)	—	(1)	23	(227)
Other income, net	—	—	9	—	9
Total interest and other income (expense), net	(249)	28	23	—	(198)
Income (loss) before taxes	(257)	562	(751)	169	(277)
Equity in earnings from subsidiaries	(206)	(844)	—	1,050	—
Income tax expense (benefit)	(48)	94	92	—	138
Net loss	\$ (415)	\$ (376)	\$ (843)	\$ 1,219	\$ (415)

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

Condensed Consolidating Statement of Operations
For the three months ended December 28, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Revenue, net	\$ —	\$ 3,392	\$ 4,857	\$ (4,016)	\$ 4,233
Cost of revenue	—	2,942	4,215	(3,968)	3,189
Gross profit	—	450	642	(48)	1,044
Operating expenses:					
Research and development	—	334	205	—	539
Selling, general and administrative	—	214	95	—	309
Intercompany operating expense (income)	—	(347)	347	—	—
Employee termination, asset impairment, and other charges	—	6	14	—	20
Total operating expenses	—	207	661	—	868
Operating income (loss)	—	243	(19)	(48)	176
Interest and other income (expense):					
Interest income	2	4	12	(3)	15
Interest expense	(118)	(2)	(1)	3	(118)
Other income (expense), net	—	(2)	8	2	8
Total interest and other income (expense), net	(116)	—	19	2	(95)
Income (loss) before taxes	(116)	243	—	(46)	81
Equity in earnings from subsidiaries	(468)	(133)	—	601	—
Income tax expense (benefit)	(97)	532	133	—	568
Net loss	\$ (487)	\$ (422)	\$ (133)	\$ 555	\$ (487)

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

Condensed Consolidating Statement of Operations
For the six months ended December 28, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Revenue, net	\$ —	\$ 6,877	\$ 9,853	\$ (7,469)	\$ 9,261
Cost of revenue	—	5,947	8,039	(7,433)	6,553
Gross profit	—	930	1,814	(36)	2,708
Operating expenses:					
Research and development	—	697	418	—	1,115
Selling, general and administrative	1	465	199	—	665
Intercompany operating expense (income)	—	(754)	754	—	—
Employee termination, asset impairment, and other charges	—	38	28	—	66
Total operating expenses	1	446	1,399	—	1,846
Operating income (loss)	(1)	484	415	(36)	862
Interest and other income (expense):					
Interest income	10	7	24	(11)	30
Interest expense	(234)	(8)	(3)	11	(234)
Other income (expense), net	1	(2)	7	—	6
Total interest and other income (expense), net	(223)	(3)	28	—	(198)
Income (loss) before taxes	(224)	481	443	(36)	664
Equity in earnings from subsidiaries	7	212	—	(219)	—
Income tax expense (benefit)	(241)	650	231	—	640
Net income	\$ 24	\$ 43	\$ 212	\$ (255)	\$ 24

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the three months ended January 3, 2020

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Net loss	\$ (139)	\$ (156)	\$ (384)	\$ 540	\$ (139)
Other comprehensive loss, before tax:					
Actuarial pension gain	2	2	2	(4)	2
Foreign currency translation adjustment	(15)	(13)	(13)	26	(15)
Net unrealized loss, on derivative contracts and available-for-sale securities	(6)	(26)	(14)	40	(6)
Total other comprehensive loss, before tax	(19)	(37)	(25)	62	(19)
Income tax benefit (expense) related to items of other comprehensive loss	(1)	4	1	(5)	(1)
Other comprehensive loss, net of tax	(20)	(33)	(24)	57	(20)
Total comprehensive loss	<u>\$ (159)</u>	<u>\$ (189)</u>	<u>\$ (408)</u>	<u>\$ 597</u>	<u>\$ (159)</u>

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the six months ended January 3, 2020

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Net loss	\$ (415)	\$ (376)	\$ (843)	\$ 1,219	\$ (415)
Other comprehensive loss, before tax:					
Actuarial pension gain	3	3	3	(6)	3
Foreign currency translation adjustment	(10)	(8)	(8)	16	(10)
Net unrealized loss, on derivative contracts and available-for-sale securities	(39)	(34)	(23)	57	(39)
Total other comprehensive loss, before tax	(46)	(39)	(28)	67	(46)
Income tax benefit (expense) related to items of other comprehensive loss	4	3	—	(3)	4
Other comprehensive loss, net of tax	(42)	(36)	(28)	64	(42)
Total comprehensive loss	<u>\$ (457)</u>	<u>\$ (412)</u>	<u>\$ (871)</u>	<u>\$ 1,283</u>	<u>\$ (457)</u>

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the three months ended December 28, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Net income	\$ (487)	\$ (422)	\$ (133)	\$ 555	\$ (487)
Other comprehensive income, before tax:					
Actuarial pension gain	1	1	1	(2)	1
Foreign currency translation adjustment	31	32	32	(64)	31
Net unrealized gain, on derivative contracts and available-for-sale securities	7	30	30	(60)	7
Total other comprehensive income, before tax	39	63	63	(126)	39
Income tax benefit (expense) related to items of other comprehensive income	3	(2)	(2)	3	2
Other comprehensive income, net of tax	42	61	61	(123)	41
Total comprehensive loss	\$ (445)	\$ (361)	\$ (72)	\$ 432	\$ (446)

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the six months ended December 28, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Net income	\$ 24	\$ 43	\$ 212	\$ (255)	\$ 24
Other comprehensive income, before tax:					
Actuarial pension gain	1	1	1	(2)	1
Foreign currency translation adjustment	(6)	(2)	(2)	4	(6)
Net unrealized gain, on derivative contracts and available-for-sale securities	6	22	20	(42)	6
Total other comprehensive income, before tax	1	21	19	(40)	1
Income tax benefit (expense) related to items of other comprehensive income	4	(2)	(1)	2	3
Other comprehensive income, net of tax	5	19	18	(38)	4
Total comprehensive income	\$ 29	\$ 62	\$ 230	\$ (293)	\$ 28

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

Condensed Consolidating Statement of Cash Flows
For the six months ended January 3, 2020

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Cash flows from operating activities					
Net cash provided by (used in) operating activities	\$ (24)	\$ 499	\$ (125)	\$ 160	\$ 510
Cash flows from investing activities					
Purchases of property, plant and equipment	—	(84)	(221)	—	(305)
Acquisitions, net of cash acquired	—	(2)	(20)	—	(22)
Notes receivable issuances to Flash Ventures	—	—	(224)	—	(224)
Notes receivable proceeds from Flash Ventures	—	—	690	—	690
Strategic investments and other, net	—	6	15	—	21
Intercompany loan from (to) consolidated affiliates	—	(952)	(208)	1,160	—
Advances from (to) parent and consolidated affiliates	(71)	71	—	—	—
Net cash provided by (used in) investing activities	(71)	(961)	32	1,160	160
Cash flows from financing activities					
Issuance of stock under employee stock plans	72	—	—	—	72
Taxes paid on vested stock awards under employee stock plans	(54)	—	—	—	(54)
Dividends paid to shareholders	(296)	—	—	—	(296)
Repayment of debt	(707)	—	—	—	(707)
Intercompany loan from (to) consolidated affiliates	929	208	23	(1,160)	—
Change in investment in consolidated subsidiaries	154	55	(49)	(160)	—
Net cash provided by (used in) financing activities	98	263	(26)	(1,320)	(985)
Effect of exchange rate changes on cash	—	—	(3)	—	(3)
Net increase (decrease) in cash and cash equivalents	3	(199)	(122)	—	(318)
Cash and cash equivalents, beginning of year	8	985	2,462	—	3,455
Cash and cash equivalents, end of period	\$ 11	\$ 786	\$ 2,340	\$ —	\$ 3,137

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

Condensed Consolidating Statement of Cash Flows
For the six months ended December 28, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	<i>(in millions)</i>				
Cash flows from operating activities					
Net cash provided by (used in) operating activities	\$ 103	\$ (819)	\$ 1,934	\$ (44)	\$ 1,174
Cash flows from investing activities					
Purchases of property, plant and equipment	—	(129)	(371)	—	(500)
Proceeds from the sale of property, plant and equipment	—	—	3	—	3
Purchases of investments	—	(11)	(22)	—	(33)
Proceeds from sale of investments	—	—	13	—	13
Proceeds from maturities of investments	—	—	7	—	7
Notes receivable issuances to Flash Ventures	—	—	(508)	—	(508)
Notes receivable proceeds from Flash Ventures	—	—	312	—	312
Strategic investments and other, net	—	(1)	(18)	—	(19)
Intercompany loan from (to) consolidated affiliates	943	(370)	—	(573)	—
Advances from (to) parent and consolidated affiliates	(215)	215	—	—	—
Net cash provided by (used in) investing activities	728	(296)	(584)	(573)	(725)
Cash flows from financing activities					
Issuance of stock under employee stock plans	61	—	—	—	61
Taxes paid on vested stock awards under employee stock plans	(69)	—	—	—	(69)
Repurchases of common stock	(563)	—	—	—	(563)
Dividends paid to shareholders	(292)	—	—	—	(292)
Repayment of debt	(75)	—	—	—	(75)
Proceeds from (repayment of) revolving credit facility	(500)	—	—	—	(500)
Intercompany loan from (to) consolidated affiliates	370	(387)	(556)	573	—
Change in investment in consolidated subsidiaries	214	1,997	(2,255)	44	—
Net cash provided by (used in) financing activities	(854)	1,610	(2,811)	617	(1,438)
Effect of exchange rate changes on cash	—	—	(3)	—	(3)
Net increase (decrease) in cash and cash equivalents	(23)	495	(1,464)	—	(92)
Cash and cash equivalents, beginning of year	40	668	4,297	—	5,005
Cash and cash equivalents, end of period	\$ 17	\$ 1,163	\$ 2,833	\$ —	\$ 4,013

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

The following discussion and analysis contains forward-looking statements within the meaning of the federal securities laws, and should be read in conjunction with the disclosures we make concerning risks and other factors that may affect our business and operating results. You should read this information in conjunction with the unaudited Condensed Consolidated Financial Statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited Consolidated Financial Statements and notes thereto and Part II, Item 8, contained in our Annual Report on Form 10-K for the fiscal year ended June 28, 2019. See also “Forward-Looking Statements” immediately prior to Part I, Item 1 in this Quarterly Report on Form 10-Q.

