WESTERN DIGITAL CORP
Form 10-Q
February 05, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 28, 2018
Or
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 1-8703

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company	Emerging growth company
ý	¨	¨	¨	¨

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 ý
As of the close of business on January 29, 2019, 290,850,938 shares of common stock, par value $0.01 per share, were outstanding.

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

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

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FORWARD-LOOKING STATEMENTS

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

- expectations regarding our Flash Ventures joint venture with Toshiba Memory Corporation, the flash industry and our flash wafer output plans;
- our cost and expense reduction actions;
- our quarterly cash dividend policy and share repurchase program;
- expectations regarding our product development and technology plans;
- expectations regarding our future results of operations;
- expectations regarding the outcome of legal proceedings in which we are involved;
- expectations regarding the impact of the Tax Cuts and Jobs Act enacted on December 22, 2017 on the Company;
- 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, our debt and debt covenants, our dividend plans and our capital expenditure needs.

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

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (unaudited)

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

	December 28, 2018	June 29, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,013	$ 5,005
Accounts receivable, net	1,715	2,197
Inventories	3,427	2,944
Other current assets	587	492
Total current assets	9,742	10,638
Property, plant and equipment, net	3,077	3,095
Notes receivable and investments in Flash Ventures	2,318	2,105
Goodwill	10,074	10,075
Other intangible assets, net	2,148	2,680
Other non-current assets	580	642
Total assets	$ 27,939	$ 29,235
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,925	$ 2,265
Accounts payable to related parties	310	259
Accrued expenses	1,526	1,274
Accrued compensation	345	479
Current portion of long-term debt	244	179
Total current liabilities	4,350	4,456
Long-term debt	10,370	10,993
Other liabilities	2,307	2,255
Total liabilities	17,027	17,704
Commitments and contingencies (Notes 7, 9, 11 and 14)		
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 — 291 shares and 296 shares, respectively	3	3
Additional paid-in capital	4,062	4,254
Accumulated other comprehensive loss	(35)	(39)
Retained earnings	8,532	8,757
Treasury stock — common shares at cost; 21 shares and 16 shares, respectively	(1,650)	(1,444)
Total shareholders' equity	10,912	11,531
Total liabilities and shareholders' equity	$ 27,939	$ 29,235

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

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

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Revenue, net	$4,233	$ 5,336	$9,261	$ 10,517
Cost of revenue	3,189	3,323	6,553	6,591
Gross profit	1,044	2,013	2,708	3,926
Operating expenses:				
Research and development	539	629	1,115	1,221
Selling, general and administrative	309	381	665	745
Employee termination, asset impairment, and other charges	20	48	66	100
Total operating expenses	868	1,058	1,846	2,066
Operating income	176	955	862	1,860
Interest and other income (expense):				
Interest income	15	14	30	30
Interest expense	(118)	(197)	(234)	(402)
Other income (expense), net	8	2	6	(4)
Total interest and other expense, net	(95)	(181)	(198)	(376)
Income before taxes	81	774	664	1,484
Income tax expense	568	1,597	640	1,626
Net income (loss)	$(487)	$ (823)	$24	$ (142)
Income (loss) per common share				
Basic	$(1.68)	$ (2.78)	$0.08	$ (0.48)
Diluted	$(1.68)	$ (2.78)	$0.08	$ (0.48)
Weighted average shares outstanding:				
Basic	290	296	291	295
Diluted	290	296	296	295
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.

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

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Net income (loss)	$ (487)	$ (823)	$ 24	$ (142)
Other comprehensive income, before tax:				
Actuarial pension gain	1	—	1	—
Foreign currency translation adjustment	31	6	(6)	2
Net unrealized gain on derivative contracts and available-for-sale securities	7	10	6	13
Total other comprehensive income, before tax	39	16	1	15
Income tax benefit (expense) related to items of other comprehensive income, before tax	2	(3)	3	(3)
Other comprehensive income, net of tax	41	13	4	12
Total comprehensive income (loss)	$ (446)	$ (810)	$ 28	$ (130)

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

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

	Six Months Ended	
	December 28, 2018	December 29, 2017
Cash flows from operating activities		
Net income (loss)	$24	$ (142)
Adjustments to reconcile net income (loss) to net cash provided by operations:		
Depreciation and amortization	952	1,068
Stock-based compensation	158	196
Deferred income taxes	281	(129)
Loss on disposal of assets	1	12
Write-off of issuance costs and amortization of debt discounts	19	23
Other non-cash operating activities, net	37	16
Changes in:		
Accounts receivable, net	482	(99)
Inventories	(483)	65
Accounts payable	(256)	(276)
Accounts payable to related parties	51	44
Accrued expenses	254	95
Accrued compensation	(134)	17
Other assets and liabilities, net	(212)	1,425
Net cash provided by operating activities	1,174	2,315
Cash flows from investing activities		
Purchases of property, plant and equipment	(500)	(416)
Proceeds from the sale of property, plant and equipment	3	10
Acquisitions, net of cash acquired	—	(99)
Purchases of investments	(33)	(57)
Proceeds from sale of investments	13	29
Proceeds from maturities of investments	7	16
Notes receivable issuances to Flash Ventures	(508)	(621)
Notes receivable proceeds from Flash Ventures	312	112
Strategic investments and other, net	(19)	19
Net cash used in investing activities	(725)	(1,007)
Cash flows from financing activities		
Issuance of stock under employee stock plans	61	99
Taxes paid on vested stock awards under employee stock plans	(69)	(67)
Repurchases of common stock	(563)	—
Repayment of revolving credit facility	(500)	—
Dividends paid to shareholders	(292)	(295)
Settlement of debt hedge contracts	—	28
Repayment of debt	(75)	(4,114)
Proceeds from debt	—	2,963
Debt issuance costs	—	(5)
Net cash used in financing activities	(1,438)	(1,391)
Effect of exchange rate changes on cash	(3)	1
Net decrease in cash and cash equivalents	(992)	(82)

Cash and cash equivalents, beginning of year	5,005	6,354
Cash and cash equivalents, end of period	$4,013	$ 6,272
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$264	$ 140
Cash paid for interest	$216	$ 308

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

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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
Employee stock plans	—	—	1	198	(256)	—	—	(58)
Adoption of New Accounting Standards	—	—	—	—	—	—	56	56
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

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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 30, 2017	312	$ 3	(18)	$(1,666)	$ 4,506	$ (58)	$ 8,633	$ 11,418
Net income	—	—	—	—	—	—	681	681
Employee stock plans	—	—	1	156	(197)	—	—	(41)
Adoption of New Accounting Standards	—	—	—	—	(19)	—	70	51
Stock-based compensation	—	—	—	—	97	—	—	97
Dividends to shareholders	—	—	—	—	9	—	(155)	(146)
Foreign currency translation adjustment	—	—	—	—	—	(4)	—	(4)
Net unrealized gain on derivative contracts and available-for-sale securities	—	—	—	—	—	3	—	3
Balance at September 29, 2017	312	$ 3	(17)	$(1,510)	$ 4,396	$ (59)	$ 9,229	$ 12,059
Net loss	—	—	—	—	—	—	(823)	(823)
Employee stock plans	—	—	2	165	(92)	—	—	73
Stock-based compensation	—	—	—	—	99	—	—	99
Dividends to shareholders	—	—	—	—	7	—	(156)	(149)
Foreign currency translation adjustment	—	—	—	—	—	6	—	6
Net unrealized gain on derivative contracts and available-for-sale securities	—	—	—	—	—	7	—	7
Balance at December 29, 2017	312	$ 3	(15)	$(1,345)	$ 4,410	$ (46)	$ 8,250	$ 11,272

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

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

Note 1. 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 industry and the infrastructure that enables the proliferation of data in virtually every other industry. The Company's broad portfolio of technology and products address the following key markets: Client Devices; Data Center Devices and Solutions; and Client Solutions. The Company also generates license and royalty revenue related to its intellectual property ("IP"), which is included in each of these three 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 29, 2018. 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 29, 2018. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

Fiscal Year

The Company's fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Fiscal years 2019, which ends on June 28, 2019, and 2018, which ended on June 29, 2018, are each comprised of 52 weeks, with all quarters presented consisting of 13 weeks. 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.

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.

Note 2. Recent Accounting Pronouncements

Accounting Pronouncements Recently Adopted

On August 29, 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-15, "Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract" ("ASU 2018-15"), to reduce diversity in practice in accounting for the costs of implementing cloud computing arrangements that are service contracts. ASU 2018-15 allows entities to apply the guidance in the FASB Accounting Standards Codification ("ASC") 350-40 to determine which implementation costs are eligible to be capitalized as assets in a cloud computing arrangement that is considered a service contract. The Company adopted this standard on a prospective basis effective June 30, 2018, the beginning of fiscal year 2019, as allowed by the standard. The adoption of this standard and the costs capitalized for the six months ended December 28, 2018 were not material to the Company's Condensed Consolidated Financial Statements.

In February 2018, the FASB issued ASU No. 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"). ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act enacted on December 22, 2017 (the "2017 Act"). Consequently, the amendments eliminate the stranded tax effects resulting from the 2017 Act and will improve the usefulness of information reported to financial statement users. Because the amendments only relate to the reclassification of the income tax effects of the 2017 Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. For tax effects that are unrelated to the 2017 Act, the Company's policy to release these from Accumulated other comprehensive loss on an individual item basis rather than a portfolio basis remains unchanged. The Company early adopted this standard effective June 30, 2018 and elected to reclassify stranded tax effects resulting from the 2017 Act from Accumulated other comprehensive loss to Retained earnings. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In August 2017, the FASB issued ASU No. 2017-12, "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities" ("ASU 2017-12"). ASU 2017-12 simplifies hedge accounting through changes to both designation and measurement requirements. For hedges that qualify as highly effective, the new standard eliminates the requirement to separately measure and record hedge ineffectiveness with the entire change in fair value of designated hedge reported in the results of operations in the same line item as the hedged item. The Company early adopted this standard effective June 30, 2018, using the modified retrospective approach. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In May 2017, the FASB issued ASU No. 2017-09, "Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2017-09"). ASU 2017-09 provides clarification when a change to the terms or conditions of a share-based payment award must be accounted for as a modification. The new guidance requires modification accounting if the fair value, vesting condition or the classification of the award is not the same immediately before and after a change to the terms and conditions of the award. The Company adopted this standard on a prospective basis effective June 30, 2018. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In March 2017, the FASB issued ASU No. 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" ("ASU 2017-07"). ASU 2017-07 requires that the Company report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. In addition, the other components of net benefit cost are now presented in Other income (expense), net in the Condensed Consolidated Statements of Operations. The Company adopted this standard effective June 30, 2018. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business" ("ASU 2017-01"). ASU 2017-01 narrows the definition of a "business." This standard provides guidance to assist entities with evaluating when a set of transferred assets and activities is a business. The Company adopted this standard effective June 30, 2018, and will apply it prospectively to transactions occurring thereafter. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In October 2016, the FASB issued ASU No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"). ASU 2016-16 removes the prohibition in the FASB ASC Topic 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The new standard is intended to reduce the complexity and diversity in practice related to the tax consequences of certain types of intra-entity asset transfers, particularly those involving IP. The Company adopted this standard effective June 30, 2018. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). ASU 2016-01 provides guidance related to accounting for equity investments, financial liabilities under the fair value option and the presentation and disclosure requirements for financial instruments. Marketable equity securities previously classified as available-for-sale equity investments are now measured and recorded at fair value with changes in fair value recorded within Other income (expense), net in the Condensed Consolidated Statements of Operations rather than as a component of Other comprehensive income as in prior years. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The Company adopted this standard effective June 30, 2018. The adoption of this standard did not have a material impact on the Company's Condensed Consolidated Financial Statements.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," which superseded the requirements in ASC 605 "Revenue Recognition" (Topic 605). Topic 606 outlines a comprehensive five-step revenue recognition model based on the principle that an entity should recognize revenue when control of the promised goods or services is transferred to customers at an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. Topic 606 also requires more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company adopted Topic 606 effective June 30, 2018, using the modified retrospective method to all contracts that were not completed contracts as of the beginning of the fiscal year. Results for reporting periods beginning with fiscal year 2019 are presented under Topic 606, while prior period information presented on the financial statements or elsewhere in this Quarterly Report on Form 10-Q is reported under the Company's historic accounting policies under Topic 605 in effect for that period and is not adjusted to reflect the retrospective effect of the adoption of Topic 606. The cumulative effect of adopting Topic 606 was a post-tax increase to the opening retained earnings of $56 million as of June 30, 2018, which was primarily related to our license and royalty revenue arrangements. These arrangements had no remaining performance obligations but were previously recognized under Topic 605 when they were reported to the Company by its licensees, which was generally one quarter in arrears from the licensees' sales of the licensed products. Adoption of the standard did not have a material impact on the Company's financial position, results of operations, and cash flows, as of or for the three and six months ended December 28, 2018, and the Company expects that the impact of the adoption of the new standard will not be material to its results of operations prospectively. See Note 3, Revenues, for additional disclosures related to this standard.

