WESTERN DIGITAL CORP
Form 10-Q
November 04, 2014
Table of Contents

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 October 3, 2014
Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number: 1-8703

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

Delaware	33-0956711
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3355 Michelson Drive, Suite 100 Irvine, California	92612
(Address of principal executive offices)	(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of the close of business on October 30, 2014, 232,201,114 shares of common stock, par value $.01 per share, were outstanding.

Table of Contents

WESTERN DIGITAL CORPORATION
INDEX

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. Our fiscal first quarters ended October 3, 2014 and September 27, 2013 consisted of 14 weeks and 13 weeks, respectively. Fiscal year 2014 was comprised of 52 weeks and ended on June 27, 2014. Fiscal year 2015 will be comprised of 53 weeks and will end on July 3, 2015. Fiscal year 2016 will be comprised of 52 weeks and will end on July 1, 2016. Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms "we," "us," "our," the "Company," "WDC" and "Western Digital" refer to Western Digital Corporation and its subsidiaries, unless we state, or the context indicates, otherwise.

WDC, a Delaware corporation, is the parent company of our storage business, which operates under two independent subsidiaries – HGST and WD. Our principal executive offices are located at 3355 Michelson Drive, Suite 100, Irvine, California 92612. Our telephone number is (949) 672-7000 and our Web site is www.westerndigital.com. The information on our Web site is not incorporated in this Quarterly Report on Form 10-Q.

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS
WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except par values; unaudited)

	October 3, 2014	June 27, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$5,159	$4,804
Short-term investments	222	284
Accounts receivable, net	1,915	1,989
Inventories	1,272	1,226
Other current assets	422	417
Total current assets	8,990	8,720
Property, plant and equipment, net	3,202	3,293
Goodwill	2,559	2,559
Other intangible assets, net	406	454
Other non-current assets	495	473
Total assets	$15,652	$15,499
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,016	$1,971
Accrued arbitration award	772	758
Accrued expenses	433	412
Accrued compensation	438	460
Accrued warranty	134	119
Current portion of long-term debt	125	125
Total current liabilities	3,918	3,845
Long-term debt	2,281	2,313
Other liabilities	490	499
Total liabilities	6,689	6,657
Commitments and contingencies (Notes 4 and 5)		
Shareholders' equity:		
Preferred stock, $.01 par value; authorized — 5 shares; issued and outstanding — none	—	—
Common stock, $.01 par value; authorized — 450 shares; issued — 261 shares; outstanding — 234 shares	3	3
Additional paid-in capital	2,285	2,331
Accumulated other comprehensive income (loss)	(14)	12
Retained earnings	8,394	8,066
Treasury stock — common shares at cost; 27 shares	(1,705)	(1,570)
Total shareholders' equity	8,963	8,842
Total liabilities and shareholders' equity	$15,652	$15,499

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

Table of Contents

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

	Three Months Ended	
	October 3, 2014	September 27, 2013
Revenue, net	$3,943	$3,804
Cost of revenue	2,794	2,705
Gross profit	1,149	1,099
Operating expenses:		
Research and development	437	401
Selling, general and administrative	220	132
Charges related to arbitration award	14	13
Employee termination, asset impairment and other charges	9	11
Total operating expenses	680	557
Operating income	469	542
Other income (expense):		
Interest income	4	3
Interest and other expense	(13)	(13)
Total other expense, net	(9)	(10)
Income before income taxes	460	532
Income tax provision	37	37
Net income	$423	$495
Income per common share:		
Basic	$1.81	$2.10
Diluted	$1.76	$2.05
Weighted average shares outstanding:		
Basic	234	236
Diluted	240	242

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

Table of Contents

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

	Three Months Ended	
	October 3, 2014	September 27, 2013
Net income	$423	$495
Other comprehensive income (loss), net of tax:		
Net unrealized gain (loss) on foreign exchange contracts	(26)	16
Other comprehensive income (loss)	(26)	16
Total comprehensive income	$397	$511

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

Table of Contents

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

	Three Months Ended	
	October 3, 2014	September 27, 2013
Cash flows from operating activities		
Net income	$423	$495
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	289	312
Stock-based compensation	39	42
Deferred income taxes	10	(10)
Gain from insurance recovery	—	(65)
Loss on disposal of assets	4	—
Non-cash portion of employee termination, asset impairment and other charges	1	7
Changes in:		
Accounts receivable, net	74	25
Inventories	(46)	(21)
Accounts payable	49	22
Accrued arbitration award	14	13
Accrued expenses	16	(52)
Accrued compensation	(22)	(65)
Other assets and liabilities	(24)	(23)
Net cash provided by operating activities	827	680
Cash flows from investing activities		
Purchases of property, plant and equipment	(160)	(136)
Proceeds from sales and maturities of investments	166	—
Purchases of investments	(120)	—
Acquisitions, net of cash acquired	—	(263)
Other investing activities, net	(12)	39
Net cash used in investing activities	(126)	(360)
Cash flows from financing activities		
Issuance of stock under employee stock plans	39	22
Taxes paid on vested stock awards under employee stock plans	(57)	(22)
Excess tax benefits from employee stock plans	20	7
Repurchases of common stock	(223)	(150)
Dividends paid to shareholders	(94)	(59)
Proceeds from debt, net of issuance costs	—	500
Repayment of debt	(31)	(58)
Net cash provided by (used in) financing activities	(346)	240
Net increase in cash and cash equivalents	355	560
Cash and cash equivalents, beginning of period	4,804	4,309
Cash and cash equivalents, end of period	$5,159	$4,869
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	$10	$63
Cash paid for interest	$12	$11
Supplemental disclosure of non-cash financing activities:		
Accrual of cash dividend declared	$94	$59

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

Table of Contents

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

1. Basis of Presentation

The accounting policies followed by Western Digital Corporation (the “Company”) are set forth in Part II, Item 8, Note 1 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended June 27, 2014. In the opinion of management, all adjustments necessary to fairly state the unaudited condensed consolidated financial statements have been made. All such adjustments are of a normal, recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended June 27, 2014. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year. The Company's fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every six years, the Company reports a 53-week fiscal year to align its fiscal year with the foregoing policy. The Company's fiscal first quarters ended October 3, 2014 and September 27, 2013 consisted of 14 weeks and 13 weeks, respectively. Fiscal year 2015 will be comprised of 53 weeks and will end on July 3, 2015.