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

Our Company

We are a leading developer, manufacturer and provider of data storage devices and solutions that address the evolving needs of the information technology (“IT”) industry and the infrastructure that enables the proliferation of data in virtually every other industry. We create environments for data to thrive. We drive the innovation needed to help customers capture, preserve, access and transform an ever-increasing diversity of data. Everywhere data lives, from advanced data centers to mobile sensors to personal devices, our industry-leading solutions deliver the possibilities of data.

Our broad portfolio of technology and products address the following key end markets: Client Devices; Data Center Devices and Solutions; and Client Solutions. We also generate license and royalty revenue from our extensive intellectual property (“IP”), which is included in each of these three end market categories.

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every five to six years, we report a 53-week fiscal year to align the fiscal year with the foregoing policy. Fiscal year 2020, which ends on July 3, 2020, will be comprised of 53 weeks, with the first quarter consisting of 14 weeks and the remaining quarters consisting of 13 weeks each. Fiscal year 2019, which ended on June 28, 2019, was comprised of 52 weeks, with all quarters presented consisting of 13 weeks.

Key Developments

Flash Ventures

Through our three business ventures with Kioxia Corporation (“Kioxia”), referred to as “Flash Ventures”, we and Kioxia operate flash-based memory wafer manufacturing facilities in Japan. We are obligated to pay for variable costs incurred in producing our share of Flash Ventures’ flash-based memory wafer supply, based on our three-month forecast, which generally equals 50% of Flash Ventures’ output. In addition, we are obligated to pay for half of Flash Ventures’ fixed costs regardless of the output we choose to purchase. We are also obligated to fund 49.9% to 50% of Flash Ventures’ capital investments to the extent that Flash Ventures’ operating cash flow is insufficient to fund these investments.

Since its inception, Flash Ventures has been based in a manufacturing site in Yokkaichi, Japan, which currently includes five wafer fabrication facilities. Production levels at the Yokkaichi site were temporarily reduced as a result of an unexpected power outage incident that occurred in the Yokkaichi region on June 15, 2019. The power outage incident impacted the facilities and process tools and resulted in the damage of flash wafers in production. The incident resulted in a reduction of our flash wafer availability by approximately 4 exabytes, the majority of which was contained in the first quarter of fiscal year 2020. As a result of this power outage incident, we incurred aggregate charges of \$68 million and \$145 million recorded in Cost of revenue in the quarters ended October 4, 2019 and June 28, 2019, respectively, which primarily consisted of the write-off of damaged inventory and unabsorbed manufacturing overhead costs. We are pursuing recovery of our losses associated with this event; however, the amount of any recovery cannot be estimated at this time.

In May 2019, we entered into additional agreements with Kioxia to extend Flash Ventures to a new wafer fabrication facility, known as “K1,” located in Kitakami, Japan. The primary purpose of K1 is to provide clean room space to continue the transition of existing flash-based wafer capacity to newer technology nodes. Output from the initial production line at K1 began in the second half of fiscal year 2020, although meaningful output from K1 is not expected to begin until the first half of fiscal year 2021. Our share of the initial commitment for K1 is expected to result in equipment investments, relocation costs and start-up costs totaling approximately \$660 million, of which \$500 million is still expected to be incurred primarily through the second half of fiscal year 2020. We also agreed to prepay an aggregate of approximately \$360 million over a 3-year period beginning in the first half of fiscal year 2020 toward K1 building depreciation, to be credited against future wafer charges. As of January 3, 2020, remaining committed prepayments totaled \$265 million.

Exit of Storage Systems Business

In September 2019, we announced the sale of our IntelliFlash business and our strategic intention to exit Storage Systems, which consists of IntelliFlash and ActiveScale. These actions will allow us to redirect investments to other higher value priorities. In November 2019, the Company completed its sale of IntelliFlash for a price of \$28 million, to be collected over the next three years. The sale of our IntelliFlash business included an immaterial amount of inventory, other tangible and intangible assets, and goodwill and resulted in a gain of approximately \$17 million recorded in Employee termination, asset impairment, and other charges in the Condensed Consolidated Statements of Operations for both the three and six months ended January 3, 2020. Additionally, in February 2020, we entered into an agreement for the sale of ActiveScale. The net assets sold and the proceeds from the sale of ActiveScale were not material.

Results of Operations

Second Quarter and First Half Overview

The following table sets forth, for the periods presented, selected summary information from our Condensed Consolidated Statements of Operations by dollars and percentage of net revenue⁽¹⁾:

	January 3, 2020		Three Months Ended December 28, 2018		\$ Change	% Change
	(\$ in millions)					
Revenue, net	\$ 4,234	100.0 %	\$ 4,233	100.0 %	\$ 1	— %
Cost of revenue	3,299	77.9	3,189	75.3	110	3
Gross profit	935	22.1	1,044	24.7	(109)	(10)
Operating Expenses:						
Research and development	578	13.7	539	12.7	39	7
Selling, general and administrative	298	7.0	309	7.3	(11)	(4)
Employee termination, asset impairment, and other charges	9	0.2	20	0.5	(11)	(55)
Total operating expenses	885	20.9	868	20.5	17	2
Operating income (loss)	50	1.2	176	4.2	(126)	(72)
Interest and other income (expense):						
Interest income	8	0.2	15	0.4	(7)	(47)
Interest expense	(105)	(2.5)	(118)	(2.8)	13	(11)
Other income (expense), net	7	0.2	8	0.2	(1)	(13)
Total interest and other expense, net	(90)	(2.1)	(95)	(2.2)	5	(5)
Income (loss) before taxes	(40)	(0.9)	81	1.9	(121)	(149)
Income tax expense	99	2.3	568	13.4	(469)	(83)
Net income (loss)	\$ (139)	(3.3)	\$ (487)	(11.5)	348	(71)

⁽¹⁾ Percentages may not total due to rounding.

	Six Months Ended					
	January 3, 2020		December 28, 2018		\$ Change	% Change
	(\$ in millions)					
Revenue, net	\$ 8,274	100.0 %	\$ 9,261	100.0 %	\$ (987)	(11)%
Cost of revenue	6,581	79.5	6,553	70.8	28	—
Gross profit	1,693	20.5	2,708	29.2	(1,015)	(37)
Operating Expenses:						
Research and development	1,152	13.9	1,115	12.0	37	3
Selling, general and administrative	603	7.3	665	7.2	(62)	(9)
Employee termination, asset impairment, and other charges	17	0.2	66	0.7	(49)	(74)
Total operating expenses	1,772	21.4	1,846	19.9	(74)	(4)
Operating income (loss)	(79)	(1.0)	862	9.3	(941)	(109)
Interest and other income (expense):						
Interest income	20	0.2	30	0.3	(10)	(33)
Interest expense	(227)	(2.7)	(234)	(2.5)	7	(3)
Other income (expense), net	9	0.1	6	0.1	3	50
Total interest and other expense, net	(198)	(2.4)	(198)	(2.1)	—	—
Income (loss) before taxes	(277)	(3.3)	664	7.2	(941)	(142)
Income tax expense	138	1.7	640	6.9	(502)	(78)
Net income (loss)	\$ (415)	(5.0)	\$ 24	0.3	(439)	(1,829)

(1) Percentages may not total due to rounding.

