WESTERN DIGITAL CORP
Form 10-Q
November 06, 2018
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 September 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. (Check one):

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 October 30, 2018, 289,424,688 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 and regarding our flash output and the flash industry;
- 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, debt, dividend and capital expenditure needs.

Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. You are urged to carefully review the disclosures we make concerning risks and other factors that may affect our business and operating results, including those made in Part 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)

	September 28, 2018	June 29, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,646	$ 5,005
Accounts receivable, net	2,219	2,197
Inventories	3,119	2,944
Other current assets	587	492
Total current assets	10,571	10,638
Property, plant and equipment, net	3,054	3,095
Notes receivable and investments in Flash Ventures	2,028	2,105
Goodwill	10,072	10,075
Other intangible assets, net	2,404	2,680
Other non-current assets	576	642
Total assets	$ 28,705	$ 29,235
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,081	$ 2,265
Accounts payable to related parties	286	259
Accrued expenses	1,305	1,274
Accrued compensation	500	479
Current portion of long-term debt	213	179
Total current liabilities	4,385	4,456
Long-term debt	10,930	10,993
Other liabilities	2,015	2,255
Total liabilities	17,330	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 — 289 shares and 296 shares, respectively	3	3
Additional paid-in capital	4,085	4,254
Accumulated other comprehensive loss	(76)	(39)
Retained earnings	9,172	8,757
Treasury stock — common shares at cost; 23 shares and 16 shares, respectively	(1,809)	(1,444)
Total shareholders' equity	11,375	11,531
Total liabilities and shareholders' equity	$ 28,705	$ 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	
	September 28, 2018	September 29, 2017
Revenue, net	$5,028	$ 5,181
Cost of revenue	3,364	3,268
Gross profit	1,664	1,913
Operating expenses:		
Research and development	576	592
Selling, general and administrative	356	364
Employee termination, asset impairment, and other charges	46	52
Total operating expenses	978	1,008
Operating income	686	905
Interest and other income (expense):		
Interest income	15	16
Interest expense	(116)	(205)
Other expense, net	(2)	(6)
Total interest and other expense, net	(103)	(195)
Income before taxes	583	710
Income tax expense	72	29
Net income	$511	$ 681
Income per common share		
Basic	$1.75	$ 2.31
Diluted	$1.71	$ 2.23
Weighted average shares outstanding:		
Basic	292	295
Diluted	298	306
Cash dividends declared per share	$0.50	$ 0.50

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
(in millions)
(Unaudited)

	Three Months Ended	
	September 28, 2018	September 29, 2017
Net income	$ 511	$ 681
Other comprehensive loss, before tax:		
Foreign currency translation adjustment	(37)	(4)
Net unrealized gain (loss) on derivative contracts and available-for-sale securities	(1)	3
Total other comprehensive loss, before tax	(38)	(1)
Income tax benefit related to items of other comprehensive loss, before tax	1	—
Other comprehensive loss, net of tax	(37)	(1)
Total comprehensive income	$ 474	$ 680

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)

	Three Months Ended	
	September 28, 2018	September 29, 2017
Cash flows from operating activities		
Net income	$511	$ 681
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	480	533
Stock-based compensation	79	97
Deferred income taxes	201	36
Loss on disposal of assets	2	1
Write-off of issuance costs and amortization of debt discounts	9	10
Other non-cash operating activities, net	20	11
Changes in:		
Accounts receivable, net	(22)	(148)
Inventories	(175)	44
Accounts payable	(77)	(146)
Accounts payable to related parties	27	20
Accrued expenses	34	164
Accrued compensation	20	(38)
Other assets and liabilities, net	(404)	(132)
Net cash provided by operating activities	705	1,133
Cash flows from investing activities		
Purchases of property, plant and equipment	(277)	(160)
Proceeds from the sale of property, plant and equipment	—	5
Acquisitions, net of cash acquired	—	(93)
Purchases of investments	(11)	(38)
Proceeds from sale of investments	6	14
Proceeds from maturities of investments	3	2
Notes receivable issuances to Flash Ventures	(115)	(229)
Notes receivable proceeds from Flash Ventures	144	98
Strategic investments and other, net	(9)	23
Net cash used in investing activities	(259)	(378)
Cash flows from financing activities		
Issuance of stock under employee stock plans	8	20
Taxes paid on vested stock awards under employee stock plans	(66)	(61)
Repurchases of common stock	(563)	—
Dividends paid to shareholders	(148)	(147)
Settlement of debt hedge contracts	—	26
Repayment of debt	(38)	(62)
Net cash used in financing activities	(807)	(224)
Effect of exchange rate changes on cash	2	1
Net increase (decrease) in cash and cash equivalents	(359)	532
Cash and cash equivalents, beginning of year	5,005	6,354
Cash and cash equivalents, end of period	$4,646	$ 6,886
Supplemental disclosure of cash flow information:		

Cash paid for income taxes	$191	$ 73
Cash paid for interest	$139	$ 71

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.

Use of Estimates

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

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

Note 2. Recent Accounting Pronouncements

Accounting Pronouncements Recently Adopted

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. This standard did not have a material impact on the Company's Condensed Consolidated Financial Statements upon adoption or for the three months ended September 28, 2018.

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 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 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 obligation 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-month period ended September 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 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.