The Company acquired Virident Systems, Inc. ("Virident") on October 17, 2013, sTec, Inc. (“sTec”) on September 12, 2013, and VeloBit, Inc. ("VeloBit") on July 9, 2013. These acquisitions are further described in Note 11 below. In connection with the acquisitions, Virident, sTec and VeloBit became indirect wholly-owned subsidiaries of the Company. Virident, sTec and VeloBit’s results of operations since their respective dates of acquisition are included in the condensed consolidated financial statements.

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

2. Supplemental Financial Statement Data

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

	October 3, 2014	June 27, 2014
	(in millions)	
Inventories:		
Raw materials and component parts	$178	$168
Work-in-process	509	493
Finished goods	585	565
Total inventories	$1,272	$1,226
Property, plant and equipment:		
Property, plant and equipment	$8,244	$8,123
Accumulated depreciation	(5,042)	(4,830)
Property, plant and equipment, net	$3,202	$3,293
Other intangible assets:		
Other intangible assets	$980	$984
Accumulated amortization	(574)	(530)
Other intangible assets, net	$406	$454

Warranty

The Company records an accrual for estimated warranty costs when revenue is recognized. The Company generally warrants its products for a period of one to five years. The warranty provision considers estimated product failure rates and trends, estimated replacement costs, estimated repair costs which include scrap costs, and estimated costs for customer compensatory claims related to product quality issues, if any. A statistical warranty tracking model is used to help prepare estimates and assist the Company in exercising judgment in determining the underlying estimates. The statistical tracking model captures specific detail on hard drive reliability, such as factory test data, historical field return rates, and costs to repair by product type. Management's judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base warranty estimates. Management reviews the warranty accrual

7

Table of Contents

quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross profit and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. If actual product return trends, costs to repair returned products or costs of customer compensatory claims differ significantly from estimates, future results of operations could be materially affected. Changes in the warranty accrual were as follows (in millions):

	Three Months Ended	
	October 3, 2014	September 27, 2013
Warranty accrual, beginning of period	$182	$187
Warranty liability assumed as a result of acquisition	—	3
Charges to operations	49	40
Utilization	(49)	(49)
Changes in estimate related to pre-existing warranties	19	14
Warranty accrual, end of period	$201	$195

The long-term portion of the warranty accrual classified in other liabilities was $67 million at October 3, 2014 and $63 million at June 27, 2014.

Investments

The following table summarizes, by major type, the fair value and cost basis of the Company's investments as of October 3, 2014 (in millions):

	Cost Basis	Unrealized Gains (Losses)	Fair Value
Available-for-sale securities:			
U.S. Treasury securities	$203	$—	$203
U.S. Government agency securities	79	—	79
Commercial paper	119	—	119
Certificates of deposit	53	—	53
Total	$454	$—	$454
Short-term investments			$222
Included in other non-current assets			232
Total			$454

The fair value of the Company's investments classified as available-for-sale securities at October 3, 2014, by remaining contractual maturity, were as follows (in millions):

	Cost Basis	Fair Value
Due in less than one year:	$222	$222
Due in one to five years:	232	232
Total	$454	$454

Table of Contents

The following table summarizes, by major type, the fair value and cost basis of the Company's investments as of June 27, 2014 (in millions):

	Cost Basis	Unrealized Gains (Losses)	Fair Value
Available-for-sale securities:			
U.S. Treasury securities	$180	$—	$180
U.S. Government agency securities	88	—	88
Commercial paper	165	—	165
Certificates of deposit	66	—	66
Total	$499	$—	$499
Short-term investments			$284
Included in other non-current assets			215
Total			$499

The fair value of the Company's investments classified as available-for-sale securities at June 27, 2014, by remaining contractual maturity, were as follows (in millions):

	Cost Basis	Fair Value
Due in less than one year:	$284	$284
Due in one to five years:	215	215
Total	$499	$499

The Company determined no available-for-sale securities were other-than-temporarily impaired in the three months ended October 3, 2014. For more information on the Company's available-for-sale securities, see Note 7 below.

In addition, the Company enters into certain strategic investments for the promotion of business and strategic objectives. These strategic investments are recorded at cost within other non-current assets in the consolidated balance sheets and were not material to the condensed consolidated financial statements as of October 3, 2014 and June 27, 2014.

Other Comprehensive Income (Loss)

Other comprehensive income (loss) refers to revenue, expenses, gains and losses that are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income (loss) is comprised of unrealized gains and losses on foreign exchange contracts. There were no unrealized gains or losses on the Company's available-for-sale securities or actuarial gains and losses related to pensions in the three months ended October 3, 2014. In addition, the income tax impact on components of other comprehensive income (loss) is immaterial for all periods presented.