The following table sets forth, for the periods presented, summary information regarding our revenue:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	(in millions)			
Revenue by Product				
Hard disk drives (“HDD”)	\$ 2,396	\$ 2,060	\$ 4,804	\$ 4,554
Flash-based	1,838	2,173	3,470	4,707
Total Revenue	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261
Revenue by End Market				
Client Devices	\$ 1,797	\$ 2,214	\$ 3,413	\$ 4,864
Data Center Devices & Solutions	1,489	1,074	3,021	2,520
Client Solutions	948	945	1,840	1,877
Total Revenue	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261
Revenue by Geography				
Americas	\$ 1,296	\$ 1,015	\$ 2,609	\$ 2,296
Europe, Middle East and Africa	811	817	1,590	1,701
Asia	2,127	2,401	4,075	5,264
Total Revenue	\$ 4,234	\$ 4,233	\$ 8,274	\$ 9,261

Net Revenue

Net revenue was essentially flat in the three months ended January 3, 2020 from the comparable period in the prior year. Higher volumes of memory for HDD and flash products contributed approximately 20 and 9 percentage points of growth, respectively, which were largely offset by lower average selling prices. Client Devices revenue decreased 19% year over year, due to lower average selling prices, predominantly in flash products, which drove 33 percentage points of the decrease. The decrease in Client Devices revenue was partially offset by higher volumes of flash and HDD memory, which contributed approximately 10 and 4 percentage points of growth, respectively. Our revenue for Data Center Devices and Solutions increased 39% year over year, with volumes essentially doubling due to strength in both capacity enterprise HDD and SSD, partially offset by lower average selling prices with more efficient form factors. Client Solutions revenue was relatively flat year over year, with higher volumes of HDD and flash products contributing approximately 7 and 19 percentage points of growth, respectively, which were largely offset by lower average selling prices. While pricing for flash products remains down compared to the prior year, pricing has stabilized compared to last quarter and we expect flash pricing to improve during fiscal 2020, if supply and demand become more closely aligned as expected.

Net revenue decreased \$987 million, or 11%, in the six months ended January 3, 2020 from the comparable period in the prior year. Lower average selling prices generated approximately 32 percentage points of the year-over-year decline, with the majority of that decline attributed to flash-based products. This decline was partially offset by growth in HDD and flash products volumes, with higher HDD volumes contributing approximately 15 percentage points of growth and higher volumes of flash products contributing approximately 5 percentage points of growth. Client Devices revenue decreased 30% year over year, with approximately 32 percentage points due to lower average selling prices, predominantly related to flash products, partially offset by slightly higher volumes for flash products. Our revenue for Data Center Devices and Solutions increased 20% year over year, resulting from an approximately 27 percentage points of growth in volume of memory, primarily driven by strength in capacity enterprise HDD, partially offset by lower average selling prices in flash products. Client Solutions revenue decreased 2% year over year, which predominantly reflects lower prices on retail products.

The changes in net revenue by geography reflect a decrease in Asia primarily driven by our decision to limit our participation in the mobile market resulting in lower sales to manufacturers in the Asia region and a slight increase in the Americas driven by increased sales of capacity enterprise HDD.

The Company's top 10 customers accounted for 44% and 43% of its net revenue for the three and six months ended January 3, 2020, respectively, and 47% of its net revenue for both the three and six months ended December 28, 2018. For the three and six months ended January 3, 2020 and December 28, 2018, no single customer accounted for 10% or more of the Company's net revenue.

Consistent with standard industry practice, we have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. For the three and six months ended January 3, 2020, these programs represented 17% and 16%, respectively, of gross revenues. For the three and six months ended December 28, 2018, these programs represented 16% and 14%, respectively, of gross revenues. The amounts attributed to our sales incentive and marketing programs generally vary according to several factors including industry conditions, list pricing strategies, seasonal demand, competitor actions, channel mix and overall availability of products. Changes in future customer demand and market conditions may require us to adjust our incentive programs as a percentage of gross revenue.

Gross Profit and Gross Margin

Substantially all of the decrease in Gross profit for both the three and six months ended January 3, 2020 from the comparable periods in the prior year was due to the lower average selling prices noted above, partially offset by lower aggregate charges for amortization expense on acquired intangible assets, manufacturing underutilization charges, and charges related to the power outage incident. These charges aggregated \$157 million and \$264 million for the three-month periods ended January 3, 2020 and December 28, 2018, respectively, and \$389 million and \$499 million, respectively, for the six-month periods then ended. Gross margin declined 3 and 9 percentage points for the three and six months ended January 3, 2020, respectively, from the comparable periods in the prior year, with substantially all of the decline attributable to the lower average selling prices noted above, partially offset by cost reductions in our manufacturing processes.

Operating Expenses

Research and development (“R&D”) expense increased \$39 million for the three months ended January 3, 2020 from the comparable period in the prior year primarily due to increased variable compensation, partially offset by savings from our cost reduction actions. R&D expense increased \$37 million for the six months ended January 3, 2020 from the comparable period in the prior year primarily due to approximately \$30 million of additional expense related to the additional week in the current year.

Selling, general and administrative (“SG&A”) expense decreased \$11 million for the three months ended January 3, 2020 from the comparable period in the prior year primarily due to savings realized from our cost reduction actions. SG&A expense decreased \$62 million for the six months ended January 3, 2020 from the comparable period in the prior year primarily due to savings realized from our cost reduction actions, partially offset by approximately \$10 million of additional expense related to the additional week in the current year.

Employee termination, asset impairment and other charges decreased from the comparable periods in the prior year as many of the actions initiated in the prior year have been substantially completed. For additional information regarding employee termination, asset impairment and other charges, see Part I, Item 1, Note 14, *Employee Termination, Asset Impairment and Other Charges*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Interest and Other Income (Expense)

The decreases in total interest and other expense, net for both the three and six months ended January 3, 2020 primarily reflect decreases in interest expense resulting from the pay-down of principal on our debt and lower index rates, partially offset by decreases in Interest income resulting from lower invested cash.

Income Tax Expense

The Tax Cuts and Jobs Act (the “2017 Act”) includes a broad range of tax reform proposals affecting businesses. We completed our accounting for the tax effects of the enactment of the 2017 Act during the second quarter of fiscal 2019. However, the U.S. Treasury and the Internal Revenue Service (“IRS”) have issued tax guidance on certain provisions of the 2017 Act since the enactment date, and we anticipate the issuance of additional regulatory and interpretive guidance. We applied a reasonable interpretation of the 2017 Act along with the then-available guidance in finalizing our accounting for the tax effects of the 2017 Act. Any additional regulatory or interpretive guidance would constitute new information, which may require further refinements to our estimates in future periods.

The following table sets forth income tax information from our Condensed Consolidated Statements of Operations by dollar and effective tax rate:

	Three Months Ended		Six Months Ended	
	January 3, 2020	December 28, 2018	January 3, 2020	December 28, 2018
	<i>(in millions, except percentages)</i>		<i>(in millions, except percentages)</i>	
Income (loss) before taxes	\$ (40)	\$ 81	\$ (277)	\$ 664
Income tax expense (benefit)	99	568	138	640
Effective tax rate	(248)%	701%	(50)%	96%

The primary drivers of the difference between the effective tax rate for the three and six months ended January 3, 2020 and the U.S. Federal statutory rate of 21% are the relative mix of earnings and losses by jurisdiction, the deduction for foreign derived intangible income, credits and tax holidays in Malaysia, Philippines and Thailand that will expire at various dates during fiscal years 2020 through 2030. In addition, the effective tax rate for the six months ended January 3, 2020 includes the discrete effect of a de-recognition of \$33 million for certain deferred tax assets associated with creditable foreign withholding taxes due to the issuance of final regulatory guidance. The regulatory guidance does not preclude us from potentially claiming these creditable taxes as a period benefit when paid.

The primary drivers of the difference between the effective tax rate for the three and six months ended December 28, 2018 and the U.S. Federal statutory rate of 21% is the discrete effect of the finalization of the accounting for the tax effects of the enactment of the 2017 Act. For the three months ended December 28, 2018, these discrete effects consist of \$230 million related to the mandatory deemed repatriation tax and \$134 million related to the decision to change our indefinite reinvestment assertion. For the six months ended December 28, 2018, these discrete effects consist of \$178 million related to the mandatory deemed repatriation tax and \$144 million related to the decision to change our indefinite reinvestment assertion. For both periods, the remaining difference is attributable primarily to the changes in the relative mix of our U.S. earnings compared to foreign earnings.

Our future effective tax rate is subject to future regulatory developments and changes in the mix of our U.S. earnings compared to foreign earnings. Our total tax expense in future fiscal years may also vary as a result of discrete items such as excess tax benefits or deficiencies.

For additional information regarding Income tax expense (benefit), see Part I, Item 1, Note 12, *Income Tax Expense*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Liquidity and Capital Resources

The following table summarizes our statements of cash flows:

	Six Months Ended	
	January 3, 2020	December 28, 2018
<i>(in millions)</i>		
Net cash provided by (used in):		
Operating activities	\$ 510	\$ 1,174
Investing activities	160	(725)
Financing activities	(985)	(1,438)
Effect of exchange rate changes on cash	(3)	(3)
Net decrease in cash and cash equivalents	<u>\$ (318)</u>	<u>\$ (992)</u>

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

During fiscal 2020, we expect expenditures for property, plant and equipment for our company plus our portion of the capital expenditures by our Flash Ventures joint venture with Kioxia for its operations to aggregate between \$2.0 billion and \$2.5 billion. After consideration of the Flash Ventures' lease financing of its capital expenditures and cash flow from operations, we expect the Flash Ventures to continue to return cash to our company through net payments on our notes receivable during the remainder of fiscal 2020. As such, we expect net cash used for our purchases of property, plant and equipment and net activity in notes receivable relating to Flash Ventures to be close to zero. The total expected cash to be used could vary depending on the timing and completion of various capital projects and the availability, timing and terms of related financing.