Recently Issued Accounting Pronouncements Not Yet Adopted

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. For public entities who have adopted ASU 2017-12, the amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, which for the Company is the first quarter of fiscal 2020. The Company is currently evaluating the impact this update will have on its Consolidated Financial Statements.

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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 Consolidated Financial Statements.

In February 2016, the FASB issued 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 standard is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. The Company's cross-functional project management team continues to identify and evaluate the impact of the amended guidance on the Company's Consolidated Financial Statements and related disclosures, business processes, internal controls, and information systems. The Company has identified its leases and selected a third-party lease accounting software solution. The Company is in the process of implementing its lease accounting software solution and changes to its processes and internal controls to address the new lease standard. The Company's implementation efforts are progressing as planned. The Company expects to adopt this standard in the first quarter of fiscal 2020 and elect the transition method provided in ASU 2018-11 to apply Topic 842 as of the date of adoption without adjusting comparative periods. The Company continues to evaluate the impact ASU 2016-02 will have on its Consolidated Financial Statements.

Note 3. Revenues

The Company offers a broad range of data storage products that include Client Devices, Data Center Devices and Solutions, and Client Solutions. Client Devices consist of hard disk drives (“HDDs”) and solid state drives (“SSDs”) for computing devices; flash-based embedded storage products; and flash-based memory wafers. Data Center Devices and Solutions consist of high-capacity enterprise HDDs and high-performance enterprise SSDs, data center software and system solutions. Client Solutions consist of HDDs and SSDs embedded into external storage products and removable flash-based products. The Company also generates license and royalty revenues related to its IP patent licenses which are not material.

The Company recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to the customer. The transaction price to be recognized as revenue is adjusted for variable consideration, such as sales incentives, and excludes amounts collected on behalf of third parties, including taxes imposed by governmental authorities. The Company’s performance obligations are typically not constrained based on the Company’s history with similar transactions and that uncertainties are resolved in a fairly short period of time.

Substantially all of the Company’s revenue is from the sale of tangible products for which the performance obligations are satisfied at a point in time, generally upon delivery. The Company’s services revenue mainly includes post contract customer support, warranty as a service and maintenance contracts. The performance obligations for the Company’s services are generally satisfied ratably over the service period based on the nature of the service provided and contract terms. Similarly, revenue from patent licensing arrangements is recognized based on whether the arrangement provides the customer a right to use or right to access the IP. Revenue for a right to use arrangement is recognized at the time the control of the license is transferred to the customer. Revenue for a right to access arrangement is recognized over the contract period using the time lapse method. For the sales-based royalty arrangements, the Company estimates and recognizes revenue in the period in which customers’ licensable sales occur.

The Company’s customer payment terms are typically less than three months from the date control over the product or service is transferred to the customer. The Company uses the practical expedient and does not recognize a significant financing component for payment considerations of less than one year. The financing components of contracts with payment terms were not material.

The Company provides distributors and retailers (collectively referred to as “resellers”) with limited price protection for inventories held by resellers at the time of published list price reductions and/or a right of return. The Company also provides resellers and original equipment manufacturers (“OEMs”) with other sales incentive programs. The Company uses judgment in its assessment of variable consideration in contracts to be included in the transaction price. The Company uses the expected value method to arrive at the amount of variable consideration. The Company believes the estimate of variable consideration is not constrained and that the expected value method is the appropriate estimate of the amount of variable consideration based on the fact that the Company has a large number of contracts with similar characteristics. The Company’s methodology for the estimates is based on several factors, including anticipated price decreases during the reseller holding period, resellers’ sell-through and inventory levels, estimated amounts to be reimbursed to qualifying customers, historical pricing information, historical and anticipated returns information and customer claim processing. The Company also has programs under which it reimburses qualified distributors and retailers for certain marketing expenditures, which are typically recorded as a reduction of the transaction price and, therefore, of revenue.

An immaterial amount of the Company's revenue arrangements include more than one performance obligation, which are typically comprised of tangible products, software and support services for multiple distinct licenses. For these multiple-element arrangements, the Company evaluates whether each deliverable is a distinct promise and should be accounted for as a separate performance obligation. If a promised good or service is not distinct in accordance with the revenue guidance, the Company combines that good or service with the other promised goods or services in the arrangement until a distinct bundle of goods is identified. The Company allocates the transaction price to the performance obligations of each distinct product or service, or distinct bundle, based on their relative standalone selling prices. Where a separate standalone selling price is not available, the transaction price is based on the Company's best estimate of the selling price. The Company uses one or a combination of more than one of the following methods to estimate the standalone selling price: the adjusted market assessment approach, the expected cost plus a margin approach, or another suitable method based on the facts and circumstances.

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 December 28, 2018 or the date of adoption of Topic 606.

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. Prior to the adoption of the new revenue standard, the Company's policy was to expense all contract acquisition costs as incurred. Other 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 and the related amortization as of and for the three and six months ended 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 December 28, 2018 and the date of adoption of Topic 606, contract liabilities were $53 million and $120 million, respectively, and were reflected in Accrued expenses. Changes in the contract liability balance during the six months ended December 28, 2018 include $80 million of revenue recognized during the period of which the substantial majority relates to the balance that was deferred at June 29, 2018, partially offset by payments received and billings in advance of satisfying performance obligations.

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 December 28, 2018 was $220 million, which is mainly attributable to the functional IP license and service arrangements. The Company expects to recognize this amount as revenue as follows: $40 million during the remainder of fiscal 2019, $60 million in fiscal 2020, $46 million in fiscal 2021 and $74 million thereafter.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's disaggregated revenue information is as follows[(1)]:

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions, except percentages)			
Revenue by End Market				
Client Devices	$2,214	$ 2,647	$4,864	$ 5,323
Data Center Devices & Solutions	1,074	1,434	2,520	2,803
Client Solutions	945	1,255	1,877	2,391
Total Revenue	$4,233	$ 5,336	$9,261	$ 10,517
Revenue by Form Factor				
HDD	$2,060	$ 2,694	$4,554	$ 5,304
Flash-based	2,173	2,642	4,707	5,213
Total Revenue	$4,233	$ 5,336	$9,261	$ 10,517
Revenue by Geography (%)				
Americas	24 %	25 %	25 %	26 %
Europe, Middle East and Africa	19	19	18	18
Asia	57	56	57	56

(1) Prior year information is presented in accordance with the accounting guidance in effect during that period and has not been updated for Topic 606. The impact of the adoption of Topic 606 was not material.

The Company's top 10 customers accounted for 47% of its net revenue for both the three and six months ended December 28, 2018, and 42% and 41% of its net revenue for the three and six months ended December 29, 2017, respectively. For the three and six months ended December 28, 2018 and December 29, 2017, no single customer accounted for 10% or more of the Company's net revenue.

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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 December 28, 2018, the Company sold trade accounts receivable and received cash proceeds of $370 million. The discounts on the trade accounts receivable sold during the period were not material and were recorded within Other income (expense), net in the Condensed Consolidated Financial Statements. During the six months ended December 29, 2017, the Company did not sell any trade accounts receivable.

Inventories

	December 28, 2018	June 29, 2018
	(in millions)	
Inventories:		
Raw materials and component parts	$1,191	$1,048
Work-in-process	864	878
Finished goods	1,372	1,018
Total inventories	$3,427	$2,944

Property, plant and equipment, net

	December 28, 2018	June 29, 2018
	(in millions)	
Property, plant, and equipment:		
Land	$307	$306
Buildings and improvements	1,975	1,949
Machinery and equipment	7,493	7,209
Computer equipment and software	450	440
Furniture and fixtures	54	48
Construction-in-process	238	234
Property, plant and equipment, gross	10,517	10,186
Accumulated depreciation	(7,440)	(7,091)
Property, plant, and equipment, net	$3,077	$3,095

Goodwill

	Carrying Amount (in millions)
Balance at June 29, 2018	$10,075
Foreign currency translation adjustment	(1)
Balance at December 28, 2018	$10,074

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

The Company tests for impairment, at a minimum, on an annual basis or earlier where certain events or changes in circumstances indicate that goodwill may more likely than not be impaired. The Company has experienced declines in the market price of its stock, resulting in the Company's market capitalization decreasing below book value for the last seven trading days of the second quarter of fiscal 2019. The Company's market capitalization based upon its stock price has fluctuated above and below book value subsequent to the end of the quarter. The fair value of the Company using a market capitalization approach based on the Company's share price would include a control premium based on recent transactions that have occurred in the technology industry. This indicative fair value exceeded the Company's book value; therefore, management does not believe it is more likely than not that goodwill was impaired as of December 28, 2018.

If there are further decreases in the Company's stock price for a sustained period or other unfavorable factors, the Company may be required to perform a goodwill impairment assessment, which may result in a recognition of goodwill impairment that could be material to the Consolidated Financial Statements.

Intangible assets

	December 28, 2018	June 29, 2018
	(in millions)	
Finite-lived intangible assets	$5,816	$5,818
In-process research and development	80	80
Accumulated amortization	(3,748)	(3,218)
Intangible assets, net	$2,148	$2,680

As part of prior acquisitions, the Company recorded at the time of the acquisition acquired in-process research and development ("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.