The following table illustrates the changes in the balances of each component of accumulated other comprehensive income (loss) for the three months ended October 3, 2014 (in millions):

	Actuarial Pension Gain	Unrealized Gain (Loss) on Foreign Exchange Contracts	Accumulated Other Comprehensive Income (Loss)
Balance at June 27, 2014	$7	$5	$12
Other comprehensive income (loss) before reclassifications	—	(22)	(22)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(4)	(4)
Net current-period other comprehensive income (loss)	—	(26)	(26)
Balance at October 3, 2014	$7	$(21)	$(14)

9

Table of Contents

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

	Actuarial Pension Gain	Unrealized Gain (Loss) on Foreign Exchange Contracts	Accumulated Other Comprehensive Income (Loss)
Balance at June 28, 2013	$11	$(46)	$(35)
Other comprehensive income (loss) before reclassifications	—	(11)	(11)
Amounts reclassified from accumulated other comprehensive income (loss)	—	27	27
Net current-period other comprehensive income	—	16	16
Balance at September 27, 2013	$11	$(30)	$(19)

3. Income per Common Share

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

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

	Three Months Ended	
	October 3, 2014	September 27, 2013
Net income	$423	$495
Weighted average shares outstanding:		
Basic	234	236
Employee stock options and other	6	6
Diluted	240	242
Income per common share:		
Basic	$1.81	$2.10
Diluted	$1.76	$2.05
Anti-dilutive potential common shares excluded*	—	1

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

4. Debt

On January 9, 2014, Western Digital Ireland, Ltd. (“WDI”) used existing cash to repay the outstanding term loan balance of $1.8 billion, and the Company, Western Digital Technologies, Inc. (“WDT”) and WDI entered into a new credit agreement with JPMorgan Chase Bank, N.A., as administrative agent, and the lenders party thereto (the "Credit Agreement"). The Credit Agreement provides for $4.0 billion of unsecured loan facilities consisting of a $2.5 billion term loan facility to WDT and a $1.5 billion revolving credit facility to WDT and WDI (the “Borrowers”). The revolving credit facility includes a $100 million sublimit for letters of credit and a $50 million sublimit for swing line loans. Subject to certain conditions, a Borrower may elect to expand the credit facilities by, or obtain incremental term loans of, up to $1.0 billion if existing or new lenders provide additional term or revolving commitments. The loans under the Credit Agreement have a five-year term. The obligations of the Borrowers under the Credit Agreement are guaranteed by the Company and its material domestic subsidiaries, and the obligations of WDI under the Credit Agreement are also guaranteed by WDT.

As of October 3, 2014, no amounts were outstanding under the revolving credit facility and the term loan facility had an outstanding balance of $2.4 billion and a variable interest rate of 1.66%. The Company is required to make quarterly principal

Table of Contents

payments on the term loan facility totaling $94 million for the remainder of fiscal 2015, $156 million in fiscal 2016, $219 million in fiscal 2017, $250 million in fiscal 2018 and the remaining balance of $1.7 billion in fiscal 2019.

The Credit Agreement requires the Company to comply with a leverage ratio and an interest coverage ratio calculated on a consolidated basis for the Company and its subsidiaries. In addition, the Credit Agreement contains customary covenants, including covenants that limit or restrict the Company's and its subsidiaries' ability to incur liens, incur indebtedness, make certain restricted payments, merge or consolidate and enter into certain speculative hedging arrangements, and customary events of default. As of October 3, 2014, the Company was in compliance with all covenants.

5. Legal Proceedings

When the Company becomes aware of a claim or potential claim, the Company assesses the likelihood of any loss or exposure. The Company discloses information regarding each material claim where the likelihood of a loss contingency is probable or reasonably possible. If a loss contingency is probable and the amount of the loss can be reasonably estimated, the Company records an accrual for the loss. In such cases, there may be an exposure to potential loss in excess of the amount accrued. Where a loss is not probable but is reasonably possible or where a loss in excess of the amount accrued is reasonably possible, the Company discloses an estimate of the amount of the loss or range of possible losses for the claim if a reasonable estimate can be made, unless the amount of such reasonably possible losses is not material to the Company's financial position, results of operations or cash flows. Unless otherwise stated below, for each of the matters described below, the Company has either recorded an accrual for losses that are probable and reasonably estimable or has determined that, while a loss is reasonably possible (including potential losses in excess of the amounts accrued by the Company), a reasonable estimate of the amount of loss or range of possible losses with respect to the claim or in excess of amounts already accrued by the Company cannot be made. The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

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

Intellectual Property Litigation

On June 20, 2008, plaintiff Convolve, Inc. ("Convolve") filed a complaint in the Eastern District of Texas against WD, HGST, and one other company alleging infringement of U.S. Patent Nos. 6,314,473 and 4,916,635. The complaint sought unspecified monetary damages and injunctive relief. On October 10, 2008, Convolve amended its complaint to allege infringement of only the '473 patent. The '473 patent allegedly relates to interface technology to select between certain modes of a disk drive's operations relating to speed and noise. A trial in the matter began on July 18, 2011 and concluded on July 26, 2011 with a verdict against WD and HGST in an amount that is not material to the Company's financial position, results of operations or cash flows, for which the Company previously recorded an accrual. WD and HGST have filed post-trial motions challenging the verdict. On January 17, 2014, the Court denied the Company's motion for judgment as a matter of law on invalidity. On May 20, 2014, the Court ordered supplemental briefing on post-trial motions related to infringement. Convolve and the Company filed their supplemental briefs on May 30, 2014 and June 6, 2014, respectively. Additional post-trial motions are pending, and the Company will evaluate its options for appeal after the Court rules on the remaining post-trial motions. The Company intends to continue to defend itself vigorously in this matter.

On August 1, 2011, plaintiff Guzik Technical Enterprises ("Guzik") filed a complaint in the Northern District of California against WD and various of its subsidiaries alleging infringement of U.S. Patent Nos. 6,023,145 and 6,785,085, breach of contract and misappropriation of trade secrets. The complaint seeks injunctive relief and unspecified monetary damages, fees and costs. The patents asserted by Guzik allegedly relate to devices used to test hard disk drive heads and media. On November 30, 2013, WD entered into a settlement agreement for an amount that is not material to the Company's financial position, results of operations or cash flows, for which the Company recorded an accrual in the three months ended December 27, 2013. Guzik is disputing the enforceability of the agreement and on December 27, 2013, WD filed a motion to enforce the agreement. The Court heard oral argument on WD’s motion on January 23, 2014. The Court granted WD’s motion to enforce the settlement agreement on March 21, 2014. On April 14, 2014, Guzik filed a Notice of Appeal to the Federal Circuit. On June 17, 2014, Guzik filed its opening appellate brief. WD filed its appellate brief on August 14, 2014. On September 11, 2014, Guzik filed its reply brief in support of its opening appellate brief. WD intends to continue to defend itself vigorously in this matter.