A total of \$2.28 billion and \$2.37 billion of our Cash and cash equivalents was held outside of the U.S. as of January 3, 2020 and June 28, 2019, respectively. During fiscal 2019, the IRS issued interpretative guidance affecting the taxation of a certain portion of our foreign undistributed earnings, which could result in additional federal taxes. After consideration of this interpretative guidance, we made the determination that we do not intend to repatriate this portion of our foreign undistributed earnings and did not establish an accrual for this liability.

Operating Activities

Cash flow from operating activities primarily consists of net income, adjusted for non-cash charges, plus or minus changes in operating assets and liabilities. This represents our principal source of cash. Net cash provided by changes in operating assets and liabilities was \$20 million for the six months ended January 3, 2020, as compared to \$298 million net cash used for changes in operating assets and liabilities for the six months ended December 28, 2018. Changes in our operating assets and liabilities are largely affected by our working capital requirements, which are dependent on the effective management of our cash conversion cycle as well as timing of payments for taxes. Our cash conversion cycle measures how quickly we can convert our products into cash through sales. The cash conversion cycles were as follows:

	Three Months Ended	
	January 3, 2020	December 28, 2018
	<i>(in days)</i>	
Days sales outstanding	38	37
Days in inventory	86	98
Days payables outstanding	(58)	(64)
Cash conversion cycle	66	71

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

For the three months ended January 3, 2020, DSOs increased by 1 day over the prior year, primarily reflecting the timing of shipments and customer collections. DIOs decreased by 12 days over the prior year, primarily reflecting reduced levels of HDD inventory. DPOs decreased by 6 days over the prior year, primarily reflecting resumptions of normal flash production volumes as well as routine variations in the timing of purchases and payments during the period.

Investing Activities

Net cash provided by investing activities for the six months ended January 3, 2020 primarily consisted of a \$466 million net decrease in notes receivable issuances to Flash Ventures, partially offset by \$305 million of capital expenditures and \$22 million for acquisitions. Net cash used in investing activities for the six months ended December 28, 2018 primarily consisted of \$500 million of capital expenditures and a net \$196 million increase in notes receivable issuances to Flash Ventures to fund its capital expansion.

Our cash equivalents are primarily invested in money market funds that invest in U.S. Treasury securities and U.S. Government agency securities. In addition, from time to time, we invest directly in U.S. Treasury securities, U.S. and international government agency securities, certificates of deposit, asset backed securities and corporate and municipal notes and bonds.

Financing Activities

During the six months ended January 3, 2020, net cash used in financing activities primarily consisted of \$707 million for repayment of debt, \$296 million to pay dividends on our common stock and \$54 million for taxes paid on vested stock awards under employee stock plans. Net cash used in financing activities for the six months ended December 28, 2018 primarily consisted of \$575 million for the repayment of our revolving credit facility and other debt, \$563 million for share repurchases and \$292 million to pay dividends on our common stock. In the near term, we may use available cash on hand and cash from operations to further reduce our debt. In this regard, on January 31, 2020, we made an incremental voluntary prepayment of \$150 million on our Term Loan B-4.

Off-Balance Sheet Arrangements

Other than the commitments related to Flash Ventures, facility lease commitments incurred in the normal course of business and certain indemnification provisions (see “Short and Long-term Liquidity-Contractual Obligations and Commitments” below), we do not have any other material off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any other obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in the Condensed Consolidated Financial Statements. Additionally, with the exception of Flash Ventures and our joint venture with Unisplendour Corporation Limited and Unisoft (Wuxi) Group Co. Ltd. (“Unis”), referred to as the “Unis Venture”, we do not have an interest in, or relationships with, any variable interest entities. For additional information regarding our off-balance sheet arrangements, see Part I, Item 1, Note 9, *Related Parties and Related Commitments and Contingencies*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Short and Long-term Liquidity

Contractual Obligations and Commitments

The following is a summary of our known contractual cash obligations and commercial commitments as of January 3, 2020:

	Total	1 Year (Remaining 6 months of 2020)	2-3 Years (2021- 2022)	4-5 Years (2023- 2024)	More than 5 Years (Beyond 2024)
	(in millions)				
Long-term debt, including current portion ⁽¹⁾	\$ 9,986	\$ 126	\$ 537	\$ 7,023	\$ 2,300
Interest on debt	1,526	182	716	409	219
Flash Ventures related commitments ⁽²⁾	5,939	1,542	2,963	1,222	212
Operating leases	321	26	75	52	168
Purchase obligations and other commitments	3,278	1,604	748	588	338
Mandatory Deemed Repatriation Tax	1,056	14	199	285	558
Total	\$ 22,106	\$ 3,494	\$ 5,238	\$ 9,579	\$ 3,795

⁽¹⁾ Principal portion of debt, excluding discounts and issuance costs.

⁽²⁾ Includes reimbursement for depreciation and lease payments on owned and committed equipment, funding commitments for loans and equity investments and payments for other committed expenses, including R&D and building depreciation. Funding commitments assume no additional operating lease guarantees. Additional operating lease guarantees can reduce funding commitments.

Debt

Additional information regarding our indebtedness, including information about availability under our revolving credit facility and the principal repayment terms, interest rates, covenants and other key terms of our outstanding indebtedness, is included in Part I, Item 1, Note 7, *Debt*, of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q and in Part II, Item 8, Note 6, *Debt*, of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 28, 2019. The credit agreement governing our revolving credit facility and Term Loan A-1 requires us to comply with certain financial covenants, consisting of a leverage ratio and an interest coverage ratio. As of January 3, 2020, we were in compliance with these financial covenants.

Flash Ventures

Flash Ventures sells to and leases back from a consortium of financial institutions a portion of its tools and has entered into equipment lease agreements of which we guarantee half or all of the outstanding obligations under each lease agreement. The leases are subject to customary covenants and cancellation events that relate to Flash Ventures and each of the guarantors. The occurrence of a cancellation event could result in an acceleration of the lease obligations and a call on our guarantees. As of January 3, 2020, we were in compliance with all covenants under these Japanese lease facilities. See Part I, Item 1, Note 9, *Related Parties and Related Commitments and Contingencies*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for information regarding Flash Ventures.

Purchase Obligations and Other Commitments

In the normal course of business, we enter into purchase orders with suppliers for the purchase of components used to manufacture our products. These purchase orders generally cover forecasted component supplies needed for production during the next quarter, are recorded as a liability upon receipt of the components, and generally may be changed or canceled at any time prior to shipment of the components. We also enter into long-term agreements with suppliers that contain fixed future commitments, which are contingent on certain conditions such as performance, quality and technology of the vendor's components. These arrangements are included under "Purchase obligations" in the table above.

Mandatory Deemed Repatriation Tax

The following is a summary of our estimated mandatory deemed repatriation tax obligations that are payable in the following fiscal years (in millions):

	January 3, 2020
Remaining six months of 2020	\$ 14
2021	99
2022	100
2023	99
2024	186
2025	248
2026	310
Total	<u>\$ 1,056</u>

For additional information regarding our estimate of the total tax liability for the mandatory deemed repatriation tax, see Part II, Item 8, Note 13, *Income Tax Expense*, of the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended June 28, 2019.

Unrecognized Tax Benefits

As of January 3, 2020, the liability for unrecognized tax benefits (excluding accrued interest and penalties) was approximately \$696 million. Accrued interest and penalties related to unrecognized tax benefits as of January 3, 2020 was approximately \$131 million. Of these amounts, approximately \$708 million could result in potential cash payments. We are not able to provide a reasonable estimate of the timing of future tax payments related to these obligations.

Interest Rate Swap

We have generally held a balance of fixed and variable rate debt. At January 3, 2020, we had \$6.55 billion of variable rate debt, comprising 66% of the par value of our debt. To balance the portfolio and moderate our exposure to fluctuations in interest rates underlying our variable debt, we entered into pay-fixed interest rate swaps on \$2.00 billion notional amount, which effectively converts a portion of our term loan to fixed rates through February 2023. After giving effect to the \$2.00 billion of interest rate swaps, we effectively had \$4.55 billion of Long-term debt subject to variations in interest rates and a one percent increase in the variable rate of interest would increase annual expense by \$46 million.

Foreign Exchange Contracts

We purchase foreign exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for Operating expenses and product costs denominated in foreign currencies. For a description of our current foreign exchange contract commitments, see Part I, Item 1, Note 6, *Derivative Instruments and Hedging Activities*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Indemnifications

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

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

Stock Repurchase Program

Our Board of Directors has authorized a stock repurchase program for the repurchase of up to \$5.00 billion of our common stock, which authorization is effective through July 25, 2023. For the six months ended January 3, 2020, we did not make any stock repurchases. The remaining amount available to be repurchased under our current stock repurchase program as of January 3, 2020 was \$4.50 billion. Repurchases under the stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan. We expect stock repurchases to be funded principally by operating cash flows.

Cash Dividend

Since the first quarter of 2013, we have issued a quarterly cash dividend. During the six months ended January 3, 2020, we declared aggregate cash dividends of \$1.00 per share on our outstanding common stock totaling \$298 million, of which \$149 million was paid on January 21, 2020. We may modify, suspend, or cancel our cash dividend policy in any manner and at any time.