Product warranty liability

Changes in the warranty accrual were as follows:

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions)			
Warranty accrual, beginning of period	$323	$ 302	$318	$ 311
Charges to operations	47	46	81	90
Utilization	(42)	(43)	(68)	(81)
Changes in estimate related to pre-existing warranties	9	(1)	6	(16)
Warranty accrual, end of period	$337	$ 304	$337	$ 304

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:

	December 28, 2018	June 29, 2018
	(in millions)	
Warranty accrual		
Current portion	$ 183	$ 168
Long-term portion	154	150
Total warranty accrual	$ 337	$ 318

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

Other liabilities

	December 28, 2018	June 29, 2018
	(in millions)	
Other non-current liabilities:		
Non-current net tax payable	$ 1,018	$ 1,315
Other non-current liabilities	1,289	940
Total other non-current liabilities	$ 2,307	$ 2,255

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)
	(in millions)			
Balance at June 29, 2018	$ (19)	$ (21)	$ 1	$ (39)
Other comprehensive income (loss) before reclassifications	1	(6)	(5)	(10)
Amounts reclassified from accumulated other comprehensive income	—	—	11	11
Income tax benefit related to items of other comprehensive loss	—	(1)	4	3
Net current-period other comprehensive loss	1	(7)	10	4
Balance at December 28, 2018	$ (18)	$ (28)	$ 11	$ (35)

During the three and six months ended December 28, 2018 and December 29, 2017, 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.

Note 5. Fair Value Measurements and Investments

The Company's total cash, cash equivalents and available-for-sale securities was as follows:

	December 28, 2018	June 29, 2018
	(in millions)	
Cash and cash equivalents	$4,013	$ 5,005
Short-term available-for-sale securities (included within Other current assets)	23	23
Long-term available-for-sale securities (included within Other non-current assets)	94	93
Total cash, cash equivalents and available-for-sale securities	$4,130	$ 5,121

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.

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

The following tables present information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of December 28, 2018 and June 29, 2018, and indicate the fair value hierarchy of the valuation techniques utilized to determine such values:

	December 28, 2018			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Assets:				
Cash equivalents:				
Money market funds	$1,744	$—	$ —	$1,744
Certificates of deposit	—	3	—	3
Total cash equivalents	1,744	3	—	1,747
Short-term available-for-sale securities:				
Corporate notes and bonds	—	11	—	11
Asset-backed securities	—	7	—	7
Municipal notes and bonds		4	—	4
Equity securities	1	—	—	1
Total short-term available-for-sale securities	1	22	—	23
Long-term available-for-sale securities:				
U.S. Treasury securities	7	—	—	7
U.S. Government agency securities	—	5	—	5
International government securities	—	1	—	1
Corporate notes and bonds	—	68	—	68
Asset-backed securities	—	4	—	4
Municipal notes and bonds	—	9	—	9
Total long-term available-for-sale securities	7	87	—	94
Foreign exchange contracts	—	29	—	29
Interest rate swap contracts	—	12	—	12
Total assets at fair value	$1,752	$153	$ —	$1,905
Liabilities:				
Foreign exchange contracts	$—	$26	$ —	$26
Interest rate swap contract	—	12	—	12
Total liabilities at fair value	$—	$38	$ —	$38

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

	June 29, 2018			
	Level 1	Level 2	Level 3	Total
	(in millions)			
Assets:				
Cash equivalents:				
Money market funds	$2,554	$—	$ —	$2,554
Certificates of deposit	—	4	—	4
Total cash equivalents	2,554	4	—	2,558
Short-term available-for-sale securities:				
U.S. Treasury securities	3	—	—	3
Corporate notes and bonds	—	12	—	12
Asset-backed securities	—	4	—	4
Municipal notes and bonds	—	2	—	2
Equity securities	2	—	—	2
Total short-term available-for-sale securities	5	18	—	23
Long-term available-for-sale securities:				
U.S. Treasury securities	3	—	—	3
U.S. Government agency securities	—	5	—	5
International government securities	—	1	—	1
Corporate notes and bonds	—	65	—	65
Asset-backed securities	—	8	—	8
Municipal notes and bonds	—	11	—	11
Total long-term available-for-sale securities	3	90	—	93
Foreign exchange contracts	—	51	—	51
Interest rate swap contracts	—	16	—	16
Total assets at fair value	$2,562	$179	$ —	$2,741
Liabilities:				
Foreign exchange contracts	$—	$28	$ —	$28
Total liabilities at fair value	$—	$28	$ —	$28

During the three and six months ended December 28, 2018, the Company had no transfers of financial assets and liabilities between levels.

Available-for-Sale Securities

The cost basis of the Company’s investments classified as available-for-sale securities, individually and in the aggregate, approximated its fair value as of December 28, 2018 and June 29, 2018.

Equity Securities Without a Readily Determinable Fair Value (“RDFV”)

From time to time, the Company enters into certain strategic investments for the promotion of business and strategic objectives. The equity securities of these privately-held companies do not have a RDFV. Under ASU 2016-01, these equity securities are now measured and recorded using the measurement alternative, which is cost minus impairment, if any, plus or minus changes resulting from qualifying observable price changes. In addition, the existing impairment

model has been replaced with a new one-step qualitative impairment model. Adjustments resulting from impairments and qualifying observable price changes are recorded in Other income (expense), net in the Condensed Consolidated Statements of Operations. As of December 28, 2018 and June 30, 2018, these investments were not material.

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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 2019 and the fourth quarter of 2018, respectively.

	December 28, 2018		June 29, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in millions)			
0.50% convertible senior notes due 2020	$32	$34	$31	$34
Variable interest rate Term Loan A-1 maturing 2023	4,920	4,722	4,982	5,013
Variable interest rate U.S. Term Loan B-4 maturing 2023	2,436	2,333	2,448	2,452
1.50% convertible notes due 2024	944	888	931	1,114
4.750% senior unsecured notes due 2026	2,282	1,994	2,280	2,238
Total	$10,614	$9,971	$10,672	$10,851

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Note 6. Derivative Instruments and Hedging Activities

As of December 28, 2018, 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 interest rate swaps that were designated as cash flow hedges. The Company did not have any foreign exchange forward contracts with credit-risk-related contingent features. As of December 28, 2018, the amount of existing net gains related to cash flow hedges recorded in AOCI was not material and the majority is expected to be reclassified to earnings over the next twelve months.

Changes in fair values of the non-designated foreign exchange contracts are recognized in Other income (expense), 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 December 28, 2018 and December 29, 2017, 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.

See Note 5, Fair Value Measurements and Investments, for additional disclosures related to the fair value of the Company’s foreign exchange forward contracts.

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 December 28, 2018 and June 29, 2018, 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Note 7. Debt

Debt consisted of the following as of December 28, 2018 and June 29, 2018:

	December 28, 2018	June 29, 2018
	(in millions)	
0.50% convertible senior notes due 2020	$35	$35
Revolving credit facility maturing 2023	—	500
Variable interest rate Term Loan A-1 maturing 2023	4,928	4,991
Variable interest rate U.S. Term Loan B-4 maturing 2023	2,437	2,449
1.50% convertible notes due 2024	1,100	1,100
4.750% senior unsecured notes due 2026	2,300	2,300
Total debt	10,800	11,375
Issuance costs and debt discounts	(186)	(203)
Subtotal	10,614	11,172
Less current portion of long-term debt	(244)	(179)
Long-term debt	$10,370	$10,993

In November 2018, the Company repaid the previously outstanding borrowings under its revolving credit facility. At December 28, 2018, the Company's borrowing capacity under the revolving credit facility was $2.25 billion.

The credit agreement governing the Company's revolving credit facility and term loans (as amended, the "Credit Agreement") requires the Company to comply with certain financial covenants with respect to the revolving credit facility and Term Loan A-1, consisting of a Leverage Ratio and an Interest Coverage Ratio (each as defined below). These covenants are based upon a trailing twelve-month consolidated adjusted EBITDA as defined in the Credit Agreement ("Adjusted EBITDA"). Adjusted EBITDA is defined as net income (loss) plus interest expense, income tax expense (benefit) and depreciation and amortization as well as other contractual adjustments as provided for in the Credit Agreement.

Pursuant to the Credit Agreement, the Company is required to maintain a maximum ratio of total funded debt to trailing twelve-month Adjusted EBITDA ("Leverage Ratio") at the end of each quarter of 4.25 to 1.00 through the quarter ending October 4, 2019, 4.00 to 1.00 through the quarter ending October 2, 2020, and 3.75 to 1.00 thereafter. In addition, the Company is required to maintain a minimum ratio of Adjusted EBITDA to interest expense ("Interest Coverage Ratio"), both calculated on a trailing twelve-month basis, at the end of each quarter of 3.50 to 1.00. As of December 28, 2018, the Company was in compliance with all financial covenants under the Credit Agreement.

The Credit Agreement also requires the Company and its subsidiaries to comply with customary covenants that include, among others, limitations on the incurrence of additional debt, liens on property, acquisitions and investments, loans and guarantees, mergers, consolidations, liquidations and dissolutions, asset sales, dividends and other payments in respect of the Company's capital stock, prepayments of certain debt, transactions with affiliates and certain modifications of organizational documents and certain debt agreements. In addition, the indentures governing the Company's 2026 Senior Unsecured Notes and the 2024 Convertible Notes contain restrictive covenants that limit the Company's and its subsidiaries' ability to, among other things, consolidate, merge or sell all or substantially all of their assets; create liens; and incur, assume or guarantee additional indebtedness.

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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:

	December 28, 2018	June 29, 2018
	(in millions)	
Benefit obligations	$ 261	$ 260
Fair value of plan assets	204	200
Unfunded status	$ 57	$ 60

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

	December 28, 2018	June 29, 2018
	(in millions)	
Current liabilities	$ 1	$ 1
Non-current liabilities	56	59
Net amount recognized	$ 57	$ 60

Net periodic benefit costs were not material for the three and six months ended December 28, 2018.

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

Note 9. Commitments, Contingencies and Related Parties

Flash Ventures

The Company's business ventures with Toshiba Memory Corporation ("TMC") 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 December 28, 2018 and June 29, 2018:

	December 28, 2018	June 29, 2018
	(in millions)	
Notes receivable, Flash Partners	$695	$ 767
Notes receivable, Flash Alliance	418	48
Notes receivable, Flash Forward	607	700
Investment in Flash Partners	193	191
Investment in Flash Alliance	286	283
Investment in Flash Forward	119	116
Total notes receivable and investments in Flash Ventures	$2,318	$ 2,105

During the three and six months ended December 28, 2018, the Company made net payments to Flash Ventures of $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.

The Company assesses financing receivable credit quality through financial and operational reviews of the borrower and creditworthiness, including credit rating agency ratings, of significant investors of the borrower, where material or known. There were no impairments in the three and six months ended December 28, 2018 or December 29, 2017.

As of December 28, 2018 and June 29, 2018, the Company had accounts payable balances due to Flash Ventures of $310 million and $259 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 December 28, 2018, 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.

December 28,
2018

Notes receivable	$ 1,720
Equity investments	598
Operating lease guarantees	1,313
Inventory and prepayments	243
Maximum estimable loss exposure	$ 3,874

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

The Company is committed to purchase its provided three-month forecast of Flash Ventures' flash-based wafer supply, 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.