On July 9, 2012, Siemens Aktiengesellschaft (“Siemens”) filed a complaint in German court against WD, Western Digital GmbH, and Digital River International, S.a.r.l. alleging patent infringement of European patent no. EP 674769, which claims an

Table of Contents

artificial antiferromagnetic (AAF) (aka, synthetic antiferromagnetic) structure for magneto-resistive sensors. On March 14-15, 2013, Western Digital GmbH filed a response of non-infringement and also filed a separate nullity action. Siemens separately served WD with the complaint on July 15, 2013. The patent expired on December 16, 2013 and, on March 10, 2014, Siemens withdrew its motion for injunctive relief. On March 7, 2014, Siemens extended the complaint including WDT as a defendant. On August 25, 2014, the parties reached a settlement agreement for an amount that is not material to the Company’s financial position, results of operations or cash flows, which the Company recorded in the three months ended October 3, 2014. On August 27, 2014, the Company withdrew the nullity action which was confirmed by the Federal Patent Court on August 29, 2014. On August 27, 2014 Siemens withdrew the infringement action which was confirmed by the infringement court on September 3, 2014. This matter is now closed.

On September 5, 2013, plaintiff Lake Cherokee Hard Drive Technologies, LLC (“Lake Cherokee”) filed a complaint in the Eastern District of Texas against: Marvell Asia PTE, Ltd., Samsung Semiconductor, Inc., Seagate Tech. LLC, Seagate Tech. Int’l., Toshiba Corp., Toshiba Am. Elec. Components, Toshiba Am. Inf. Sys., Inc., Toshiba Am. Inf. Equip. (Philippines), Inc., and WDT alleging infringement of US Patent Nos. 5,844,738 and 5,978,162. Lake Cherokee alleges that WDT’s hard disk drive products that contain Marvell read channel systems-on-a-chip (SOCs) infringe its ’738 and ’162 patents. The complaint seeks unspecified monetary damages, fees and costs. On April 3, 2014, Lake Cherokee and Marvell Semiconductor, Inc. (“MSI”) engaged in mediation which resulted in a settlement-in-principle on April 8, 2014. On April 21, 2014, Lake Cherokee and MSI filed a motion to stay deadlines while the parties finalized a settlement agreement. In this motion, Lake Cherokee and MSI represented to the Court that the settlement between Lake Cherokee and MSI will result in a with-prejudice dismissal of Lake Cherokee’s claims against each of the defendants, including WDT, with respect to their sale or use of Marvell chips. On April 23, 2014, the Court granted a stay of deadlines. The parties submitted a Joint Stipulation of Dismissal with Prejudice, and on September 5, 2014, the Court ordered that the Stipulation of Dismissal is granted and that the claims are dismissed with prejudice. This matter is now closed.

On September 25, 2013, plaintiff Lake Cherokee filed a complaint in the Eastern District of Texas against: Marvell Semiconductor, Inc., Marvell Asia PTE, Ltd., Dell Inc., and WDT alleging infringement of US Patent No. 5,583,706. Lake Cherokee alleges that WDT’s hard disk drive products that contain Marvell read channel systems-on-a-chip (SOCs) infringe its ’706 patent. The complaint seeks an injunction, unspecified monetary damages, fees and costs. On April 3, 2014, Lake Cherokee and MSI engaged in mediation which resulted in a settlement-in-principle on April 8, 2014. On April 21, 2014, Lake Cherokee and MSI filed a motion to stay deadlines while the parties finalized a settlement agreement. In this motion, Lake Cherokee and MSI represented to the Court that the settlement between Lake Cherokee and MSI will result in a with-prejudice dismissal of Lake Cherokee’s claims against each of the defendants, including WDT, with respect to their sale or use of Marvell chips. On April 23, 2014, the Court granted a stay of deadlines. The parties submitted a Joint Stipulation of Dismissal with Prejudice, and on August 27, 2014, the Court ordered that the Stipulation of Dismissal is granted and that the claims are dismissed with prejudice. This matter is now closed.

On March 24, 2014, plaintiff Steven F. Reiber (“Reiber”) filed a complaint in the Eastern District of California against the Company, alleging infringement of U.S. Patent Nos. 7,124,927 and 7,389,905. On September 16, 2014, Reiber filed an amended complaint in the Eastern District of California against the Company alleging infringement of three additional patents-U.S. Patent Nos. 6,935,548, 6,651,864, and 6,354,479. Reiber alleges that WD products (including hard disk drive heads, head gimbal assemblies, head stack assemblies and SSDs) infringe these patents based on the allegation that the manufacturing of these products involves the use of certain bonding tools (e.g., wire-bonding tips, capillary tips, and flip-chip handling tools) that have electrically “dissipative” properties, and which are used when bonding components, such as leads, wires and flip chips. The complaint seeks an injunction, unspecified monetary damages, interests, fees and costs. On September 30, 2014, the Company filed a motion to dismiss Reiber’s claims for induced infringement and contributory infringement. The parties' initial case management conference is set for February 5, 2015. The Company intends to defend itself vigorously in this matter.