Recent Accounting Pronouncements

For a description of recently issued and adopted accounting pronouncements, including the respective dates of adoption and expected effects on our results of operations and financial condition, see Part I, Item 1, Note 2, *Recent Accounting Pronouncements*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Critical Accounting Policies and Estimates

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States (U.S. GAAP). The preparation of the financial statements requires the use of judgments and estimates that affect the reported amounts of revenues, expenses, assets, liabilities and shareholders' equity. We have adopted accounting policies and practices that are generally accepted in the industry in which we operate. If these estimates differ significantly from actual results, the impact to the Condensed Consolidated Financial Statements may be material.

See Part I, Item 1, Note 2, *Recent Accounting Pronouncements*, and Note 10, *Leases and Other Commitments*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a discussion of a recently adopted accounting pronouncement that affects our accounting for lease obligations. There have been no other material changes in our critical accounting policies and estimates from those disclosed in our Annual Report on Form 10-K for the fiscal year ended June 28, 2019. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 28, 2019 for a discussion of our critical accounting policies and estimates.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our market risk during the six months ended January 3, 2020. For a discussion of our exposure to market risk, see Part II, Item 7A, “Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for the fiscal year ended June 28, 2019.

Item 4. Controls and Procedures

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

There were no changes in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

We are implementing an enterprise resource planning (“ERP”) system on a worldwide basis, which is expected to improve the efficiency of certain financial and related transactional processes. The gradual implementation is expected to occur in phases over the next several years. We have completed the implementation of certain processes, including the financial consolidation and reporting, fixed assets, supplier management and indirect procure-to-pay processes, and have revised and updated the related controls. These changes did not materially affect our internal control over financial reporting. As we implement the remaining functionality under this ERP system over the next several years, we will continue to assess the impact on our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

None.

Item 1A. *Risk Factors*

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

Adverse global or regional conditions could harm our business, results of operations and financial condition.

A large portion of our revenue is derived from our international operations, and many of our products and components are produced overseas. As a result, our business, results of operations and financial condition depend significantly on global and regional conditions. Adverse changes in global or regional economic conditions, including, but not limited to, volatility in the financial markets, tighter credit, slower growth in certain geographic regions, political uncertainty, other macroeconomic factors, and changes to social conditions, policies, rules and regulations, could significantly harm demand for our products, increase credit and collectability risks, result in revenue reductions, cause us to change our business practices, increase manufacturing and operating costs or result in impairment charges or other expenses.

Our revenue and future growth are significantly dependent on the growth of international markets, and we may face difficulties in entering or maintaining international sales markets. We are subject to risks associated with our global manufacturing operations and global marketing and sales efforts, as well as risks associated with our utilization of and reliance on contract manufacturers, including:

- obtaining requisite governmental permits and approvals, compliance with foreign laws and regulations and changes in foreign laws and regulations;
- the need to comply with regulations on international business, including the Foreign Corrupt Practices Act, the United Kingdom Bribery Act 2010, the anti-bribery laws of other countries and rules regarding conflict minerals;
- copyright levies or similar fees or taxes imposed in European and other countries;
- exchange, currency and tax controls and reallocations;
- weaker protection of IP rights;
- trade restrictions, such as export controls, export bans, embargoes, sanctions, license and certification requirements (including semiconductor, encryption and other technology), new or increased tariffs and fees and complex customs regulations; and
- difficulties in managing international operations, including appropriate internal controls.

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

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

We depend on our ventures with Kioxia to develop and manufacture our flash-based memory. We partner with Kioxia on the development of flash-based technology, including future generations of 3D NAND, as well as other non-volatile memory technology in support of Flash Ventures. Flash Ventures is subject to various risks that could harm the value of our investments, our revenue and costs, our future rate of spending, our technology plans and our future growth opportunities.

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

Under the Flash Ventures agreements, we have limited power to unilaterally direct most of the activities that most significantly impact Flash Ventures' performance and we have limited ability to source or fabricate flash-based memory outside of Flash Ventures. Lack of alignment with Kioxia with respect to Flash Ventures could adversely impact our ability to stay at the forefront of technological advancement and our investment in Flash Ventures and otherwise harm our business. Misalignment could arise due to changes in Kioxia's strategic priorities, management and/or ownership, which has changed significantly recently and could continue to change. Kioxia's stakeholders may include, or have included in the past, flash and HDD competitors, customers, a private equity firm and a bank owned by the Government of Japan. Kioxia's management changes, ownership and capital structure could lead to delays in decision-making, disputes, or changes in strategic direction that could adversely impact Flash Ventures and/or adversely affect our business prospects, results of operations and financial condition. There may exist conflicts of interest between Kioxia's stakeholders and Flash Ventures or us with respect to, among other things, protecting and growing Flash Ventures' business, IP and competitively sensitive confidential information.

Flash Ventures requires significant investments by both Kioxia and us for technology transitions, including the transition to 3D NAND, and capacity expansions. In May 2019, Kioxia's parent company, Kioxia Holdings Corporation ("KHC"), announced new financing in the amount of 1.2 trillion Japanese yen. KHC's financing agreements and/or its high level of debt could limit Kioxia's ability to timely fund or finance investments in Flash Ventures or our joint development efforts, as well as limit Flash Ventures' ability to enter into lease financings. Availability of lease financings for Flash Ventures could also be limited by our and/or Kioxia's financial performance. To the extent that lease financings for Flash Ventures are not accessible on favorable terms or at all, more cash would be required to fund investments. If Kioxia does not or we do not provide sufficient resources, or have adequate access to credit, to timely fund investments in Flash Ventures, our investments could be delayed or reduced. Delayed or reduced investment in manufacturing capacity or R&D could harm Flash Ventures' competitiveness and/or our investment in Flash Ventures. In addition, KHC's financing arrangements might be secured by Kioxia's equity interests in Flash Ventures, permitting the lenders to foreclose on those equity interests under certain circumstances.

In May 2019, we entered into definitive agreements with Kioxia regarding a new 3D NAND wafer fabrication facility in Kitakami, Iwate, Japan, known as "K1." Under the K1 agreement, we agreed to, among other things, fund 50% of K1's initial production line. Output from the initial production line, which began in the second half of fiscal year 2020, could be delayed, reduced or otherwise fail to meet our expectations. As K1 is located at a new manufacturing site, K1 could be particularly susceptible to delays and other challenges in the production ramp and yields, qualification of wafers, shipment of samples to customers and customer approval process. Further, although we intend to continue to jointly invest with Kioxia to ramp up manufacturing capacity at K1, there is no certainty as to when, and on what terms, we will do so. If and for so long as our share of the K1 capacity falls below a specified threshold, we will be responsible for bearing fixed costs associated with K1's operations at that threshold, which could adversely affect our financial results.

We participate in a highly competitive industry that is subject to declining average selling prices (“ASPs”), volatile demand, rapid technological change and industry consolidation, all of which could adversely affect our operating results and financial condition.

Demand for our devices, software and solutions that we offer to our customers, which we refer to in this Item 1A as our “products”, depends in large part on the demand for systems (including personal computers and mobile devices) manufactured by our customers and on storage upgrades to existing systems. The demand for systems has been volatile in the past and often has had an exaggerated effect on the demand for our products in any given period. The prices of our products are influenced by, among other factors, the balance between supply and demand in the storage market, including the effects of new fab capacity, macroeconomic factors, business conditions, technology transitions and other actions taken by us or our competitors. The storage market has experienced volatile product life cycles, which can adversely affect our ability to recover the cost of product development, and periods of excess capacity, which can lead to liquidation of excess inventories, significant reductions in ASPs and adverse impacts on our revenue and gross margins.

Further, our ASPs and gross margins tend to decline when there is a shift in the mix of product sales, and sales of lower priced products increase relative to those of higher priced products. Further, we face potential gross margin pressures resulting from our ASPs declining more rapidly than our cost of revenue. Rapid technological changes often reduce the volume and profitability of sales of existing products and increase the risk of inventory obsolescence. Finally, the data storage industry has experienced consolidation over the past several years. Further consolidation across the industry could enhance the capacity, abilities and resources and lower the cost structure of some of our competitors, causing us to be at a competitive disadvantage. These factors may result in significant shifts in market share among the industry’s major participants, including a substantial decrease in our market share, all of which could adversely impact our operating results and financial condition.

In addition, we compete based on our ability to offer our customers competitive solutions that provide the most current and desired products and service features. As we compete in new product areas, the overall complexity of our business may increase at an accelerated rate and may result in increases in R&D expenses and substantial investments in manufacturing capability, technology enhancements and go-to-market capability. We must also qualify our products with customers through potentially lengthy testing processes, which may result in delayed, reduced or lost product sales. Some of our competitors offer products and technologies that we do not offer and may be able to use their broader product and technology portfolio to win sales from us, and some of our customers may be developing storage solutions internally, which may reduce their demand for our products. We expect that competition will continue to be intense, and there is a risk that our competitors may be able to gain a product offering or cost structure advantage over us, which may result in a loss of business to us. Further, some of our competitors may utilize certain pricing strategies, including offering products at prices at or below cost, that we may be unable to competitively match. We may also have difficulty effectively competing with manufacturers benefitting from governmental investments.