Flash Ventures has historically operated near 100% of its manufacturing capacity. As a result of reduced demand for flash-based products, the Company temporarily reduced its utilization of its share of Flash Ventures' manufacturing capacity to an abnormally low level to more closely align the Company's flash-based wafer supply with the projected demand. The Company incurred costs of $49 million associated with the reduction in utilization which was recorded as a charge to cost of revenue in the three months ended December 28, 2018.

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 contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the lease agreements contain acceleration clauses for certain events of default related to the guarantors, including the Company.

The following table presents the Company's portion of the remaining guarantee obligations under the Flash Ventures' lease facilities in both Japanese yen and U.S. dollar-equivalent, based upon the Japanese yen to U.S. dollar exchange rate as of December 28, 2018.

	Lease Amounts	
	(Japanese yen, in billions)	(U.S. dollar, in millions)
Total guarantee obligations	¥145	$ 1,313

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 December 28, 2018 in U.S. dollars, based upon the Japanese yen to U.S. dollar exchange rate as of December 28, 2018:

Annual Installments	Payment of Principal Amortization	Purchase Option Exercise Price at Final Lease Terms	Guarantee Amount
	(in millions)		

Remaining six months of 2019	$294	$ 34	$ 328
2020	294	67	361
2021	207	121	328
2022	112	22	134
2023	49	88	137
Thereafter	4	21	25
Total guarantee obligations	$960	$ 353	$ 1,313

The Company and TMC 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 December 28, 2018, no amounts have been accrued in the Condensed Consolidated Financial Statements with respect to these indemnification agreements.

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Unis Venture

In November 2015, the Company entered into an agreement with Unisplendour Corporation Limited and Unissoft (Wuxi) Group Co. Ltd. ("Unis") to form a joint venture, 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 became operational during 2017. 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 the three and six months ended December 28, 2018 and December 29, 2017, the Company recognized less than 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 December 28, 2018 or June 29, 2018.

Purchase Agreements

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 purchase agreements with various component suppliers that carry fixed volumes and pricing, which obligates the Company to make certain future purchases, contingent on certain conditions of performance, quality and technology of the vendor's components. As of December 28, 2018, the Company had the following minimum long-term purchase commitments:

	Long-term purchase commitments (in millions)
Fiscal year	
Remaining six months of 2019	$ 34
2020	193
2021	208
2022	227
2023 and thereafter	250
Total	$ 912

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

Note 10. 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	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions)			
Options	$4	$ 6	$9	$ 13
Restricted and performance stock units	70	88	137	171
Employee stock purchase plan	5	5	12	12
Subtotal	79	99	158	196
Tax benefit	(14)	(10)	(25)	(34)
Total	$65	$ 89	$133	$ 162

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions)			
Cost of revenue	$13	$ 13	$24	$ 26
Research and development	42	45	81	89
Selling, general and administrative	24	41	53	81
Subtotal	79	99	158	196
Tax benefit	(14)	(10)	(25)	(34)
Total	$65	$ 89	$133	$ 162

Compensation cost related to unvested stock options, restricted stock unit awards ("RSUs"), performance-based restricted stock unit awards ("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 December 28, 2018:

	Unamortized Compensation Costs	Weighted Average Service Period
	(in millions)	(years)
Options	$ 15	1.4
RSUs and PSUs [(1)]	657	2.5
ESPP	71	1.9
Total unamortized compensation cost	$ 743	

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

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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	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value
	(in millions)		(in years)	(in millions)
Options outstanding at June 29, 2018	4.8	$ 64.23		
Exercised	(0.2)	37.64		$ —
Canceled or expired	(0.3)	79.73		
Options outstanding at December 28, 2018	4.3	$ 64.73	3.3	$ 1
Exercisable at December 28, 2018	3.1	$ 69.86	2.9	$ 1

RSUs and PSUs

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

	Number of Shares	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value at Vest Date
	(in millions)		(in millions)
RSUs and PSUs outstanding at June 29, 2018	12.6	$ 58.31	
Granted	6.6	59.42	
Vested	(3.1)	61.96	$ 211
Forfeited	(0.7)	56.05	
RSUs and PSUs outstanding at December 28, 2018	15.4	$ 59.51	

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 previously authorized $5.00 billion for the repurchase of the Company's common stock. On July 25, 2018, the Company's Board of Directors authorized a new $5.00 billion share repurchase program that is effective through July 25, 2023, replacing all prior programs. For the three months ended December 28, 2018, the Company did not make any stock repurchases. For the six months ended December 28, 2018, the Company repurchased 0.8 million shares for a total cost of $61 million under the previous authorization and 7.6 million shares for a total cost of $502 million under the new authorization. Therefore, the Company's stock repurchases under all

stock repurchase authorizations in effect for the six months ended December 28, 2018 totaled $563 million. The remaining amount available to be repurchased under the Company's current stock repurchase program as of December 28, 2018 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 December 28, 2018, the Company declared aggregate cash dividends of $1.00 per share on its outstanding common stock totaling $290 million, of which $146 million was paid on January 14, 2019.

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

Note 11. Income Tax Expense

The 2017 Act, enacted on December 22, 2017, includes a broad range of tax reform proposals affecting businesses, including a reduction in the U.S. federal corporate tax rate from 35% to 21%, a one-time mandatory deemed repatriation tax on earnings of certain foreign subsidiaries that were previously tax deferred and the creation of new taxes on certain foreign earnings.

When initially accounting for the tax effects of the enactment of the 2017 Act, the Company applied the applicable SEC guidance and made a reasonable estimate of the effects on the Company's existing deferred tax balances and the one-time mandatory deemed repatriation tax required by the 2017 Act. As the Company finalized the accounting for the tax effects of the enactment of the 2017 Act during the one-year measurement period permitted by applicable SEC guidance, the Company reflected adjustments to the recorded provisional amounts. As of December 28, 2018, the Company completed its accounting for the tax effects of the enactment of the 2017 Act. Although 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, the Company anticipates the issuance of additional regulatory and interpretive guidance. Although the Company was able to apply a reasonable interpretation of the law along with any available guidance in finalizing its accounting for the tax effects of the 2017 Act, such additional regulatory or interpretive guidance would constitute new information which may require further refinements to its estimates in future periods.

Additional information regarding the significant provisions of the 2017 Act that impacted the Company is provided below.

Re-measurement of deferred taxes

The Company recorded a provisional income tax benefit of $65 million for the year ended June 29, 2018, which related to the re-measurements of the Company's deferred tax balances and is based primarily on the rates at which the deferred tax assets and liabilities are expected to reverse in the current and future fiscal years, which are generally 29% and 22%, respectively. The Company has now finalized the accounting for the tax effects related to the re-measurements of the Company's deferred tax balances with no material change for the six months ended December 28, 2018. The Company has not yet finalized the filing of its U.S. federal income tax return for the year ended June 29, 2018, which may affect the re-measurement of the Company's deferred tax balances.

Mandatory deemed repatriation tax

In connection with the transition from a global to a territorial U.S. tax system, companies are required to pay a mandatory deemed repatriation tax. For the year ended June 29, 2018, the Company recorded a provisional amount for the mandatory deemed repatriation tax liability of $1.57 billion for foreign subsidiaries. The calculation of the mandatory deemed repatriation tax liability is based upon post-1986 earnings and profits. In addition, the mandatory deemed repatriation tax is based on the amount of foreign earnings held in cash and other specified assets, which are taxed at 15.5% and 8%, respectively, and is payable over an 8-year period.

As of December 28, 2018, the Company has finalized the accounting for the tax effects of the mandatory deemed repatriation tax during the one-year measurement period permitted by applicable SEC guidance. During the three months ended September 28, 2018, the Company reduced its mandatory deemed repatriation tax liability by $302 million, of which $250 million was for the utilization of recorded deferred tax assets related to existing tax attributes.

The utilization of the deferred tax assets is a reclassification that did not have an impact on the Company's income tax provision for the three months ended September 28, 2018. The remaining $52 million reduction to the mandatory deemed repatriation tax primarily relates to the Company's decision to no longer carry forward its 2018 operating loss and, instead, apply it against the mandatory deemed repatriation tax. The $52 million benefit results from utilizing the existing fiscal year 2018 operating losses at a 28% tax rate on the Company's 2018 tax return as compared to the carryforward tax rate of 21%.

During the three months ended December 28, 2018, the Company also finalized its post-1986 earnings and profits along with the amount of earnings held in cash and other specified assets and increased its mandatory deemed repatriation tax liability by $95 million. The Company's estimate of the mandatory deemed repatriation tax liability after these refinements is $1.36 billion, excluding a $135 million increase in its liability for unrecognized tax benefits.

On January 15, 2019, the IRS issued final regulations with respect to the mandatory deemed repatriation tax liability. The Company believes this guidance constitutes a subsequent event and will account for the impact of these regulations in the period in which they were issued. These regulations may impact certain positions previously taken with respect to amounts recorded in the Company's Consolidated Financial Statements. The Company may adjust such amounts to reflect the final regulations in its Condensed Consolidated Financial Statements for the period ending March 28, 2019.

During the one-year measurement period, the Company evaluated the expected manner of recovery to determine whether or not to continue to assert indefinite reinvestment on a part or all the foreign undistributed earnings. This required the Company to re-evaluate its existing short and long-term capital allocation policies in light of the 2017 Act and calculate the tax cost that is incremental to the deemed repatriation tax of repatriating cash to the U.S. The provisional tax expense recorded by the Company as of June 28, 2018 was based upon an assumption that all of its foreign undistributed earnings are indefinitely reinvested.

As of December 28, 2018, the Company finalized the accounting for the tax effects of the mandatory deemed repatriation tax on its indefinite reinvestment assertion. The Company now intends to repatriate all of its foreign undistributed earnings. Accordingly, during the six months ended December 28, 2018, the Company recorded a foreign income tax expense of $242 million related to foreign withholding taxes partially offset by foreign tax credits of $82 million. In addition, a state income tax expense of $54 million was recorded, partially offset by a decrease to the Company's valuation allowance of $45 million. Amounts related to federal taxes other than the repatriation tax were not material. The Company's decision to change its indefinite reinvestment assertion is based on interpretative guidance issued by the IRS to date related to the ordering and the taxation of a repatriation of the Company's foreign undistributed earnings.

Deferred taxes on foreign earnings

As a result of the shift to a territorial system for U.S. taxation, the new minimum tax on certain foreign earnings ("global intangible low-tax income") provision of the 2017 Act imposes a tax on foreign earnings and profits in excess of a deemed return on tangible assets of foreign subsidiaries. This provision is effective for tax years beginning on or after January 1, 2018, which for the Company is the fiscal year that began on June 30, 2018 (fiscal year 2019). During the one-year measurement period permitted by applicable SEC guidance, the Company evaluated its accounting policy regarding whether to make an election to account for the effects of this provision either as a component of future income tax expense in the period in which the tax arises or as a component of deferred taxes on the related investments. Accordingly, no deferred tax assets and liabilities were established for timing differences between foreign U.S. GAAP income and U.S. taxable income that would be expected to reverse under the new minimum tax in future years for the year ended June 28, 2018.

After further consideration during the six months ended December 28, 2018, the Company has made the election to account for the effects of the global intangible low-tax income provision as a component of future income tax expense in the period in which the tax arises. As the Company had previously accounted for the tax as a period cost in its income tax provision for the three months ended September 28, 2018, there was no change in the Company's accounting as a result of this election.