On October 20, 2014, plaintiff SOTA Semiconductor LLC (“SOTA”) filed a complaint in the Central District of California against the Company, Marvell Semiconductor, Inc., Belkin International, Inc., Dell Inc., Hewlett-Packard Company, Hisense USA Corp., Konica Minolta Business Solutions U.S.A., Inc., Lenovo (United States) Inc., Netgear, Inc., Samsung Electronics America, Inc., and Seagate Technology LLC, alleging infringement of U.S. Patent No. 5,991,545 (“’545 patent”). SOTA alleges that the Company’s devices that incorporate Marvell Thumb Processors, including WD’s My Cloud EX2 network attached storage devices, which include model numbers WDBVKW0080JCH, WDBVKW0060JCH, WDBVKW0040JCH and WDBVKW0000NCH, infringe the ’545 patent. The complaint seeks unspecified monetary damages, interests, fees, costs and expenses. The Company intends to defend itself vigorously in this matter.

12

Table of Contents

Seagate Matter

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

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

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

On October 30, 2012, Seagate initiated an appeal of the Court's decision with the Minnesota Court of Appeals. On July 22, 2013, the Minnesota Court of Appeals reversed the District Court's decision and remanded for entry of an order and judgment confirming the arbitration award. On August 20, 2013, the Company filed a petition for review with the Minnesota Supreme Court and, on October 15, 2013, the Minnesota Supreme Court granted the Company's petition. The appeal before the Minnesota Supreme Court was fully briefed, and oral argument was held on February 5, 2014. On October 8, 2014, the Minnesota Supreme Court affirmed the decision of the Minnesota Court of Appeals; the Minnesota Supreme Court's decision is not subject to appeal. As a result, on October 14, 2014, the Company paid Seagate $773.4 million to satisfy the full amount of the final arbitration award plus interest accrued through October 13, 2014. This amount was paid by one of the Company's foreign subsidiaries using cash held outside of the United States.

Seagate disputes the method the Company used for calculating post-award interest. If not resolved, the interest dispute, which involves an amount that is not material to the Company's financial position, results of operations or cash flows, will be determined by the Minnesota courts.

Other Matters

On December 22, 2011 the German Central Organization for Private Copying Rights (Zentralstelle für private Überspielungsrechte), ("ZPÜ"), an organization consisting of several levy collecting societies, submitted a pleading to the Copyright Arbitration Board ("CAB") in Munich claiming retroactive copyright levies for multimedia hard drives, external hard drives and network hard drives sold or introduced into commerce in Germany by WD from January 2008 through December 2010. The CAB was required to issue a settlement proposal within one year of the initiation of the action, failed to do so and requested the parties to consent to continue the deadline. WD declined to provide consent and, on February 1, 2013, WD filed a declaratory relief against ZPÜ in the Higher Regional Court of Munich (the "Higher Court"), seeking an order from the court to determine the copyright levy issue. On May 21, 2013, ZPÜ filed a counter-claim against WD 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 on November 3, 2011. On May 22, 2014, oral argument on the pleadings occurred. A decision from the Higher Court is expected by January 15, 2015, which either party may appeal. WD intends to defend itself vigorously in this matter.

Table of Contents

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

6. Income Taxes

The Company's income tax provision for both the three months ended October 3, 2014 and September 27, 2013 was $37 million. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia, the Philippines, Singapore and Thailand that expire at various dates from 2015 through 2025 and the current year generation of income tax credits.

In the three months ended October 3, 2014, the Company recorded a net increase of $7 million in its liability for unrecognized tax benefits. As of October 3, 2014, the Company's liability for unrecognized tax benefits was approximately $307 million. Interest and penalties recognized on such amounts were not material to the condensed consolidated financial statements during the three months ended October 3, 2014.

The Internal Revenue Service ("IRS") previously completed its field examination of the Company's federal income tax returns for fiscal years 2006 and 2007, and the Company and the IRS reached agreement with respect to all matters except on the proposed adjustments to income before income taxes relating to intercompany payable balances. The proposed adjustments relating to intercompany payable balances for fiscal years 2006 and 2007 will be addressed in conjunction with the IRS's examination of the Company's fiscal years 2008 and 2009, which commenced in January 2012. In addition, in January 2012, the IRS commenced an examination of the 2007 fiscal period ended September 5, 2007 of Komag, Incorporated, which was acquired by the Company on September 5, 2007. The Company anticipates that the IRS fieldwork will be completed in the fourth quarter of fiscal year 2015. With respect to the 2008 and 2009 audit, the Company received a notice of proposed adjustment from the IRS relating to intercompany payable balances. The proposed adjustments to income before income taxes relating to intercompany payable balances for fiscal years 2006, 2007, 2008 and 2009 total approximately $200 million. The Company disagrees with the proposed adjustments, believes that its tax position is properly supported and will vigorously contest the position taken by the IRS. The IRS examined calendar years 2010 and 2011 of HGST, which was acquired by the Company on March 8, 2012, and completed the examination with no material adjustments.

The Company believes that adequate provision has been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs. As of October 3, 2014, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company's liability for unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company's tax returns.

7. Fair Value Measurements

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

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

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

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

The following table presents information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of October 3, 2014, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

Table of Contents

	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	$1,245	$—	$—	$1,245
Commercial paper	—	53	—	53
Total cash equivalents	1,245	53	—	1,298
Short-term investments:				
U.S. Government agency securities	—	50	—	50
Commercial paper	—	119	—	119
Certificates of deposit	—	53	—	53
Total short-term investments	—	222	—	222
Long-term investments:				
U.S. Treasury securities	—	203	—	203
U.S. Government agency securities	—	29	—	29
Total long-term investments	—	232	—	232
Total assets at fair value	$1,245	$507	$—	$1,752
Liabilities:				
Foreign exchange contracts	$—	$24	$—	$24
Total liabilities at fair value	$—	$24	$—	$24

The following table presents information about the Company's financial assets and liabilities that are measured at fair value on a recurring basis as of June 27, 2014, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash equivalents:				
Money market funds	$756	$—	$—	$756
Bank acceptances	—	1	—	1
Total cash equivalents	756	1	—	757
Short-term investments:				
U.S. Government agency securities	—	53	—	53
Commercial paper	—	165	—	165
Certificates of deposit	—	66	—	66
Total short-term investments	—	284	—	284
Long-term investments:				
U.S. Treasury securities	—	180	—	180
U.S. Government agency securities	—	35	—	35
Total long-term investments	—	215	—	215
Foreign exchange contracts	—	7	—	7
Total assets at fair value	$756	$507	$—	$1,263
Liabilities:				
Foreign exchange contracts	$—	$2	$—	$2
Total liabilities at fair value	$—	$2	$—	$2

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

Table of Contents

Certificates of Deposit. The Company’s certificates of deposit are investments which are held in custody by a third party and recorded within short-term investments in the condensed consolidated balance sheets. Certificates of deposit are valued using fixed interest rates.