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

The storage markets in which we offer our products continuously undergo technology transitions that we must anticipate and adapt our existing products or develop new products to address in a timely manner. If we fail to implement new technologies successfully, if we are slower than our competitors at implementing new technologies, or if our technology transitions or product development are more costly to complete than anticipated, we may not be able to offer products our customers desire and our costs may not remain competitive, which would harm revenues, our gross margin and operating results.

In addition, the success of our technology transitions and product development and introduction depends on a number of other factors, including:

- R&D expenses and results;
- difficulties faced in manufacturing ramp;
- market acceptance/qualification;
- effective management of inventory levels in line with anticipated product demand;

- the vertical integration of some of our products, which may result in more capital expenditures and greater fixed costs than if we were not vertically integrated;
- our ability to cost effectively respond to customer requests for new products or features and software associated with our products;
- our ability to increase our software development capability; and
- the effectiveness of our go-to-market capability in selling new products.

Moving to new technologies and products may require us to align to, and build, a new supply base. Our success in new product areas may be dependent in part on our ability to develop close relationships with new suppliers and on our ability to enter into favorable supply agreements. Where this cannot be done, our business and operations may be adversely affected. In addition, if our customers choose to delay transition to new technologies, if demand for the products that we develop is lower than expected or if the supporting technologies to implement these new technologies are not available, we may be unable to achieve the cost structure required to support our profit objectives or may be unable to grow or maintain our market position.

Additionally, new technologies and products could substitute for or replace our current technologies and products and make them obsolete. We also develop products to meet certain industry and technical standards, which may change. We could incur substantial costs as a result of shifts in technology and standards, such as adopting new standards or investing in different capital equipment or manufacturing processes to remain competitive.

For additional technology transition risks related to Flash Ventures, see the risk factor entitled “*We rely substantially on our business ventures with Kioxia for the development and supply of flash-based memory, which subjects us to risks and uncertainties that could harm our business, financial condition and operating results.*”

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

We have entered into strategic relationships with various partners for future product development, sales growth and the supply of technologies, components, equipment and materials for use in our product design and manufacturing, including our partnership with Kioxia for flash-based memory development and manufacturing. These strategic relationships are subject to various risks that could adversely affect the value of our investments and our results of operations and financial condition. These risks include, but are not limited to, the following:

- our interests could diverge from our partners’ interests or we may not agree with co-venturers on ongoing activities, technology transitions or on the amount, timing or nature of further investments in the relationship;
- we may experience difficulties and delays in product and technology development at, ramping production at, and transferring technology to, our business ventures;
- our control over the operations of our business ventures is limited;
- due to financial constraints, our co-venturers may be unable to meet their commitments to us or may pose credit risks for our transactions with them;
- due to differing business models, financial constraints or long-term business goals, our partners may decide not to join us in funding capital investment by our business ventures, which may result in higher levels of cash expenditures by us or prevent us from proceeding in the investment;
- we may lose the rights to technology or products being developed by the strategic relationship, including if any of our co-venturers is acquired by another company or otherwise transfers its interest in the business venture, files for bankruptcy or experiences financial or other losses;
- a bankruptcy event involving a co-venturer could result in the early termination or adverse modification of the business venture or agreements governing the business venture;
- we may experience difficulties or delays in collecting amounts due to us from our co-venturers;

- the terms of our arrangements may turn out to be unfavorable; and
- changes in tax, legal or regulatory requirements may necessitate changes in the agreements with our co-venturers.

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

We are dependent on a limited number of qualified suppliers who provide critical materials or components, and a disruption in our supply chain, including a shortage in supply or a supplier's failure to support us in a timely manner with goods or services at a quality level and cost acceptable to us, or supplier consolidation, could adversely affect our margins, revenues and operating results.

We depend on an external supply base for technologies, software (including firmware), preamps, controllers, DRAM, components, equipment and materials for use in our product design and manufacturing. We also depend on suppliers for a portion of our wafer testing, chip assembly, product assembly and product testing, and on service suppliers for providing technical support for our products. In addition, we use logistics partners to manage our just-in-time hubs, distribution centers and freight from suppliers to our factories and from our factories to our customers throughout the world. Many of the components and much of the equipment we acquire must be specifically designed to be compatible for use in our products or for developing and manufacturing our future products, and are only available from a limited number of suppliers, some of whom are our sole-source suppliers. We are therefore dependent on these suppliers to be able and willing to meet our business needs including dedicating adequate engineering resources to develop components that can be successfully integrated into our products, technology and equipment.

Our suppliers have in the past been, and may in the future be, unable or unwilling to meet our requirements. If we are unable to purchase sufficient quantities from our current suppliers or qualify and engage additional suppliers, or if we cannot purchase materials at a reasonable price, we may not be able to meet demand for our products. Trade restrictions, including tariffs, quotas and embargoes, demand from other high volume industries for materials or components used in our products, disruptions in supplier relationships or shortages in other components and materials used in our customers' products could result in increased costs to us or decreased demand for our products, which could negatively impact our operating results. Delays or cost increases experienced by our suppliers in developing or sourcing materials and components for use in our products or incompatibility or quality issues relating to our products, could also harm our financial results as well as business relationships with our customers.

We do not have long-term contracts with some of our existing suppliers, nor do we always have guaranteed manufacturing capacity with our suppliers and, therefore, we cannot guarantee that they will devote sufficient resources or capacity to manufacturing our products. Any significant problems that occur at our suppliers, or their failure to perform at the level we expect, could lead to product shortages or quality assurance problems, either of which would harm our operating results and financial condition. When we do have contractual commitments with component suppliers in an effort to increase and stabilize the supply of those components, those 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 and may cause us to have inadequate or excess component inventory, which could increase our operating costs and adversely affect our operating results.

In addition, our supply base has experienced industry consolidation. Our suppliers may be acquired by our competitors, consolidate, decide to exit the industry, or redirect their investments and increase costs to us, each of which may have an adverse effect on our business and operations. In addition, some of our suppliers have experienced a decline in financial performance. Where we rely on a limited number of suppliers or a single supplier, the risk of supplier loss due to industry consolidation or a decline in financial performance is enhanced. Some of our suppliers may also be competitors in other areas of our business, which could lead to difficulties in price negotiations or meeting our supply requirements. Any disruption in our supply chain could reduce our revenue and adversely impact our financial results.

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

As a result of our cost structure and strategy of vertical integration, we conduct our operations at large, high volume, purpose-built facilities in California and throughout Asia. The facilities of many of our customers, our suppliers and our customers' suppliers are also concentrated in certain geographic locations throughout Asia and elsewhere. A fire, flood, earthquake, tsunami or other natural disaster, condition or event such as a power outage, terrorist attack, political instability, civil unrest, localized labor unrest or other employment issues, or a health epidemic that adversely affects any of these facilities, the employees, the technology infrastructure or logistics operators at these facilities, would significantly affect our ability to manufacture or sell our products and source components, which would result in a substantial loss of sales and revenue and a substantial harm to our operating results. In addition, the geographic concentration of our manufacturing sites could exacerbate the negative impacts resulting from any of these problems. A significant event that impacts any of our manufacturing sites, or the sites of our customers or suppliers, could adversely affect our ability to manufacture or sell our products, and our business, financial condition and results of operations could suffer.

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

We experience sales seasonality and cyclicity, which could cause our operating results to fluctuate. In addition, accurately forecasting demand has become more difficult, which could adversely affect our business and financial results or operating efficiencies.

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

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

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

Our success depends upon the continued contributions of our key management, staff and skilled employees, many of whom would be extremely difficult to replace. Changes in our key management team can result in loss of continuity, loss of accumulated knowledge, departure of other key employees, disruptions to our operations and inefficiency during transitional periods. Global competition for skilled employees in the technology related industry is intense, and our business success becomes increasingly dependent on our ability to retain our key staff and skilled employees, to implement succession plans for our key management and staff, to attract, integrate and retain new skilled employees, including employees from acquisitions, and to make decisions to realign our business to take advantage of efficiencies or reduce redundancies. Additionally, because a substantial portion of our key employees' compensation is placed "at risk" and linked to the performance of our business, including through equity compensation, when our operating results are negatively impacted, we may be at a competitive disadvantage for retaining and hiring key management, staff and skilled employees versus other companies that may pay a relatively higher portion of base compensation. If we are unable to hire and retain key management, staff or skilled employees, our operating results would likely be harmed.

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

We seek to be an industry-leading developer, manufacturer and provider of innovative storage solutions, balancing our core hard drive and flash memory business with growing investments in newer areas that we believe will provide us with higher growth opportunities. Acquisitions of, investment opportunities in, or other significant transactions with companies that are complementary to our business are a key part of our overall business strategy. In order to pursue this part of our growth strategy successfully, we must continue to identify attractive acquisition or investment opportunities, successfully complete the transactions, some of which may be large and complex, and manage post-closing issues such as integration of the acquired company or employees. We may not be able to continue to identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. 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. There may be difficulties with implementing new systems and processes or with integrating systems and processes of companies with complex operations, which could result in inconsistencies in standards, controls, procedures and policies and may increase the risk that our internal controls are found to be ineffective. Failing to successfully integrate or realign our business to take advantage of efficiencies or reduce redundancies of an acquisition may result in not realizing all or any of the anticipated benefits of the acquisition. In addition, failing to achieve the financial model projections for an acquisition or changes in technology development and related roadmaps following an acquisition may result in the incurrence of impairment charges and other expenses, both of which could adversely impact our results of operations or financial condition. Acquisitions and investments may also result in the issuance of equity securities that may be dilutive to our shareholders and the issuance of additional indebtedness that would put additional pressure on liquidity. Furthermore, we may agree to provide continuing service obligations or enter into other agreements in order to obtain certain regulatory approvals of our corporate transactions, and failure to satisfy these additional obligations could result in our failing to obtain regulatory approvals or the imposition of additional obligations on us, any of which could adversely affect our business, financial condition and results of operations. In addition, new legislation or additional regulations may affect or impair our ability to invest with or in certain other countries or require us to obtain regulatory approvals to do so, including investments in joint ventures, minority investments and outbound technology transfers to certain countries.