The following table presents the Company's income tax expense and the effective tax rate, which includes the discrete effects of the finalization of the accounting for the tax effects of the enactment of the 2017 Act as discussed above:

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions)			
Income before taxes	$81	$ 774	$664	$ 1,484
Income tax expense	$568	$ 1,597	$640	$ 1,626
Effective tax rate	701 %	206 %	96 %	110 %

The primary driver 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.

The primary drivers for the difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are related to the net charge of $1.66 billion for the one-time mandatory deemed repatriation tax, offset in part by an income tax benefit related to the re-measurement of deferred taxes as required by the 2017 Act. Excluding these items, the effective tax rate for the three and six months ended December 29, 2017 would be approximately 4%. The primary drivers for the remaining difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are tax credits generated for 2017, and tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates during fiscal years 2018 through 2030 and windfall tax benefits related to vesting and exercises of stock-based awards. The windfall tax benefits are a result of the adoption of ASU 2016-09, which requires the Company to now recognize $5 million and $27 million of windfall tax benefits related to vesting and exercises of stock-based awards as a component of its income tax expense for the three and six months ended December 29, 2017, respectively.

During the six months ended December 28, 2018, the Company recorded an increase of $139 million in its liability for unrecognized tax benefits (excluding accrued interest and penalties). As of December 28, 2018, the Company's liability for unrecognized tax benefits (excluding accrued interest and penalties) was approximately $690 million. Accrued interest and penalties related to unrecognized tax benefits as of December 28, 2018 was $116 million.

The Internal Revenue Service ("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 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 plans to file a petition with the U.S. Tax Court by March 2019. 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 December 28, 2018, 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.

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WESTERN DIGITAL CORPORATION
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Note 12. 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	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions, except per share data)			
Net income (loss)	$(487)	$ (823)	$24	$ (142)
Weighted average shares outstanding:				
Basic	290	296	291	295
Employee stock options, RSUs, PSUs and ESPP	—	—	5	—
Diluted	290	296	296	295
Income (loss) per common share				
Basic	$(1.68)	$ (2.78)	$0.08	$ (0.48)
Diluted	$(1.68)	$ (2.78)	$0.08	$ (0.48)

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 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 8 million 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 months ended December 28, 2018 and the three and six months ended December 29, 2017, the Company reported a net loss, and all outstanding equity awards have been excluded from such periods because including them would be anti-dilutive. See Note 10, Shareholders' Equity.

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WESTERN DIGITAL CORPORATION
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Note 13. 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	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions)			
Employee termination and other charges:				
Restructuring Plan 2016	$—	$ 32	$ —	$ 77
Closure of Foreign Manufacturing Facilities	7	—	11	—
Business Realignment	13	16	55	23
Total employee termination and other charges	$20	$ 48	$ 66	$ 100

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 now currently expects the closure to be substantially completed by the fourth quarter of fiscal 2019 and to result in total pre-tax charges of approximately $110 million. These charges are expected to consist of approximately $70 million in employee termination benefits and $40 million in asset-related, contract termination and other charges, of which $56 million were recognized in the year ended June 29, 2018. During the six months ended December 28, 2018, the Company recognized an additional $3 million in employee termination benefits and $8 million in asset-related, contract termination and other charges.

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 December 28, 2018:

	Employee Termination Benefits	Contract Termination and Other	Total
	(in millions)		
Accrual balance at June 29, 2018	$56	$ —	$56
Charges	3	8	11
Cash payments	—	(5)	(5)
Accrual balance at December 28, 2018	$59	$ 3	$62

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. The following table presents an analysis of the components of the activity against the reserve during the six months ended December 28, 2018:

Employee Termination	Contract Termination and	Total

	Benefits (in millions)	Other	
Accrual balance at June 29, 2018	$ 36	$ 7	$ 43
Charges	46	9	55
Cash payments	(35)	(5)	(40)
Accrual balance at December 28, 2018	$ 47	$ 11	$ 58

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Note 14. Legal Proceedings

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

Solely for purposes of this note, "WD" refers to Western Digital Corporation or one or more of its subsidiaries excluding HGST prior to the closing of the Company's acquisition of HGST on March 8, 2012 (the "HGST Closing Date") and SanDisk prior to the Company's acquisition of SanDisk on May 12, 2016 (the "SanDisk Closing Date"); "HGST" refers to Hitachi Global Storage Technologies Holdings Pte. Ltd. or one or more of its subsidiaries as of the HGST Closing Date; "SanDisk" refers to SanDisk Corporation or one or more of its subsidiaries as of the SanDisk Closing Date; and "the Company" refers to Western Digital Corporation and all of its subsidiaries on a consolidated basis including HGST and SanDisk.

Intellectual Property Litigation

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

Antitrust

In March 2011, a complaint was filed against SanDisk, SD-3C LLC, Panasonic Corporation, Panasonic Corporation of North America, Toshiba Corporation and Toshiba America Electronic Components, Inc. with the U.S. District Court for the Northern District of California. The lawsuit purports to be on behalf of a nationwide class of indirect purchasers of SD cards. The complaint asserts claims under federal antitrust laws and California antitrust and unfair competition laws, as well as common law claims. The complaint seeks damages, restitution, injunctive relief, and fees and costs. The plaintiffs allege that the defendants conspired to artificially inflate the royalty costs associated with manufacturing SD cards, which in turn allegedly caused the plaintiffs to pay higher prices for SD cards. In November 2015, the defendants filed a motion to dismiss the plaintiffs' federal law claims. In October 2016, the District Court granted the defendants' motion with leave to amend and the defendants filed a motion to dismiss the plaintiffs' remaining claims. In July 2018, ten of the thirteen named plaintiffs voluntarily dismissed their claims against the defendants. In December 2018, the remaining three plaintiffs stipulated to dismiss their claims against the defendants.

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

Securities

Beginning in March 2015, SanDisk and two of its officers, Sanjay Mehrotra and Judy Bruner, were named in three putative class action lawsuits filed with the U.S. District Court for the Northern District of California. Two complaints are brought on behalf of a purported class of purchasers of SanDisk's securities between October 2014 and March 2015, and one is brought on behalf of a purported class of purchasers of SanDisk's securities between April 2014 and April 2015. The complaints generally allege violations of federal securities laws arising out of alleged misstatements or omissions by the defendants during the alleged class periods. The complaints seek, among other things, damages and fees and costs. In July 2015, the District Court consolidated the cases and appointed Union Asset Management Holding AG and KBC Asset Management NV as lead plaintiffs. The lead plaintiffs filed an amended complaint in August 2015. In January 2016, the District Court granted the defendants' motion to dismiss and dismissed the amended complaint with leave to amend. In February 2016, the District Court issued an order appointing as new lead plaintiffs Bristol Pension Fund; City of Milford, Connecticut Pension & Retirement Board; Pavers and Road Builders Pension, Annuity and Welfare Funds; the Newport News Employees' Retirement Fund; and Massachusetts Laborers' Pension Fund (collectively, the "Institutional Investor Group"). In March 2016, the Institutional Investor Group filed an amended complaint. In June 2016, the District Court granted the defendants' motion to dismiss and dismissed the amended complaint with leave to amend. In July 2016, the Institutional Investor Group filed a further amended complaint. In June 2017, the District Court denied the defendants' motion to dismiss. In September 2018, the District Court granted the Institutional Investor Group's motion to certify a class of all persons and entities who purchased or otherwise acquired SanDisk's publicly traded common stock between October 2014 and April 2015, excluding those who purchased or otherwise acquired SanDisk's publicly traded common stock during the class period but who sold their stock prior to the first corrective disclosure in March 2015. The Institutional Investor Group alleges artificial inflation in the price of SanDisk's publicly traded common stock of $9.04 per share from October 16, 2014 through March 25, 2015, $2.26 per share on March 26, 2015, and $1.35 per share from March 27, 2015 through April 15, 2015. The Company believes the allegations to be without merit and intends to defend itself vigorously in this matter.

Copyright

In December 2011, the German Central Organization for Private Copying Rights (Zentralstelle für private Überspielungsrechte) ("ZPÜ"), an organization consisting of several copyright collecting societies, instituted arbitration proceedings against WD's German subsidiary ("WD Germany") before the Copyright Arbitration Board ("CAB") claiming copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce in Germany by WD Germany from January 2008 through December 2010. In February 2013, WD Germany filed a declaratory relief action against ZPÜ in the Higher Regional Court of Munich (the "Higher Court"), seeking an order from the Higher Court to determine the copyright levy issue. In May 2013, ZPÜ filed a counter-claim against WD Germany with the Higher Court, seeking copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce from January 2008 through December 2010 based on tariffs published by ZPÜ in November 2011. In January 2015, the Higher Court ruled in favor of ZPÜ. In its ruling, the Higher Court declared that WD Germany must pay certain levies on certain products that it sold in Germany between January 2008 and December 2010. The judgment specified levy amounts on certain products sold from January 2008 through December 2010 and directed WD Germany to disclose applicable sales data to ZPÜ. The exact amount of the judgment had not been determined. ZPÜ and WD Germany filed appeals with the German Federal Court of Justice in February 2015. In March 2017, the German Federal Court of Justice rendered a judgment affirming ZPÜ's claim concerning the disclosure of WD Germany's sales data regarding HDDs sold between January 2008 and

December 2010. The German Federal Court of Justice also set aside the Higher Court’s decision on the levy amounts and referred the case back to the Higher Court for further fact finding and decision on the levy amounts.

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

On or around June 22, 2018, Bitkom, an industry association, and ZPÜ entered into an agreement for regulating the obligation to pay compensation under copyright law in Germany for hard drives for the period beginning January 1, 2008. On or around June 29, 2018, the Company elected to join the agreement. Pursuant to the agreement, all court proceedings have been terminated. The entry into this agreement did not have a material impact on the Company’s financial condition, results of operations or cash flows.

Tax

For disclosures regarding statutory notices of deficiency issued by the IRS on June 28, 2018 and December 10, 2018, and a petition filed by the Company with the U.S. Tax Court in September 2018, see Note 11, Income Tax Expense.

Other Matters

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

Note 15. Separate Financial Information of Guarantor Subsidiaries

The Company’s 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 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.