Commercial Paper. The Company’s commercial paper securities are investment grade debt issued by corporations which are held in custody by a third party with original maturities of twelve months or less and are recorded within cash and cash equivalents or short-term investments in the condensed consolidated balance sheets depending on their original maturities. Commercial paper securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

U.S. Government Agency Securities. The Company’s U.S. Government agency securities are investments in fixed income securities sponsored by the U.S. Government and are held in custody by a third party and recorded within short-term investments or long term other assets in the condensed consolidated balance sheets depending on their original maturities. U.S. Government agency securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

U.S. Treasury Securities. The Company’s U.S. Treasury securities are direct obligations of the U.S. federal government, are held in custody by a third party and are recorded within long-term other assets in the condensed consolidated balance sheets. U.S. Treasury securities are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

Bank Acceptances. The Company’s bank acceptances are held in custody by a third party and recorded within cash and cash equivalents in the condensed consolidated balance sheets. Bank acceptances are valued using a market approach which is based on observable inputs including market interest rates from multiple pricing sources.

Foreign Exchange Contracts. The Company’s foreign exchange contracts are short-term contracts to hedge the Company’s foreign currency risk. Foreign exchange contracts are classified within other current assets and liabilities in the condensed consolidated balance sheets. For contracts that have a right of offset by its individual counterparties under master netting arrangements, the Company presents its foreign exchange contracts on a net basis by counterparty in the condensed consolidated balance sheets. For more information on the Company's foreign exchange contracts, see Note 8. Foreign exchange contracts are valued using an income approach that is based on a present value of future cash flows model. The market-based observable inputs for the model include forward rates and credit default swap rates.

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

8. Foreign Exchange Contracts

Although the majority of the Company’s transactions are in U.S. dollars, some transactions are based in various foreign currencies. The Company purchases short-term, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedging transactions is to minimize the impact of foreign currency fluctuations on the Company’s results of operations. These contract maturity dates do not exceed 12 months. All foreign exchange contracts are for risk management purposes only. The Company does not purchase foreign exchange contracts for trading purposes. As of October 3, 2014, the Company had outstanding foreign exchange contracts with commercial banks for British Pound Sterling, Euro, Japanese Yen, Malaysian Ringgit, Philippine Peso, Singapore Dollar and Thai Baht, which were designated as either cash flow or fair value hedges.

If the derivative is designated as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially deferred in other comprehensive income (loss), net of tax. These amounts are subsequently recognized into earnings when the underlying cash flow being hedged is recognized into earnings. Recognized gains and losses on foreign exchange contracts entered into for manufacturing-related activities are reported in cost of revenue and presented within cash flow from operations. Hedge effectiveness is measured by comparing the hedging instrument’s cumulative change in fair value from inception to maturity to the underlying exposure’s terminal value. The Company determined the ineffectiveness associated with its cash flow hedges to be immaterial to the condensed consolidated financial statements for the three months ended October 3, 2014 and September 27, 2013.

A change in the fair value of fair value hedges is recognized in earnings in the period incurred and is reported as a component of operating expenses. All fair value hedges were determined to be effective. The fair value and the changes in fair value on these contracts were immaterial to the condensed consolidated financial statements during the three months ended October 3, 2014 and September 27, 2013.

Table of Contents

As of October 3, 2014, the net amount of unrealized losses with respect to the Company’s foreign exchange contracts that is expected to be reclassified into earnings within the next 12 months was $21 million. In addition, as of October 3, 2014, the Company did not have any foreign exchange contracts with credit-risk-related contingent features. The Company opened $1.0 billion and $1.0 billion, and closed $1.0 billion and $1.4 billion, in foreign exchange contracts in the three months ended October 3, 2014 and September 27, 2013, respectively. The fair value and balance sheet location of the Company's foreign exchange contracts as of October 3, 2014 and June 27, 2014 were as follows (in millions):

	Asset Derivatives				Liability Derivatives			
	October 3, 2014		June 27, 2014		October 3, 2014		June 27, 2014	
Derivatives Designated as Hedging Instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Foreign exchange contracts	Other current assets	$—	Other current assets	$7	Accrued expenses	$24	Accrued expenses	$2

The following table presents the gross amounts of the Company's derivative instruments, amounts offset due to master netting arrangements with the Company's various counterparties, and the net amounts recognized in the condensed consolidated balance sheet as of October 3, 2014 (in millions):

Derivatives Designated as Hedging Instruments	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets (Liabilities) Presented in the Balance Sheet
Foreign exchange contracts			
Financial assets	$2	$(2)	$—
Financial liabilities	(26)	2	(24)
Total derivative instruments	$(24)	$—	$(24)

The following table presents the gross amounts of the Company's derivative instruments, amounts offset due to master netting arrangements with the Company's various counterparties, and the net amounts recognized in the condensed consolidated balance sheet as of June 27, 2014 (in millions):

Derivatives Designated as Hedging Instruments	Gross Amounts of Recognized Assets (Liabilities)	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets (Liabilities) Presented in the Balance Sheet
Foreign exchange contracts			
Financial assets	$9	$(2)	$7
Financial liabilities	(4)	2	(2)
Total derivative instruments	$5	$—	$5

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

	Amount of Loss Recognized in Accumulated OCI on Derivatives		Location of (Gain) Loss Reclassified from Accumulated OCI into Income	Amount of (Gain) Loss Reclassified From Accumulated OCI into Income	
Derivatives in Cash Flow Hedging Relationships	Three Months Ended October 3, 2014	Three Months Ended September 27, 2013		Three Months Ended October 3, 2014	Three Months Ended September 27, 2013
Foreign exchange contracts	$(22)	$(11)	Cost of revenue	$(4)	$27

The total net realized transaction and foreign exchange contract currency gains and losses were not material to the condensed consolidated financial statements during the three months ended October 3, 2014 and September 27, 2013.