Any cost saving initiatives, restructurings or divestitures that we undertake may result in disruptions to our operations and may not deliver the results we expect, which may adversely affect our business.

From time to time, we engage in cost saving initiatives, restructurings and divestitures that may result in workforce reduction and consolidation of our manufacturing or other facilities. As a result of these actions, we may experience a loss of continuity, loss of accumulated knowledge, disruptions to our operations and inefficiency during transitional periods. These actions could also impact employee retention. In addition, we cannot be sure that these actions will be as successful in reducing our overall expenses as we expect, that additional costs will not offset any such reductions or consolidations or that we do not forego future business opportunities as a result of these actions. If our operating costs are higher than we expect or if we do not maintain adequate control of our costs and expenses, our operating results could be adversely affected.

Our high level of debt may adversely impact our liquidity, restrict our operations and ability to respond to business opportunities, and increase our vulnerability to adverse economic and industry conditions.

As of January 3, 2020, our total indebtedness was \$9.99 billion in aggregate principal, and we had \$2.25 billion of additional borrowing availability under our revolving credit facility.

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

- limiting our ability to obtain additional financing for working capital, capital expenditures, acquisitions or other general corporate purposes;
- requiring a substantial portion of our cash flows to be dedicated to debt service payments instead of other purposes;
- imposing financial and other restrictive covenants on our operations, including limiting our ability to (i) declare or pay dividends or repurchase shares of our common stock; (ii) purchase assets, make investments, complete acquisitions, consolidate or merge with or into, or sell all or substantially all of our assets to, another person; (iii) dispose of assets; (iv) incur liens; and (v) enter into transactions with affiliates; and
- making us more vulnerable to economic downturns and limiting our ability to withstand competitive pressures or take advantage of new opportunities to grow our business.

Our ability to meet the debt service obligations and to comply with our debt covenants depends on our cash flows and financial performance, which are affected by financial, business, economic and other factors. Failure to meet our debt service obligations or comply with our debt covenants could result in an event of default under the applicable indebtedness. We may be unable to cure, or obtain a waiver of, an event of default or otherwise amend our debt agreements to prevent an event of default thereunder on terms acceptable to us or at all. In that event, the debt holders could accelerate the related debt, which may result in the cross-acceleration or cross-default of other debt, leases or other obligations. We may not have sufficient funds available to repay accelerated indebtedness, and we may be required to refinance all or part of our debt, sell important strategic assets at unfavorable prices, incur additional indebtedness or issue common stock or other equity securities, which we may be unable to do on terms acceptable to us, in amounts sufficient to meet our needs or at all. Our inability to service our debt obligations or refinance our debt could have a material adverse effect on our business, operating results and financial condition. Further, if we are unable to repay, refinance or restructure our secured indebtedness, the holder of such debt could proceed against the collateral securing that indebtedness. Refinancing our indebtedness may also require us to expense previous debt issuance costs or to incur new debt issuance costs.

As our bank debt contains a variable interest rate component based on our corporate credit ratings, a decline in our ratings could result in increased interest rates and debt service obligations. In addition, our ratings impact the cost and availability of future borrowings and, accordingly, our cost of capital. Our ratings reflect the opinions of the ratings agencies as to our financial strength, operating performance and ability to meet our debt obligations. There can be no assurance that we will achieve a particular rating or maintain a particular rating in the future.

Our credit agreement uses LIBOR as a reference rate for our term loans and revolving credit facility, such that the applicable interest rate may, at our option, be calculated based on LIBOR. In July 2017, the U.K.'s Financial Conduct Authority, which regulates LIBOR, announced that it intends to phase out LIBOR by the end of 2021. In April 2018, the Federal Reserve Bank of New York began publishing a Secured Overnight Funding Rate, which is intended to replace U.S. dollar LIBOR. Plans for alternative reference rates for other currencies have also been announced. At this time, we cannot predict how markets will respond to these proposed alternative rates or the effect of any changes to LIBOR or the discontinuation of LIBOR. If LIBOR is no longer available or if our lenders have increased costs due to changes in LIBOR, we may experience potential increases in interest rates on our variable rate debt, which could adversely impact our interest expense, results of operations and cash flows. In addition, replacing LIBOR with an alternative reference rate for any of our debt could be a taxable event.

We may from time to time seek to further refinance our substantial indebtedness by issuing additional shares of common stock, which may dilute our existing shareholders, reduce the value of our common stock, or both.

Tax matters may materially affect our financial position and results of operations.

Changes in tax laws in the United States, the European Union and around the globe have impacted and will continue to impact our effective worldwide tax rate, which may materially affect our financial position and results of operations. Further, organizations such as the Organization for Economic Cooperation and Development, have published action plans that, if adopted by countries where we do business, could increase our tax obligations in these countries. Due to the large scale of our U.S. and international business activities, many of these enacted and proposed changes to the taxation of our activities could increase our worldwide effective tax rate and harm our financial position and results of operations. Additionally, portions of our operations are subject to a reduced tax rate or are free of tax under various tax holidays that expire in whole or in part from time to time, or may be terminated if certain conditions are not met. Although many of these holidays may be extended when certain conditions are met, we may not be able to meet such conditions. If the tax holidays are not extended, or if we fail to satisfy the conditions of the reduced tax rate, then our effective tax rate could increase in the future.

Our determination of our tax liability in the U.S. and other jurisdictions is subject to review by applicable domestic and foreign tax authorities. For example, as disclosed in Part I, Item 1, Note 12, *Income Tax Expense*, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, we are under examination by the Internal Revenue Service for certain fiscal years and in connection with that examination, we received statutory notices of deficiency seeking certain adjustments to income and have filed petitions with the U.S. Tax Court. Although we believe our tax positions are properly supported, the final timing and resolution of any tax examinations are subject to significant uncertainty and could result in litigation or the payment of significant amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations or cash flows.

Sales in the distribution channel and to the retail market are important to our business, and if we fail to respond to demand changes within these markets, or maintain and grow our applicable market share, 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. As a result of the shift to mobile devices, 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 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, our operating results would be adversely affected. Negative changes in the credit-worthiness or the ability to access credit, or the bankruptcy or shutdown of any of our significant retail or distribution partners would harm our revenue and our ability to collect outstanding receivable balances.

A significant portion of our sales is also made through retailers. 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 retail market channels. Particularly in the retail market, adverse publicity, whether or not justified, or allegations of product or service quality issues, even if false or unfounded, could damage our reputation and cause our customers to choose products offered by our competitors. If customers no longer maintain a preference for our product brands or if our retailers are not successful in selling our products, our operating results may 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 six months ended January 3, 2020, 43% of our revenue came from sales to our top 10 customers. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, often resulting in the allocation of risk to us as the supplier. Our ability to maintain strong relationships with our principal customers is essential to our future performance. We have experienced and may in the future experience events such as the loss of a key customer, prohibition or restriction of sales to a key customer by law, regulation or other government action, reductions in sales to or orders by a key customer, customer requirements to reduce our prices before we are able to reduce costs or the acquisition of a key customer by one of our competitors. These events would likely harm our operating results and financial condition.

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. Consolidation among our customer base may also lead to reduced demand for our products, increased customer pressure on our prices, replacement of our products by the combined entity with those of our competitors and cancellations of orders, each of which could harm our operating results.

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

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

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

- weakness in demand for one or more product categories;
- the timing of orders from and shipment of products to major customers or loss of major customers;
- our product mix;
- reductions in the ASPs of our products and lower margins;
- excess output, capacity or inventory, resulting in lower ASPs, financial charges or impairments, or insufficient output, capacity or inventory, resulting in lost revenue opportunities;
- inability to successfully implement technology transitions or other technology developments, or other failure to reduce product costs to keep pace with reduction in ASPs;
- manufacturing delays or interruptions;
- delays in design wins or customer qualifications, acceptance by customers of competing products in lieu of our products;
- variations in the cost of and lead times for components for our products, disruptions of our supply chain;
- increase in costs due to warranty claims; and
- higher costs as a result of currency exchange rate fluctuations.

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.