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

Condensed Consolidating Balance Sheet
As of December 28, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
ASSETS					
Current assets:					
Cash and cash equivalents	$17	$ 1,163	$ 2,833	$ —	$ 4,013
Accounts receivable, net	—	873	842	—	1,715
Intercompany receivables	2,474	4,971	2,215	(9,660)	—
Inventories	—	1,165	2,495	(233)	3,427
Loans due from consolidated affiliates	—	—	40	(40)	—
Other current assets	15	248	324	—	587
Total current assets	2,506	8,420	8,749	(9,933)	9,742
Property, plant and equipment, net	—	1,056	2,021	—	3,077
Notes receivable and investments in Flash Ventures	—	—	2,318	—	2,318
Goodwill	—	388	9,686	—	10,074
Other intangible assets, net	—	33	2,115	—	2,148
Investments in consolidated subsidiaries	21,070	17,984	—	(39,054)	—
Loans due from consolidated affiliates	—	386	—	(386)	—
Other non-current assets	57	49	484	(10)	580
Total assets	$23,633	$ 28,316	$ 25,373	$ (49,383)	$ 27,939
LIABILITIES AND SHAREHOLDERS’ EQUITY					
Current liabilities:					
Accounts payable	$—	$ 217	$ 1,708	$ —	$ 1,925
Accounts payable to related parties	—	—	310	—	310
Intercompany payables	1,548	4,161	3,951	(9,660)	—
Accrued expenses	206	640	680	—	1,526
Accrued compensation	—	208	137	—	345
Loans due to consolidated affiliates	—	40	—	(40)	—
Current portion of long-term debt	244	—	—	—	244
Total current liabilities	1,998	5,266	6,786	(9,700)	4,350
Long-term debt	10,338	—	32	—	10,370
Loans due to consolidated affiliates	370	—	16	(386)	—
Other liabilities	15	1,777	525	(10)	2,307
Total liabilities	12,721	7,043	7,359	(10,096)	17,027
Total shareholders’ equity	10,912	21,273	18,014	(39,287)	10,912
Total liabilities and shareholders’ equity	$23,633	$ 28,316	$ 25,373	$ (49,383)	$ 27,939

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

Condensed Consolidating Balance Sheet
As of June 29, 2018

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
ASSETS					
Current assets:					
Cash and cash equivalents	$40	$ 668	$ 4,297	$ —	$ 5,005
Accounts receivable, net	—	1,358	839	—	2,197
Intercompany receivables	1,903	4,256	2,674	(8,833)	—
Inventories	—	990	2,159	(205)	2,944
Other current assets	20	195	277	—	492
Total current assets	1,963	7,467	10,246	(9,038)	10,638
Property, plant and equipment, net	—	1,092	2,003	—	3,095
Notes receivable and investments in Flash Ventures	—	—	2,105	—	2,105
Goodwill	—	387	9,688	—	10,075
Other intangible assets, net	—	38	2,642	—	2,680
Investments in consolidated subsidiaries	20,847	19,893	—	(40,740)	—
Loans due from consolidated affiliates	943	16	—	(959)	—
Other non-current assets	182	29	431	—	642
Total assets	$23,935	$ 28,922	$ 27,115	$ (50,737)	$ 29,235
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current liabilities:					
Accounts payable	$—	$ 279	$ 1,986	$ —	$ 2,265
Accounts payable to related parties	—	—	259	—	259
Intercompany payables	1,066	4,648	3,119	(8,833)	—
Accrued expenses	198	505	571	—	1,274
Accrued compensation	—	297	182	—	479
Current portion of long-term debt	179	—	—	—	179
Total current liabilities	1,443	5,729	6,117	(8,833)	4,456
Long-term debt	10,962	—	31	—	10,993
Loans due to consolidated affiliates	—	427	532	(959)	—
Other liabilities	(1)	1,768	488	—	2,255
Total liabilities	12,404	7,924	7,168	(9,792)	17,704
Total shareholders' equity	11,531	20,998	19,947	(40,945)	11,531
Total liabilities and shareholders' equity	$23,935	$ 28,922	$ 27,115	$ (50,737)	$ 29,235

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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
	(in millions)				
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)

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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
	(in millions)				
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

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

Condensed Consolidating Statement of Operations
For the three months ended December 29, 2017

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
Revenue, net	$—	$ 3,764	$ 5,173	$ (3,601)	$ 5,336
Cost of revenue	—	3,256	3,703	(3,636)	3,323
Gross profit	—	508	1,470	35	2,013
Operating expenses:					
Research and development	—	400	229	—	629
Selling, general and administrative	1	276	104	—	381
Intercompany operating expense (income)	—	(430)	430	—	—
Employee termination, asset impairment, and other charges	—	10	38	—	48
Total operating expenses	1	256	801	—	1,058
Operating income (loss)	(1)	252	669	35	955
Interest and other income (expense):					
Interest income	66	2	12	(66)	14
Interest expense	(197)	(4)	(62)	66	(197)
Other income (expense), net	—	(4)	6	—	2
Total interest and other expense, net	(131)	(6)	(44)	—	(181)
Income (loss) before taxes	(132)	246	625	35	774
Equity in earnings from subsidiaries	(725)	593	—	132	—
Income tax expense (benefit)	(34)	1,601	30	—	1,597
Net income (loss)	$(823)	$ (762)	$ 595	$ 167	$ (823)

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

Condensed Consolidating Statement of Operations
For the six months ended December 29, 2017

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
Revenue, net	$—	$ 7,474	$ 10,254	$ (7,211)	$ 10,517
Cost of revenue	—	6,456	7,350	(7,215)	6,591
Gross profit	—	1,018	2,904	4	3,926
Operating expenses:					
Research and development	—	781	440	—	1,221
Selling, general and administrative	3	534	208	—	745
Intercompany operating expense (income)	—	(830)	830	—	—
Employee termination, asset impairment, and other charges	—	21	79	—	100
Total operating expenses	3	506	1,557	—	2,066
Operating income (loss)	(3)	512	1,347	4	1,860
Interest and other income (expense):					
Interest income	147	4	26	(147)	30
Interest expense	(401)	(10)	(138)	147	(402)
Other income (expense), net	(8)	7	(3)	—	(4)
Total interest and other income (expense), net	(262)	1	(115)	—	(376)
Income (loss) before taxes	(265)	513	1,232	4	1,484
Equity in earnings from subsidiaries	32	1,185	—	(1,217)	—
Income tax expense (benefit)	(91)	1,655	62	—	1,626
Net income (loss)	$(142)	$ 43	$ 1,170	$ (1,213)	$(142)

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
	(in millions)				
Net loss	$(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
	(in millions)				
Net income (loss)	$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

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

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the three months ended December 29, 2017

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
Net income (loss)	$(823)	$ (762)	$ 595	$ 167	$ (823)
Other comprehensive income, before tax:					
Foreign currency translation adjustment	6	5	5	(10)	6
Net unrealized gain on derivative contracts and available-for-sale securities	10	3	3	(6)	10
Total other comprehensive income, before tax	16	8	8	(16)	16
Income tax benefit (expense) related to items of other comprehensive income	(3)	—	1	(1)	(3)
Other comprehensive income, net of tax	13	8	9	(17)	13
Total comprehensive income (loss)	$(810)	$ (754)	$ 604	$ 150	$ (810)

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the six months ended December 29, 2017

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
Net income (loss)	$(142)	$ 43	$ 1,170	$ (1,213)	$ (142)
Other comprehensive income, before tax:					
Actuarial pension gain	—	—	—	—	—
Foreign currency translation adjustment	2	1	1	(2)	2
Net unrealized gain on derivative contracts and available-for-sale securities	13	5	5	(10)	13
Total other comprehensive income, before tax	15	6	6	(12)	15
Income tax benefit (expense) related to items of other comprehensive income	(3)	—	(1)	1	(3)
Other comprehensive income, net of tax	12	6	5	(11)	12
Total comprehensive income (loss)	$(130)	$ 49	$ 1,175	$ (1,224)	$ (130)

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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
	(in millions)				
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)
Repayment of revolving credit facility	(500)	—	—	—	(500)
Dividends paid to shareholders	(292)	—	—	—	(292)
Repayment of debt	(75)	—	—	—	(75)
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)	—	(992)
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

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

Condensed Consolidating Statement of Cash Flows
For the six months ended December 29, 2017

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total Company
	(in millions)				
Cash flows from operating activities					
Net cash provided by (used in) operating activities	$(279)	$ 108	$ 2,560	$ (74)	$ 2,315
Cash flows from investing activities					
Purchases of property, plant and equipment	—	(113)	(303)	—	(416)
Proceeds from the sale of property, plant and equipment	—	—	10	—	10
Acquisitions, net of cash acquired	—	(93)	(6)	—	(99)
Purchases of investments	—	(11)	(46)	—	(57)
Proceeds from sale of investments	—	—	29	—	29
Proceeds from maturities of investments	—	—	16	—	16
Notes receivable issuances to Flash Ventures	—	—	(621)	—	(621)
Notes receivable proceeds from Flash Ventures	—	—	112	—	112
Strategic investments and other, net	—	(1)	20	—	19
Intercompany loan from consolidated affiliates	1,395	—	—	(1,395)	—
Advances from (to) parent and consolidated affiliates	65	(65)	—	—	—
Net cash provided by (used in) investing activities	1,460	(283)	(789)	(1,395)	(1,007)
Cash flows from financing activities					
Issuance of stock under employee stock plans	99	—	—	—	99
Taxes paid on vested stock awards under employee stock plans	(67)	—	—	—	(67)
Dividends paid to shareholders	(295)	—	—	—	(295)
Settlement of debt hedge contracts	28	—	—	—	28
Repayment of debt	(4,114)	—	—	—	(4,114)
Proceeds from debt	2,963	—	—	—	2,963
Debt issuance costs	(5)	—	—	—	(5)
Intercompany loan to consolidated affiliates	—	(54)	(1,341)	1,395	—
Change in investment in consolidated subsidiaries	214	204	(492)	74	—
Net cash provided by (used in) financing activities	(1,177)	150	(1,833)	1,469	(1,391)
Effect of exchange rate changes on cash	—	—	1	—	1
Net increase (decrease) in cash and cash equivalents	4	(25)	(61)	—	(82)
Cash and cash equivalents, beginning of year	18	1,212	5,124	—	6,354
Cash and cash equivalents, end of period	$22	$ 1,187	$ 5,063	$ —	$ 6,272

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

The following discussion and analysis contains forward-looking statements within the meaning of the federal securities laws, and should be read in conjunction with the disclosures we make concerning risks and other factors that may affect our business and operating results. You should read this information in conjunction with the unaudited Condensed Consolidated Financial Statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited Consolidated Financial Statements and notes thereto and Part II, Item 8, contained in our Annual Report on Form 10 K for the fiscal year ended June 29, 2018. 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 industry and the infrastructure that enables the proliferation of data in virtually every other industry. Our broad portfolio of technology and products address the following key markets: Client Devices; Data Center Devices and Solutions; and Client Solutions. We also generate license and royalty revenue related to our intellectual property ("IP"), which is included in each of these three categories.

Key Developments

Flash Ventures

The flash industry is characterized by cyclicality as it responds to variations in customers' demand for products and manages production capacity to meet that demand. The favorable demand environment for flash-based products during the last several quarters has begun to normalize as technology conversions are maturing and manufacturing yields are improving, thus increasing flash supply relative to demand. As a result, average selling price per gigabyte of flash-based products has declined.

Through our strategic partnership with Toshiba Memory Corporation ("TMC") referred to as "Flash Ventures", we and TMC operate flash-based memory wafer manufacturing facilities in Yokkaichi, Japan. We are obligated to purchase half of Flash Ventures' flash-based memory wafer supply or pay for half of Flash Ventures' fixed costs regardless of the output we choose to purchase. We are also obligated to fund 49.9% to 50% of Flash Ventures' capital investments to the extent that Flash Ventures' operating cash flow is insufficient to fund these investments.

