SEAGATE TECHNOLOGY
Form 10-Q
November 07, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 29, 2006

¨ **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 001-31560

SEAGATE TECHNOLOGY

(Exact name of registrant as specified in its charter)

Cayman Islands	**98-0355609**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

P.O. Box 309GT

Ugland House, South Church Street

George Town, Grand Cayman

Cayman Islands

(Address of Principal Executive Offices)

Telephone: (345) 949-8066

(Registrant s Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: Common shares, par value $0.00001

Securities registered pursuant to Section 12(g) of the Act: None

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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 x No ¨

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

Large accelerated filer: x Accelerated filer: ¨ Non-accelerated filer: ¨

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

As of October 27, 2006, 574,103,709 shares of the registrant s common shares, par value $0.00001 per share, were issued and outstanding.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SEAGATE TECHNOLOGY

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

(Unaudited)

	September 29, 2006	June 30, 2006 (a)
ASSETS		
Cash and cash equivalents	$ 1,856	$ 910
Short-term investments	797	823
Accounts receivable, net	1,331	1,445
Inventories	939	891
Other current assets	315	264
Total Current Assets	5,238	4,333
Property, equipment and leasehold improvements, net	2,179	2,106
Other intangible assets	272	307
Other assets, net	343	323
Goodwill	2,488	2,475
Total Assets	$ 10,520	$ 9,544
LIABILITIES		
Accounts payable	$ 1,448	$ 1,692
Accrued employee compensation	237	385
Accrued restructuring	111	210
Accrued expenses, other	710	648
Accrued income taxes	67	72
Current portion of long-term debt	731	330
Total Current Liabilities	3,304	3,337
Accrued restructuring	23	23
Other non-current liabilities	332	332
Long-term debt, less current portion	1,737	640
Total Liabilities	5,396	4,332
Commitments and contingencies		
SHAREHOLDERS EQUITY		
Common shares and additional paid-in capital	2,944	2,858
Deferred stock compensation		(1)
Accumulated other comprehensive loss	(5)	(7)
Retained earnings	2,185	2,362

Total Shareholders Equity		5,124	5,212
Total Liabilities and Shareholders Equity	$	10,520	$ 9,544

(a) The information in this column was derived from the Company s audited consolidated balance sheet as of June 30, 2006.

See notes to condensed consolidated financial statements.

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SEAGATE TECHNOLOGY

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except per share data)

(Unaudited)

	For the Three Months Ended	
	September 29, 2006	September 30, 2005
Revenue	$ 2,793	$ 2,088
Cost of revenue	2,351	1,553
Product development	243	180
Marketing and administrative	180	86
Amortization of intangibles	11	
Restructuring, net	(4)	4
Total operating expenses	2,781	1,823
Income from operations	12	265
Interest income	19	15
Interest expense	(20)	(13)
Other, net	3	5
Other income, net	2	7
Income before income taxes	14	272
Benefit from income taxes	(5)	
Net income	$ 19	$ 272
Net income per share:		
Basic	$ 0.03	$ 0.57
Diluted	0.03	0.54
Number of shares used in per share calculations:		
Basic	576	479
Diluted	602	506
Cash dividends declared per share	$ 0.08	$ 0.08

See notes to condensed consolidated financial statements.

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SEAGATE TECHNOLOGY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	For the Three Months Ended	
	September 29, 2006	September 30, 2005
OPERATING ACTIVITIES		
Net income	$ 19	$ 272
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	199	137
Stock-based compensation	38	16
Allowance for doubtful accounts receivable	40	
Excess tax benefits from exercise of stock options		(5)
Other non-cash operating activities, net	(4)	(2)
Changes in operating assets and liabilities:		
Accounts receivable	78	(22)
Inventories	(42)	(46)
Accounts payable	(244)	(108)
Accrued expenses, employee compensation and warranty	(246)	(35)
Accrued income taxes	(5)	2
Other assets and liabilities	(14)	(3)
Net cash (used in) provided by operating activities	(181)	206
INVESTING ACTIVITIES		
Acquisition of property, equipment and leasehold improvements	(227)	(169)
Purchases of short-term investments	(305)	(1,159)
Maturities and sales of short-term investments	335	1,284
Acquisitions, net of cash and cash equivalents acquired		(15)
Other investing activities, net	(6)	(57)
Net cash used in investing activities	(203)	(116)
FINANCING ACTIVITIES		
Net proceeds from issuance of long-term debt	1,477	
Proceeds from exercise of employee stock options and employee stock purchase plan	49	28
Dividends to shareholders	(46)	(38)
Excess tax benefits from exercise of stock options		5
Repurchases of common shares	(150)	
Net cash provided by (used in) financing activities	1,330	(5)
Increase in cash and cash equivalents	946	85
Cash and cash equivalents at the beginning of the period	910	746
Cash and cash equivalents at the end of the period	$ 1,856	$ 831