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

We experience cyber attacks of varying degrees on our technology infrastructure and systems and, as a result, unauthorized parties have obtained in the past, and may in the future obtain, access to our computer systems and networks, including cloud-based platforms. The technology infrastructure and systems of our suppliers, vendors, service providers, cloud solution providers and partners have in the past experienced and may in the future experience such attacks. Cyber attacks can include computer viruses, computer denial-of-service attacks, worms, and other malicious software programs or other attacks, covert introduction of malware to computers and networks, impersonation of authorized users, and efforts to discover and exploit any design flaws, bugs, security vulnerabilities or security weaknesses, as well as intentional or unintentional acts by employees or other insiders with access privileges, intentional acts of vandalism or fraud by third parties and sabotage. In some instances, efforts to correct vulnerabilities or prevent attacks may reduce the performance of our computer systems and networks, which could negatively impact our business. We believe cyber attack attempts are increasing in number and that cyber attackers are developing increasingly sophisticated systems and means to not only attack systems, but also to evade detection or to obscure their activities.

Our products are also targets for cyber attacks, including those products utilized in cloud-based environments as well as our cloud service offerings. While some of our products contain encryption or security algorithms to protect third-party content or user-generated data stored on our products, these products could still be hacked or the encryption schemes could be compromised, breached, or circumvented by motivated and sophisticated attackers. Further, our products contain sophisticated hardware and operating system software and applications that may contain security problems, security vulnerabilities, or defects in design or manufacture, including “bugs” and other problems that could interfere with the intended operation of our products. To the extent our products are hacked or the encryption schemes are compromised or breached, this could harm our business by requiring us to employ additional resources to fix the errors or defects, exposing us to litigation and indemnification claims and hurting our reputation.

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

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

We are subject to laws, rules, and regulations relating to the collection, use, and security and privacy of third-party data including data that relates to or identifies an individual person. In many cases, these laws apply not only to third-party transactions, but also to transfers of information between us and our subsidiaries, and among us, our subsidiaries and other parties with which we have commercial relations. Our possession and use of third-party data, including personal data and employee data in conducting our business, subjects us to legal and regulatory burdens that may require us to notify vendors, customers or employees or other parties with which we have commercial relations of a data security breach and to respond to regulatory inquiries and to enforcement proceedings. Laws and regulations relating to the collection, use, and security and privacy of third-party data change over time and new laws and regulations become effective from time to time. For example, the California Consumer Privacy Act (“CCPA”), which became effective January 1, 2020, imposes new obligations on certain companies doing business in California with respect to the personal information of California residents. These obligations include new notice and privacy policy requirements, as well as new obligations to respond to requests to know and access personal information, delete personal information and say no to the sale of personal information. Global privacy and data protection legislation, enforcement, and policy activity in this area are rapidly expanding and evolving, and may be inconsistent from jurisdiction to jurisdiction. Compliance requirements and even our inadvertent failure to comply with applicable laws may cause us to incur substantial costs, subject us to proceedings by governmental entities or others, and cause us to incur penalties or other significant legal liability, or lead us to change our business practices.

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, litigation or indemnification claims.

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

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

We are subject to state, federal and international legal and regulatory requirements, such as environmental, labor, trade, health, safety, anti-corruption and tax regulations, customers' standards of corporate citizenship, and industry and coalition standards, such as those established by the Responsible Business Alliance ("RBA"), and compliance with those requirements could cause an increase in our operating costs and failure to comply may harm our business.

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

In connection with our compliance with environmental laws and regulations, as well as our compliance with industry and coalition environmental initiatives, such as those established by the RBA, 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 or our suppliers, customers or partners were found to be in violation of these laws or noncompliant with these initiatives or standards of conduct, we could be subject to governmental fines, liability to our customers and damage to our reputation and corporate brand, which could cause our financial condition and operating results to suffer.

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

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

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

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

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

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

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

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

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

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

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

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

Flash Ventures sells to and leases back a portion of its equipment from a consortium of financial institutions. Most of the lease obligations are guaranteed 50% by us and 50% by Kioxia. Some of the lease obligations are guaranteed in full by us. As of January 3, 2020, the portion of outstanding obligations covered by our guarantees totaled approximately \$1.75 billion, based upon the Japanese yen to U.S. dollar exchange rate at January 3, 2020. The leases are subject to customary covenants and cancellation events that relate to Flash Ventures and each of the guarantors. Cancellation events include, among other things, an assignment of all or a substantial part of a guarantor's business and acceleration of other monetary debts of Flash Ventures or a guarantor above a specified threshold. If a cancellation event were to occur, Flash Ventures would be required to negotiate a resolution with the other parties to the lease transactions to avoid cancellation and acceleration of the lease obligations. Such resolution could include, among other things, supplementary security to be supplied by us, increased interest rates or waiver fees. If a resolution is not reached, we may be required to pay all of the outstanding lease obligations covered by our guarantees, which would significantly reduce our cash position and may force us to seek additional financing, which may not be available on terms acceptable to us, if at all.

Any decisions to reduce or discontinue paying cash dividends to our shareholders or to reduce or discontinue repurchases of shares of our common stock pursuant to our previously announced stock repurchase program could cause the market price for our common stock to decline.

We may modify, suspend or cancel our cash dividend policy in any manner and at any time. In addition, we may start, stop or vary repurchases of shares of our common stock as we deem appropriate and as market conditions allow. Any reduction or discontinuance by us of the payment of quarterly cash dividends or the repurchases of our common stock pursuant to our stock repurchase program could cause the market price of our common stock to decline. Moreover, in the event our payment of quarterly cash dividends or repurchases of shares of our common stock are reduced or discontinued, our failure or inability to resume paying cash dividends or repurchasing shares of our common stock at historical levels could cause the market price of our common stock to decline.

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

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

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

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

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

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

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 net realizable value;
- testing of goodwill and other long-lived assets for impairment;

- accruals for product returns;
- accruals for litigation and other contingencies;
- valuation allowances on deferred tax assets;
- liabilities for unrecognized tax benefits; and
- provisional estimates related to tax reform.

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

The market price of our common stock is volatile.

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

- actual or anticipated fluctuations in our operating results, including those resulting from the seasonality of our business;
- perceptions about our strategic relationships and joint ventures, access to supply of flash-based memory, new technologies and technology transitions;
- announcements of technological innovations or new products 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;
- strategic actions by us or competitors, such as acquisitions and restructurings;
- periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures or industry consolidation;
- proposed or adopted regulatory changes or developments or anticipated or pending investigations, proceedings or litigation that involve or affect us or our competitors;
- failure to meet analysts' revenue or earnings estimates or changes in financial estimates or publication of research reports and recommendations by financial analysts relating specifically to us or the storage industry in general;
- announcements relating to dividends and share repurchases; and
- macroeconomic conditions that affect the market generally and, in particular, developments related to market conditions for our industry.

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

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

Further, a sustained decline in our stock price or market capitalization are among the factors that may be considered a change in circumstances indicating that the carrying value of our long-lived assets or goodwill may be impaired and, if an impairment review is triggered, could require us to record a significant charge to earnings in our Consolidated Financial Statements.

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

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

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

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

Recent Sales of Unregistered Securities

There were no unregistered sales of equity securities during the quarter ended January 3, 2020.

Issuer Purchases of Equity Securities

There were no repurchases of shares of our common stock during the quarter ended January 3, 2020.

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *Mine Safety Disclosures*

Not applicable.

Item 5. *Other Information*

None.

Item 6. *Exhibits*

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

EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (File No. 1-08703) with the Securities and Exchange Commission on February 8, 2006)
3.2	Amended and Restated By-Laws of Western Digital Corporation, as amended effective as of May 2, 2018 (Filed as Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on May 7, 2018)
10.1	Western Digital Corporation Amended and Restated 2017 Performance Incentive Plan (Filed as Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 1-08703) with the Securities and Exchange Commission on November 14, 2019)*
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**
101.INS	XBRL Instance Document - formatted in Inline XBRL†
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†
104	Cover Page Interactive Data File - formatted in Inline XBRL and contained in Exhibit 101

† Filed with this report.

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

** Furnished with this report.

SIGNATURES

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

WESTERN DIGITAL CORPORATION

By: /s/ Gene Zamiska

Gene Zamiska

Vice President, Global Accounting and Chief Accounting Officer
(Principal Accounting Officer)

Dated: February 10, 2020

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Stephen D. Milligan, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Western Digital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Stephen D. Milligan

Stephen D. Milligan
Chief Executive Officer

Dated: February 10, 2020

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Robert K. Eulau, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Western Digital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Robert K. Eulau

Robert K. Eulau

Executive Vice President and Chief Financial Officer

Dated: February 10, 2020

The following certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350 and in accordance with SEC Release No. 33-8238. This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that Western Digital Corporation specifically incorporates it by reference.

Certification of Chief Executive Officer

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Western Digital Corporation, a Delaware corporation (the “Company”), hereby certifies, to his knowledge, that:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the period ended January 3, 2020 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Stephen D. Milligan

Stephen D. Milligan
Chief Executive Officer

Dated: February 10, 2020

The following certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350 and in accordance with SEC Release No. 33-8238. This certification shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that Western Digital Corporation specifically incorporates it by reference.

Certification of Chief Financial Officer

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Western Digital Corporation, a Delaware corporation (the “Company”), hereby certifies, to his knowledge, that:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the period ended January 3, 2020 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert K. Eulau

Robert K. Eulau

Executive Vice President and Chief Financial Officer

Dated: February 10, 2020