9. Stock-Based Compensation

Stock-based Compensation Expense

During the three months ended October 3, 2014, the Company recognized in expense $19 million for stock-based compensation related to the vesting of options issued under the Company's stock plans and the ESPP, as compared to $21 million in the prior-year period. The tax benefit realized as a result of the aforementioned stock-based compensation expense was $5 million in both the three months ended October 3, 2014 and September 27, 2013. As of October 3, 2014, total compensation cost

Table of Contents

related to unvested stock options and ESPP rights issued to employees but not yet recognized was $145 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.3 years.

During the three months ended October 3, 2014, the Company recognized in expense $20 million for stock-based compensation related to the vesting of awards of RSUs issued under the Company's stock plans, as compared to $21 million in the prior-year period. The tax benefit realized as a result of the aforementioned stock-based compensation expense was $5 million in the three months ended October 3, 2014, as compared to $4 million in the prior-year period. As of October 3, 2014, the aggregate unamortized fair value of all unvested RSUs was $179 million, which will be recognized on a straight-line basis over a weighted average vesting period of approximately 1.9 years. RSUs include performance stock unit awards (“PSUs”). The effect of PSUs was immaterial to the condensed consolidated financial statements during the three months ended October 3, 2014 and September 27, 2013.

During both the three months ended October 3, 2014 and September 27, 2013, the Company recognized in expense $4 million related to adjustments to market value as well as the vesting of stock appreciation rights (“SARs”). The tax benefit realized as a result of the aforementioned SARs expense was $1 million in both the three months ended October 3, 2014 and September 27, 2013. The SARs will be settled in cash upon exercise. As a result, the Company had a total liability of $58 million and $61 million related to SARs included in accrued expenses in the condensed consolidated balance sheets, as of October 3, 2014 and June 27, 2014, respectively. As of October 3, 2014, total compensation cost related to unvested SARs issued to employees but not yet recognized was not material to the Company's consolidated statement of income.

Stock Option Activity

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

	Number of Shares		Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding at June 27, 2014	10.1		$37.03		
Granted	1.2		100.06		
Exercised	(1.3	)	31.04		
Options outstanding at October 3, 2014	10.0		$45.16	4.7	$514
Exercisable at October 3, 2014	4.5		$32.19	3.3	$290
Vested and expected to vest after October 3, 2014	9.8		$44.56	4.7	$509

If an option has an exercise price that is less than the quoted price of the Company’s common stock at the particular time, the aggregate intrinsic value of that option at that time is calculated based on the difference between the exercise price of the underlying options and the quoted price of the Company’s common stock at that time. As of October 3, 2014, the Company had options outstanding to purchase an aggregate of 8.7 million shares with an exercise price below the quoted price of the Company’s stock on that date resulting in an aggregate intrinsic value of $514 million at that date. During the three months ended October 3, 2014, the aggregate intrinsic value of options exercised under the Company’s stock option plans was $86 million, determined as of the date of exercise, as compared to $27 million in the prior-year period.

Table of Contents

RSU Activity

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

	Number of Shares	Weighted Average Grant-Date Fair Value
RSUs outstanding at June 27, 2014	3.7	$49.77
Granted	1.1	100.07
Vested	(1.5)	40.57
RSUs outstanding at October 3, 2014	3.3	70.88
Expected to vest after October 3, 2014	3.1	$70.38

The fair value of each RSU is the market price of the Company's stock at the date of grant. RSUs are generally payable in an equal number of shares of the Company's common stock at the time of vesting of the units. The grant-date fair value of the shares underlying the RSU awards at the date of grant was $113 million in the three months ended October 3, 2014. These amounts are being recognized to expense over the corresponding vesting periods. The Company has assumed a forfeiture rate of 4.4% for the three months ended October 3, 2014, based on a historical analysis indicating forfeitures for these types of awards.

SARs Activity

The share-based compensation liability for SARs is recognized for the portion of fair value for which service has been rendered at the reporting date. The share-based liability is remeasured at each reporting date, using a binomial option-pricing model, through the requisite service period. As of October 3, 2014, 0.7 million SARs were outstanding with a weighted average exercise price of $8.06. There were no SARs granted and all other SARs activity was immaterial to the condensed consolidated financial statements for the three months ended October 3, 2014 and September 27, 2013.

Fair Value Disclosure — Binomial Model

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

	Three Months Ended	
	October 3, 2014	September 27, 2013
Suboptimal exercise factor	2.51	2.06
Range of risk-free interest rates	0.11% to 2.16%	0.10% to 2.02%
Range of expected stock price volatility	0.24 to 0.47	0.31 to 0.50
Weighted average expected volatility	0.36	0.43
Post-vesting termination rate	1.25%	3.09%
Dividend yield	1.68%	1.58%
Fair value	$32.29	$24.00

The weighted average expected term of the Company's stock options granted during the three months ended October 3, 2014 was 5.8 years, as compared to 5.0 years in the prior-year period.