Flash Ventures has historically operated near 100% of its manufacturing capacity. As a result of the reduced demand for flash-based products, we have temporarily reduced our utilization of our share of Flash Ventures' manufacturing capacity to an abnormally low level to more closely align our flash-based wafer supply with the projected demand. We do not expect this action to result in any incremental cash payments; however, as a result of this temporary reduction to abnormally low production levels, we incurred costs of $49 million associated with the reduction in utilization, which was recorded as a charge to cost of revenue in the three months ended December 28, 2018. Including the $49 million recorded through December 28, 2018, we expect total underutilization charges to be recorded in cost of revenue in the range of $250 million to $300 million with the substantial majority expected to be recognized by the end of the fiscal year. We may adjust our plans based on market conditions, which could impact the timing and amount of any charges.

Cost and Expense Reduction Actions

We are taking actions to better align our cost and expense structure to near-term business conditions, including accelerating the closure of our HDD manufacturing facility in Kuala Lumpur, Malaysia, rationalizing other HDD manufacturing costs and other measures to reduce our cost of revenue and operating expenses.

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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]:

	Three Months Ended					
	December 28, 2018		December 29, 2017		$ Change	% Change
	(in millions, except percentages)					
Revenue, net	$4,233	100.0 %	$5,336	100.0 %	$(1,103)	(20.7)%
Cost of revenue	3,189	75.3	3,323	62.3	(134)	(4.0)
Gross profit	1,044	24.7	2,013	37.7	(969)	(48.1)
Operating Expenses:						
Research and development	539	12.7	629	11.8	(90)	(14.3)
Selling, general and administrative	309	7.3	381	7.1	(72)	(18.9)
Employee termination, asset impairment, and other charges	20	0.5	48	0.9	(28)	(58.3)
Total operating expenses	868	20.5	1,058	19.8	(190)	(18.0)
Operating income	176	4.2	955	17.9	(779)	(81.6)
Interest and other income (expense):						
Interest income	15	0.4	14	0.3	1	7.1
Interest expense	(118)	(2.8)	(197)	(3.7)	79	(40.1)
Other income, net	8	0.2	2	—	6	300.0
Total interest and other expense, net	(95)	(2.2)	(181)	(3.4)	86	(47.5)
Income before taxes	81	1.9	774	14.5	(693)	(89.5)
Income tax expense	568	13.4	1,597	29.9	(1,029)	(64.4)
Net loss	$(487)	(11.5)	$(823)	(15.4)	$336	(40.8)

[1] Percentages may not total due to rounding.

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	Six Months Ended					
	December 28, 2018		December 29, 2017		$ Change	% Change
	(in millions, except percentages)					
Revenue, net	$9,261	100.0 %	$10,517	100.0 %	$(1,256)	(11.9)%
Cost of revenue	6,553	70.8	6,591	62.7	(38)	(0.6)
Gross profit	2,708	29.2	3,926	37.3	(1,218)	(31.0)
Operating Expenses:						
Research and development	1,115	12.0	1,221	11.6	(106)	(8.7)
Selling, general and administrative	665	7.2	745	7.1	(80)	(10.7)
Employee termination, asset impairment, and other charges	66	0.7	100	1.0	(34)	(34.0)
Total operating expenses	1,846	19.9	2,066	19.6	(220)	(10.6)
Operating income	862	9.3	1,860	17.7	(998)	(53.7)
Interest and other income (expense):						
Interest income	30	0.3	30	0.3	—	—
Interest expense	(234)	(2.5)	(402)	(3.8)	168	(41.8)
Other income (expense), net	6	0.1	(4)	—	10	(250.0)
Total interest and other expense, net	(198)	(2.1)	(376)	(3.6)	178	(47.3)
Income before taxes	664	7.2	1,484	14.1	(820)	(55.3)
Income tax expense	640	6.9	1,626	15.5	(986)	(60.6)
Net income (loss)	$24	0.3	$(142)	(1.4)	$166	(116.9)

(1) Percentages may not total due to rounding.

The following table sets forth, for the periods presented, summary information regarding our revenue[1]:

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
	(in millions, except percentages)			
Revenue by End Market				
Client Devices	$2,214	$ 2,647	$4,864	$ 5,323
Data Center Devices & Solutions	1,074	1,434	2,520	2,803
Client Solutions	945	1,255	1,877	2,391
Total Revenue	$4,233	$ 5,336	$9,261	$ 10,517
Revenue by Geography (%)				
Americas	24 %	25 %	25 %	26 %
Europe, Middle East and Africa	19	19	18	18
Asia	57	56	57	56

(1) Prior year information is presented in accordance with the accounting guidance in effect during that period and has not been updated for Topic 606.

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Net Revenue and Gross Margin

Net Revenue. The decrease in net revenue in the three months ended December 28, 2018 from the comparable period of the prior year was primarily driven by lower average selling prices per gigabyte for flash-based products and lower sales of client compute HDD, capacity enterprise HDD and performance enterprise HDD products. Client Devices revenue decreased 16.4% year over year, primarily driven by a reduction in client compute HDD and flash-based mobile products, partially offset by higher revenue in client SSD. Our revenue for Data Center Devices and Solutions decreased 25.1% year over year, primarily driven by lower sales of enterprise SSD, capacity enterprise HDD and performance enterprise HDD products. Client Solutions revenue decreased 24.7% year over year, primarily driven by lower sales of retail HDD and lower average selling prices per gigabyte of flash-based products.

The decrease in net revenue for the six months ended December 28, 2018, compared to the same period in the prior year, is primarily due to lower average selling prices per gigabyte for flash-based products and lower sales of client compute HDD, enterprise SSD and performance enterprise HDD products, partially offset by higher sales of capacity enterprise HDD, flash-based mobile products and client SSD. Client Devices revenue for the six months ended December 28, 2018 decreased 8.6% year over year, primarily driven by lower sales of client compute HDD products, partially offset by stronger sales in the first quarter of flash-based mobile products and client SSD. Our revenue for Data Center Devices and Solutions for the six months ended December 28, 2018 decreased 10.1% year over year, driven primarily by lower sales of our enterprise SSDs and performance enterprise HDDs, partially offset by higher sales of capacity enterprise HDDs. Client Solutions revenue for the six months ended December 28, 2018 decreased 21.5% year over year, primarily driven by lower sales of retail HDD and lower average selling prices per gigabyte of flash-based products.

Our top 10 customers accounted for 47% of our net revenue for the three and six months ended December 28, 2018, respectively, and 42% and 41% of our net revenue for the three and six months ended December 29, 2017, respectively. For the three and six months ended December 28, 2018 and December 29, 2017, no single customer accounted for 10% or more of our net revenue.

Changes in the net revenue by geography generally reflect normal fluctuations in market demand and competitive dynamics.

Consistent with standard industry practice, we have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. For the three and six months ended December 28, 2018, these programs represented 16% and 14% of gross revenues, respectively. For the three and six months ended December 29, 2017, these programs represented 12% and 13% of gross revenues, respectively. 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. The decreases in gross profit for the three and six months ended December 28, 2018 from the comparable periods in the prior year were primarily due to the lower average selling prices per gigabyte for flash-based products and the flash manufacturing underutilization charge recorded in the three months ended December 28, 2018. Gross profit and gross margin include amortization expense on acquired intangible assets, stock-based compensation, a flash manufacturing underutilization charge, and charges related to the implementation of cost-saving initiatives and other charges, which aggregated $283 million, or 6.7%, of revenue, compared to $293 million, or 5.5%, of revenue, for the three months ended December 28, 2018 and December 29, 2017, respectively, and $530 million, or 5.7%, of revenue, compared to $572 million, or 5.4%, of revenue, for the six months ended December 28, 2018 and December 29, 2017, respectively. Including the $49 million recognized through

December 28, 2018, we expect gross margins to be negatively impacted by flash manufacturing underutilization charges to be recorded in cost of revenue in the range of $250 million to $300 million with the substantial majority expected to be recognized by the end of the fiscal year.

Operating Expenses

The decreases in research and development ("R&D") expense for both the three and six months ended December 28, 2018 from the same periods in the prior year are primarily due to lower variable compensation expense and lower stock-based compensation expenses.

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The decreases in selling, general and administrative ("SG&A") expense for both the three and six months ended December 28, 2018 from the same periods in the prior year are primarily due to lower variable compensation expense. In addition, we had lower charges related to stock-based compensation expenses, amortization expense on acquired intangible assets, charges related to the implementation of cost-saving initiatives, acquisition-related charges and other charges which aggregated to $68 million for the three months ended December 28, 2018 compared to $97 million for the three months ended December 29, 2017 and aggregated to $141 million for the six months ended December 28, 2018 compared to $187 million in the six months ended December 29, 2017.

Employee termination, asset impairment and other charges primarily related to actions associated with the realignment of our business. For additional information regarding employee termination, asset impairment and other charges, see Part I, Item 1, Note 13, 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 December 28, 2018 are primarily due to lower interest expense resulting from reductions in the principal amount of debt and lower interest rates as a result of changes to our debt facilities in the third and fourth quarters of fiscal 2018, partially offset by increases in the LIBOR interest rate.

Income Tax Expense

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

	December 28, 2018	December 29, 2017
	(in millions, except percentages)	
Income before taxes	$81	$ 774
Income tax expense	568	1,597
Effective tax rate	701 %	206 %

The Tax Cuts and Jobs Act (the "2017 Act"), enacted on December 22, 2017, includes a broad range of tax reform proposals affecting businesses, including a reduction in the U.S. federal corporate tax rate from 35% to 21%, a one-time mandatory deemed repatriation tax on earnings of certain foreign subsidiaries that were previously tax deferred and the creation of new taxes on certain foreign earnings.

When initially accounting for the tax effects of the enactment of the 2017 Act, we applied the applicable Securities and Exchange Commission ("SEC") guidance and made a reasonable estimate of the effects on our existing deferred tax balances and the one-time mandatory deemed repatriation tax required by the 2017 Act. As we finalized the accounting for the tax effects of the enactment of the 2017 Act during the one-year measurement period permitted by applicable SEC guidance, we reflected adjustments to the recorded provisional amounts. As of December 28, 2018, we completed our accounting for the tax effects of the enactment of the 2017 Act. Although 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, we anticipate the issuance of future additional regulatory and interpretive guidance, even though the one-year measurement period has ended. Although we were able to apply a reasonable interpretation of the law along with any available guidance in finalizing our accounting for the tax effects of the 2017 Act, such future additional regulatory or interpretive guidance would constitute new information which may require further refinements to our estimates in future periods.

The primary driver 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.

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The primary drivers for the difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are related to the net charge of $1.66 billion for the one-time mandatory deemed repatriation tax, offset in part by an income tax benefit related to the re-measurement of deferred taxes as required by the 2017 Act. Excluding these items, the effective tax rate for the three and six months ended December 29, 2017 would be approximately 4%. The primary drivers for the remaining difference between the effective tax rate for the three and six months ended December 29, 2017 and the U.S. Federal statutory rate of 28% are the current year generation of tax credits, and tax holidays in Malaysia, Philippines, Singapore and Thailand that expire at various dates during fiscal years 2018 through 2030 and windfall tax benefits related to vesting and exercises of stock-based awards. The windfall tax benefits are a result of the adoption of ASU 2016-09, which requires us to now recognize $5 million and $27 million of windfall tax benefits related to vesting and exercises of stock-based awards as a component of our income tax expense for the three and six months ended December 29, 2017, respectively.