Supplemental Disclosure of Cash Flow Information				
Cash paid for interest	$	5	$	5
Cash paid for income taxes, net of refunds		2		4

See notes to condensed consolidated financial statements.

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SEAGATE TECHNOLOGY

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY

Three Months Ended September 29, 2006

(In millions)

(Unaudited)

	Number of Common Shares	Par Value of Shares	Additional Paid-in Capital	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
Balance at June 30, 2006	576	$	$ 2,858	$ (1)	$ (7)	$ 2,362	$ 5,212
Comprehensive income, net of tax:							
Unrealized gain on marketable securities					4		4
Loss on derivatives					(2)		(2)
Net income						19	19
Comprehensive income							21
Issuance of common shares related to exercise of employee stock options	2		21				21
Issuance of common shares related to employee stock purchase plan	2		28				28
Repurchases of common shares	(7)					(150)	(150)
Dividends to shareholders						(46)	(46)
Stock-based compensation			37	1			38
Balance at September 29, 2006	573	$	$ 2,944	$	$ (5)	$ 2,185	$ 5,124

See notes to condensed consolidated financial statements.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Summary of Significant Accounting Policies

Nature of Operations The Company designs, manufactures and markets rigid disc drives. Rigid disc drives, which are commonly referred to as disc drives, are used as the primary medium for storing electronic information in systems ranging from desktop and notebook computers and consumer electronics devices to data centers delivering information over corporate networks and the Internet. The Company produces a broad range of disc drive products addressing enterprise applications, where its products are primarily used in enterprise servers, mainframes and workstations; desktop applications, where its products are used in desktop computers; mobile computing applications, where its products are used in notebook computers; and consumer electronics applications, where its products are used in digital video recorders, digital music players and gaming devices. The Company sells its disc drives primarily to major original equipment manufacturers, or OEMs, distributors and retailers.

Basis of Presentation and Consolidation The condensed consolidated financial statements include the accounts of the Company and all its wholly-owned subsidiaries, after elimination of intercompany transactions and balances. On May 19, 2006, the Company acquired all of the outstanding common stock, stock options and nonvested stock of Maxtor. Maxtor is a wholly-owned subsidiary of the Company and the condensed consolidated financial statements include the results of operations of Maxtor subsequent to May 19, 2006. The condensed consolidated financial statements have been prepared by the Company and have not been audited. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. The condensed consolidated financial statements reflect, in the opinion of management, all material adjustments necessary to summarize fairly the consolidated financial position, results of operations, cash flows and shareholders equity for the periods presented. Such adjustments are of a normal recurring nature. The Company s consolidated financial statements for the fiscal year ended June 30, 2006 are included in its Annual Report on Form 10-K as filed with the United States Securities and Exchange Commission on September 11, 2006. The Company believes that the disclosures included in the unaudited condensed consolidated financial statements, when read in conjunction with its consolidated financial statements as of June 30, 2006 and the notes thereto, are adequate to make the information presented not misleading.

The results of operations for the three months ended September 29, 2006 are not necessarily indicative of the results that may be expected for the fiscal year ending June 29, 2007.

The Company operates and reports financial results on a fiscal year of 52 or 53 weeks ending on the Friday closest to June 30. The quarters ended September 29, 2006 and September 30, 2005 were 13 weeks. Fiscal year 2007 will be comprised of 52 weeks and will end on June 29, 2007.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

1. Summary of Significant Accounting Policies (continued)

Critical Accounting Policies and Use of Estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

The Company establishes certain distributor and OEM sales programs aimed at increasing customer demand. These programs are typically related to a distributor s level of sales, order size, advertising or point of sale activity or an OEM s level of sale activity or agreed upon rebate programs. The Company provides for these obligations at the time that revenue is recorded based on estimated requirements. These contra-revenue estimates are based on various factors, including estimated future price erosion, distributor sell-through levels, program participation, customer claim submittals and sales returns. During periods in which the Company distributors inventories of its products are at higher than historical levels, the Company s contra-revenue estimates are subject to a greater degree of subjectivity and the potential for actual results to vary is accordingly higher. Currently, the Company s distributors inventories are within the historical range. Significant actual variations in any of the factors upon which the Company bases its contra-revenue estimates could have a material effect on the Company s operating results. In addition, the Company s failure to accurately predict the level of future sales returns by its distribution customers could have a material impact on the Company s financial condition and results of operations.