Fair Value Disclosure — Black-Scholes-Merton Model

The fair value of ESPP purchase rights issued is estimated at the date of grant of the purchase rights using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until options are exercised. Purchase rights under the current ESPP are granted on either June 1st or December 1st of each year. ESPP activity was immaterial to the condensed consolidated financial statements for the three months ended October 3, 2014 and September 27, 2013.

Table of Contents

Stock Repurchase Program

Since May 18, 2012, the Company's Board of Directors has authorized $3.0 billion for the repurchase of its common stock and approved the extension of its stock repurchase program to September 13, 2017. The Company repurchased 2.2 million shares for a total cost of $223 million during the three months ended October 3, 2014. The remaining amount available to be purchased under the Company’s stock repurchase program as of October 3, 2014 was $931 million. The Company may continue to repurchase its stock as it deems appropriate and market conditions allow. Repurchases under the stock repurchase program may be made in the open market or in privately negotiated transactions and may be made under a Rule 10b5-1 plan. The Company expects stock repurchases to be funded principally by operating cash flows and borrowings under the Company's Credit Agreement.

Dividends to Shareholders

On September 13, 2012, the Company announced that its Board of Directors had authorized the adoption of a quarterly cash dividend policy. Under the cash dividend policy, holders of the Company’s common stock receive dividends when and as declared by the Company’s Board of Directors. In the three months ended October 3, 2014, the Company declared a cash dividend of $0.40 per share of the Company’s common stock to shareholders of record as of October 3, 2014, totaling $94 million, which was paid on October 15, 2014. The Company may modify, suspend or cancel its cash dividend policy in any manner and at any time.

10. Pensions and Other Post-retirement Benefit Plans

The Company’s principal pension and other post-retirement benefit plans are in Japan. All pension and other post-retirement benefit plans outside of the Company’s Japanese plans were immaterial to the Company’s condensed consolidated financial statements for the three months ended October 3, 2014 and September 27, 2013. The expected long-term rate of return on the Japanese plan assets is 3.5%.

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

	October 3, 2014	June 27, 2014
Benefit obligation	$240	$255
Fair value of plan assets	(182)	(191)
Unfunded status	$58	$64

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

	October 3, 2014	June 27, 2014
Current liabilities	$1	$1
Non-current liabilities	57	63
Net amount recognized	$58	$64

The net periodic benefit cost of the Company’s pension plans was not material to the condensed consolidated financial statements for the three months ended October 3, 2014 and September 27, 2013. The Company’s expected employer contribution for its Japanese defined benefit pension plans is $12 million in fiscal 2015.

11. Acquisitions

Acquisition of Virident

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

The Company identified and recorded the assets acquired and liabilities assumed at their estimated fair values at the date of acquisition, and allocated the remaining value of $506 million to goodwill. The values assigned to the acquired assets and

Table of Contents

liabilities were finalized during the three months ended June 27, 2014. The individual tangible and intangible assets acquired as well as the liabilities assumed in the acquisition were immaterial to the Company's condensed consolidated financial statements.

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

Tangible assets acquired and liabilities assumed	$58
Intangible assets	49
Goodwill	506
Total	$613

The $506 million of goodwill recognized is primarily attributable to the benefits the Company expects to derive from an ability to create server-side flash storage solutions leveraging the core technology acquired and is not expected to be deductible for tax purposes.

Acquisition of sTec

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

The Company identified and recorded the assets acquired and liabilities assumed at their estimated fair values at the date of acquisition, and allocated the remaining value of $89 million to goodwill. The values assigned to the acquired assets and liabilities were finalized during the three months ended October 3, 2014. The individual tangible and intangible assets acquired as well as the liabilities assumed in the acquisition were immaterial to the Company's condensed consolidated financial statements.

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

Tangible assets acquired and liabilities assumed	$189
Intangible assets	58
Goodwill	89
Total	$336

The $89 million of goodwill recognized is primarily attributable to the benefits the Company expects to derive from augmenting HGST's existing solid-state storage capabilities and accelerating its ability to expand its participation in the growing area of enterprise solid-state drives and is not expected to be deductible for tax purposes.

Acquisition of VeloBit

On July 9, 2013, the Company acquired VeloBit, a privately held provider of high-performance storage I/O optimization software. As a result of the acquisition, VeloBit was fully integrated into the Company's HGST subsidiary and became a wholly owned indirect subsidiary of the Company. The acquisition is intended to build on HGST's strategy to enhance the overall value of datacenter storage by integrating HGST SSDs with software. The acquisition was not material to the Company's condensed consolidated financial statements.

12. Employee Termination, Asset Impairment and Other Charges

During the three months ended October 3, 2014, the Company recorded employee termination, asset impairment and other charges of $9 million in order to realign its operations with anticipated market demand, as compared to $11 million in the prior-year period. These charges were classified as operating expenses and included in Employee termination, asset impairment and other charges on the condensed consolidated statements of income.

13. Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-11, "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists" ("ASU 2013-11"). The new standard requires the presentation of certain unrecognized tax benefits as reductions to deferred tax assets rather than as liabilities in the consolidated balance sheets when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The new standard is effective for fiscal years and interim periods

within those fiscal years, beginning after December 15, 2013, which for the Company was the first quarter of fiscal 2015. The Company adopted this pronouncement in the first quarter of fiscal 2015. The adoption of this pronouncement did not have a material effect on the Company’s condensed consolidated financial statements.
In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which amends the guidance in former Accounting Standards Codification Topic 605, "Revenue Recognition", to provide a single, comprehensive revenue recognition model for all contracts with customers. The new standard requires an entity to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in amounts that reflect the consideration to which an entity expects to be entitled in exchange for those goods or services. The new standard also requires entities to enhance disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The new standard allows for either a full retrospective or a modified retrospective transition method and is effective for fiscal years beginning after December 15, 2016, which for the Company is the first quarter of fiscal 2018. The Company has not yet selected a transition method and is currently