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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. As the Company plans for the adoption of this standard, the Company has completed its first phase of identifying its leases including the identification of embedded leases. The Company is in the process of identifying changes to its processes, internal controls and system requirements and configurations for a new lease accounting system 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 expects to elect the practical expedient to not present historical comparative information. The Company continues to evaluate the impact ASU 2016-02 will have on its Consolidated Financial Statements.

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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.

Some 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.

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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 September 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 months ended September 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 September 28, 2018 and the date of adoption of Topic 606, contract liabilities were $86 million and $120 million, respectively, and were reflected in Accrued expenses. Changes in the contract liability balance during the three months ended September 28, 2018 were primarily the result of $41 million of revenue recognized during the period 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 unearned revenue and multi-year contracts with future installment payments at the end of any given period. The transaction price allocated to the other remaining performance obligations as of September 28, 2018 was $263 million, which is mainly attributable to the functional IP license and service arrangements. The Company expects to recognize this amount as revenue as follows: $87 million during the remainder of fiscal 2019, $58 million in fiscal 2020, $45 million in fiscal 2021 and $73 million thereafter.

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

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

	Three Months Ended	
	September 28, 2018	September 29, 2017
	(in millions, except percentages)	
Revenue by End Market		
Client Devices	$2,650	$ 2,676
Data Center Devices & Solutions	1,446	1,369
Client Solutions	932	1,136
Total Revenue	5,028	5,181
Revenue by Form Factor		
HDD	$2,494	$ 2,610
Flash-based	2,534	2,571
Total Revenue	$5,028	$ 5,181
Revenue by Geography (%)		
Americas	25 %	26 %
Europe, Middle East and Africa	18	18
Asia	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.

For the three months ended September 28, 2018 and September 29, 2017, two customers accounted for 11% and 10%, respectively, of the Company's net revenue. For the three months ended September 28, 2018 and September 29, 2017, the Company's top 10 customers accounted for 48% and 42% of the Company's net revenue, respectively.

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

Note 4. Supplemental Financial Statement Data

Accounts receivable, net

From time to time, in connection with factoring agreements, the Company sells trade accounts receivable without recourse to third party purchasers in exchange for cash. During the three months ended September 28, 2018, the Company sold trade accounts receivable and received cash proceeds of $243 million. The discounts on the trade accounts receivable sold during the period were not material and were recorded within Other expense, net in the Condensed Consolidated Financial Statements. During the three months ended September 29, 2017, the Company did not sell any trade accounts receivable.

Inventories

	September 28, 2018	June 29, 2018
	(in millions)	
Inventories:		
Raw materials and component parts	$1,139	$1,048
Work-in-process	934	878
Finished goods	1,046	1,018
Total inventories	$3,119	$2,944

Property, plant and equipment, net

	September 28, 2018	June 29, 2018
	(in millions)	
Property, plant, and equipment:		
Land	$306	$306
Buildings and improvements	1,965	1,949
Machinery and equipment	7,311	7,209
Computer equipment and software	447	440
Furniture and fixtures	51	48
Construction-in-process	251	234
Property, plant and equipment, gross	10,331	10,186
Accumulated depreciation	(7,277)	(7,091)
Property, plant, and equipment, net	$3,054	$3,095

Goodwill

	Carrying Amount (in millions)
Balance at June 29, 2018	$10,075
Foreign currency translation adjustment	(3)
Balance at September 28, 2018	$10,072

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

Intangible assets

	September 28, 2018	June 29, 2018
	(in millions)	
Finite-lived intangible assets	$5,818	$5,818
In-process research and development	80	80
Accumulated amortization	(3,494)	(3,218)
Intangible assets, net	$2,404	$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	
	September 28, 2018	September 29, 2017
	(in millions)	
Warranty accrual, beginning of period	$318	$ 311
Charges to operations	34	44
Utilization	(26)	(38)
Changes in estimate related to pre-existing warranties	(3)	(15)
Warranty accrual, end of period	$323	$ 302

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:

	September 28, 2018	June 29, 2018
	(in millions)	
Warranty accrual		
Current portion	$169	$ 168
Long-term portion	154	150
Total warranty accrual	$323	$ 318

Other liabilities

	September 28, 2018	June 29, 2018
	(in millions)	
Other non-current liabilities:		
Non-current net tax payable	$939	$ 1,315

Other non-current liabilities	1,076	940
Total other non-current liabilities	$2,015	$ 2,255

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

Accumulated other comprehensive income (loss)

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

	Actuarial Pension Gains (Losses)	Foreign Currency Translation Gains (Losses)	Unrealized Gains (Losses) on Derivative Contracts and Available for Sale Securities	Total Accumulated Comprehensive Income (Loss)
	(in millions)			
Balance at June 29, 2018	$(19)	$ (21)	$ 1	$ (39)
Other comprehensive loss before reclassifications	—	(37)	(6)	(43)
Amounts reclassified from accumulated other comprehensive loss	—	—	5	5
Income tax benefit related to items of other comprehensive loss	—	—	1	1
Net current-period other comprehensive loss	—	(37)	—	(37)
Balance at September 28, 2018	$(19)	$ (58)	$ 1	$ (76)

During the three months ended September 28, 2018 and September 29, 2017, the amounts reclassified out of AOCI related to derivative contracts were not material and were charged to Cost of revenue in the Condensed Consolidated Statements of Operations.

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Note 5.