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 11, 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	
	December 28, 2018	December 29, 2017
	(in millions)	
Net cash provided by (used in):		
Operating activities	$1,174	$ 2,315
Investing activities	(725)	(1,007)
Financing activities	(1,438)	(1,391)
Effect of exchange rate changes on cash	(3)	1
Net decrease in cash and cash equivalents	$(992)	$ (82)

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, stock repurchases, 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. See also “Debt” below for information regarding the credit agreement governing our revolving credit facility and term loans (as amended, the “Credit Agreement”).

During fiscal 2019, we expect cash used for purchases of property, plant and equipment and net activity in notes receivable and equity investments relating to our Flash Ventures joint venture with Toshiba Memory Corporation to be approximately $1.50 billion to $1.90 billion. 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 $2.68 billion and $4.15 billion of our cash and cash equivalents was held outside of the U.S. as of December 28, 2018 and June 29, 2018, respectively. As of December 28, 2018, we finalized the accounting for the tax effects of the mandatory deemed repatriation tax on our indefinite reinvestment assertion. After re-evaluating the

existing short- and long-term capital allocation polices, we intend to repatriate all of our foreign undistributed earnings. Accordingly, during the six months ended December 28, 2018, we included a foreign income tax expense of $242 million related to foreign withholding taxes partially offset by foreign tax credits of $82 million. In addition, a state income tax expense of $54 million was recorded, partially offset by a decrease to our valuation allowance of $45 million. Amounts related to federal taxes other than the repatriation tax were not material. Our decision to change our indefinite reinvestment assertion is based on interpretative guidance issued by the IRS to date related to the ordering and the taxation of a repatriation of our foreign undistributed earnings. For additional information regarding our indefinite reinvestment assertion, see Part I, Item 1, Note 11, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

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Operating Activities

Cash flow from operating activities primarily consists of net income, adjusted for non-cash charges, plus or minus changes in other operating assets and liabilities. This represents our principal source of cash. Net cash used for changes in other operating assets and liabilities was $298 million for the six months ended December 28, 2018, as compared to net cash provided of $1.27 billion for the six months ended December 29, 2017. The net cash provided by changes in other operating assets and liabilities in the six months ended December 29, 2017 primarily reflects the payable recorded for the mandatory deemed repatriation tax as described in Part I, Item 1, Note 11, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q. Changes in our other operating assets and liabilities are also largely affected by our working capital requirements, which are dependent on the effective management of our cash conversion cycle. Our cash conversion cycle measures how quickly we can convert our products into cash through sales. The cash conversion cycles were as follows:

	Quarter to Date	
	December 28, 2018	December 29, 2017
	(in days)	
Days sales outstanding	37	35
Days in inventory	98	62
Days payables outstanding	(64)	(59)
Cash conversion cycle	71	38

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 December 28, 2018, DSO increased by 2 days over the prior year, primarily reflecting the timing of shipments and customer collections. DIO increased by 36 days over the prior year, primarily reflecting increases in hard drive inventory in preparation for the planned plant closures in Kuala Lumpur, Malaysia and increases in flash inventory. DPO increased by 5 days over the prior year, primarily reflecting routine variations in timing of purchases and payments during the period.

Investing Activities

During the six months ended December 28, 2018, net cash used in investing activities 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. Net cash used in investing activities for the six months ended December 29, 2017 primarily consisted of $416 million of capital expenditures, a $509 million net increase in notes receivable issuances to and investments in Flash Ventures and $99 million for acquisitions.

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

Financing Activities

During the six months ended December 28, 2018, net cash used in financing activities primarily consisted of $575 million for the repayment of our revolving credit facility and debt, $563 million of share repurchases and $292 million to pay dividends on our common stock. Net cash used in financing activities for the six months ended December 29, 2017 primarily consisted of a net $1.15 billion reduction in debt and $295 million to pay dividends on our common stock.

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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, we do not have an interest in, or relationships with, any special-purpose entities. For additional information regarding our off-balance sheet arrangements, see Part I, Item 1, Note 9, Commitments, Contingencies and Related Parties, 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 December 28, 2018:

	Total	1 Year (Remaining 6 months of 2019)	2-3 Years (2020-2021)	4-5 Years (2022-2023)	More than 5 Years (Beyond 2023)
	(in millions)				
Long-term debt, including current portion[1]	$10,800	$ 107	$ 517	$ 6,776	$ 3,400
Interest on debt	2,137	215	847	731	344
Flash Ventures and other related commitments[2]	6,769	1,968	2,772	1,582	447
Operating leases	170	28	84	39	19
Purchase obligations	2,816	1,777	561	478	—
Mandatory Deemed Repatriation Tax	1,208	—	186	215	807
Total	$23,900	$ 4,095	$ 4,967	$ 9,821	$ 5,017

(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 reimbursement for other committed expenses, including R&D. Funding commitments assume no additional operating lease guarantees. Additional operating lease guarantees can reduce funding commitments.

Debt

We had $10.80 billion of debt outstanding as of December 28, 2018, including $7.37 billion of term loans under our Credit Agreement, $2.30 billion of senior unsecured notes due 2024 and $1.10 billion of convertible notes due 2024.

Under the Credit Agreement, we are required to comply with certain financial covenants with respect to the revolving credit facility and Term Loan A-1, which consist of a leverage ratio and an interest coverage ratio. As of December 28, 2018, we were in compliance with all financial covenants under the Credit Agreement.

The financial covenants are based upon a trailing twelve-month Adjusted EBITDA as defined in the Credit Agreement. Our Adjusted EBITDA declined significantly during the three months ended December 28, 2018, and

such decline may continue. Sustained deterioration in our operating results could cause our trailing twelve-month Adjusted EBITDA to drop below the threshold required for compliance with our leverage ratio, which could result in an event of default under the Credit Agreement. If an event of default under the Credit Agreement were to occur and if we were not able to obtain a waiver from the required lenders (or if we were not able to obtain such waiver on terms acceptable to us), there could be significant negative consequences for the Company. See Part II, Item 1A, "Risk Factors—Our high level of debt may have an adverse impact on our liquidity, restrict our current and future operations, particularly our ability to respond to business opportunities, and increase our vulnerability to adverse economic and industry conditions" for a discussion of risks related to our level of debt, including the consequences of an event of default thereunder.

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Additional information regarding our indebtedness, including information about new borrowings and repayments, increased 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 included in this Quarterly Report on Form 10 Q and 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 year ended June 29, 2018.

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 lease agreements contain customary covenants for Japanese lease facilities. In addition to containing customary events of default related to Flash Ventures that could result in an acceleration of Flash Ventures' obligations, the lease agreements contain acceleration clauses for certain events of default related to the guarantors, including us. As of December 28, 2018, we were in compliance with all covenants under these Japanese lease facilities. See Part I, Item 1, Note 9, Commitments, Contingencies and Related Parties, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q for information regarding Flash Ventures.

Purchase Obligations

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. In addition, we have entered into long-term purchase agreements with various component suppliers, containing minimum quantity requirements. However, the dollar amount of the purchases may depend on the specific products ordered, achievement of pre-defined quantity or quality specifications or future price negotiations. The estimated related minimum purchase requirements are included in "Purchase obligations" in the table above. We have also entered into long-term purchase agreements with various component suppliers that carry fixed volumes and pricing which obligate us to make certain future purchases, contingent on certain conditions of performance, quality and technology of the vendor's components. 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):

Remaining six months of 2019	$—
2020	78
2021	108
2022	108
2023	108
2024	202
2025	268
2026	336
Total	$1,208

The 2017 Act allows for the mandatory deemed repatriation tax of $1.36 billion to be payable over an 8-year period without interest. The payments are due with 8% of the tax to be paid in each of the first five years, 15% in the 6th

year, 20% in the 7th year, and 25% in the 8th year. As of December 28, 2018, total payments of $150 million have been made towards the mandatory deemed repatriation tax of $1.36 billion for a remaining net tax liability owed of $1.21 billion. For additional information regarding our estimate of the total tax liability for the mandatory deemed repatriation tax, see Part I, Item 1, Note 11, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

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Unrecognized Tax Benefits

As of December 28, 2018, the liability for unrecognized tax benefits (excluding accrued interest and penalties) was approximately $690 million. Accrued interest and penalties related to unrecognized tax benefits as of December 28, 2018 was approximately $116 million. Of these amounts, approximately $688 million could result in potential cash payments. We are not able to provide a reasonable estimate of the timing of future tax payments related to these obligations. For additional information regarding our total tax liability for unrecognized tax benefits, see Part I, Item 1, Note 11, Income Tax Expense, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

Interest Rate Swap

We have entered into interest rate swap agreements to moderate our exposure to fluctuations in interest rates underlying our variable rate debt. For a description of our current interest rate swaps, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk included in this Quarterly Report on Form 10 Q.

Foreign Exchange Contracts

We purchase foreign exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. For a description of our current foreign exchange contract commitments, see Part I, Item 3, Quantitative and Qualitative Disclosures About Market Risk and 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 previously authorized $5.00 billion for the repurchase of our common stock. On July 25, 2018, our Board of Directors authorized a new $5.00 billion share repurchase program that is effective through July 25, 2023, replacing all prior programs. For the three months ended December 28, 2018, we did not make any stock repurchases. For the six months ended December 28, 2018, we repurchased 0.8 million shares for a total cost of $61 million under the previous authorization and 7.6 million shares for a total cost of $502 million under the new authorization. Therefore, our stock repurchases under all stock repurchase authorizations in effect for the six months ended December 28, 2018 totaled $563 million. The remaining amount available to be repurchased under our current

stock repurchase program as of December 28, 2018 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. On July 16, 2018, we paid $148 million for a dividend declared in the fourth quarter of fiscal 2018. During the six months ended December 28, 2018, we declared aggregate cash dividends of $1.00 per share on our outstanding common stock totaling $290 million, of which $146 million was paid on January 14, 2019. We may modify, suspend, or cancel our cash dividend policy in any manner and at any time.

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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 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 3, Revenues, 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 recognition of revenue. 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 29, 2018. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 29, 2018 for a discussion of our critical accounting policies and estimates.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Disclosure About Foreign Currency Risk

Although the majority of our transactions are in U.S. dollars, some transactions are based in various foreign currencies. We purchase short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for product costs and operating expenses denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on our results of operations. Substantially all of the contract maturity dates do not exceed 12 months. We do not purchase foreign exchange contracts for speculative or trading purposes. For additional information, see Part I, Item 1, Note 5, Fair Value Measurements and Investments and Note 6, Derivative Instruments and Hedging Activities, of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10 Q.

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As of December 28, 2018, we had outstanding the foreign exchange contracts presented in the following table. The designated foreign exchange contracts are entered to protect the U.S. dollar value of our product cost and operating expenses. Changes in fair values of the non-designated foreign exchange contracts are recognized in other income (expense), net and are largely offset by corresponding changes in the fair values of the foreign currency denominated monetary assets and liabilities.

	Contract Amount	Weighted-Average Contract Rate [1]	Mark to Market Unrealized Gain (Loss)
	(in millions, except weighted-average contract rate)		
Designated Hedges (cash flow hedges):			
Japanese yen	$955	111.46	$ 19
Malaysian ringgit	95	4.17	—
Philippine peso	33	53.37	—
Thai baht	112		