The Company s warranty provision considers estimated product failure rates, trends and estimated repair or replacement costs. The Company uses a statistical model to help with its estimates and the Company exercises considerable judgment in determining the underlying estimates. Should actual experience in any future period differ significantly from its estimates, or should the rate of future product technological advancements fail to keep pace with the past, the Company s future results of operations could be materially affected. The actual results with regard to warranty expenditures could have a material adverse effect on the Company if the actual rate of unit failure or the cost to repair a unit is greater than that which the Company has used in estimating the warranty expense accrual.

The Company s recording of deferred tax assets each period depends primarily on the Company s ability to generate current and future taxable income in the United States. Each period the Company evaluates the need for a valuation allowance for the deferred tax assets and adjusts the valuation allowance so that net deferred tax assets are recorded only to the extent the Company concludes it is more likely than not that these deferred tax assets will be realized. With the acquisition of Maxtor Corporation (Maxtor) on May 19, 2006, the realizability of U.S. deferred tax assets was determined on a consolidated return basis. As a result, Maxtor s deferred tax assets that were determined to be realizable were recorded as a reduction of goodwill and Seagate deferred tax assets that were determined to be no longer realizable were written off with a charge to income tax expense at the date of acquisition.

SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

1. Summary of Significant Accounting Policies (continued)

In accordance with the provisions of Financial Accounting Standards Board (FASB) Statement (SFAS) No. 141, *Business Combinations* (SFAS 141), the purchase price of an acquired company is allocated between tangible and intangible assets acquired and liabilities assumed from the acquired business based on their estimated fair values, with the residual of the purchase price recorded as goodwill. The Company engages third-party appraisal firms to assist management in determining the fair values of certain assets acquired and liabilities assumed. Such valuations require management to make significant judgments, estimates and assumptions, especially with respect to intangible assets. Management makes estimates of fair value based upon assumptions it believes to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies, and are inherently uncertain. Critical estimates in valuing certain of the intangible assets include but are not limited to: future expected cash flows from existing technology, customer relationships, trade names, and other intangible assets; the acquired company s brand awareness and market position, as well as assumptions about the period of time the acquired brand will continue to be used in the combined company s product portfolio; and discount rates. Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

The Company is required to periodically evaluate the carrying values of intangible assets for impairment. If any of the Company s intangible assets are determined to be impaired, the Company may have to write-down the impaired asset and its earnings would be adversely impacted in the period that occurs.

At September 29, 2006, the Company s goodwill totaled approximately $2.5 billion and our identifiable intangible assets totaled $272 million. In accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), the Company assesses the impairment of goodwill at least annually, or more often if warranted by events or changes in circumstances indicating that the carrying value may exceed its fair value. This assessment requires the projection and discounting of cash flows, analysis of the Company s market capitalization and estimating the fair values of tangible and intangible assets and liabilities. The estimate of cash flow is based upon, among other things, certain assumptions about expected future operating performance and an appropriate discount rate determined by management. The Company s estimates of discounted cash flows may differ from actual cash flows due to, among other things, economic conditions, changes to the business model, or changes in operating performance. Significant differences between these estimates and actual cash flows could materially affect the Company s future financial results.

The Company also has other key accounting policies and accounting estimates relating to uncollectible customer accounts, valuation of inventory and valuation of share-based payments. The Company believes that these other accounting policies and other accounting estimates either do not generally require it to make estimates and judgments that are as difficult or as subjective, or it is less likely that they would have a material impact on its reported results of operations for a given period.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

1. Summary of Significant Accounting Policies (continued)

Net Income Per Share

In accordance with SFAS No. 128, *Earnings per Share*, the following table sets forth the computation of basic and diluted net income per share for the three months ended September 29, 2006 and September 30, 2005:

	For the Three Months Ended	
	September 29, 2006	September 30, 2005
	(In millions, except per share data)	
Basic net income per share		
Net Income	$ 19	$ 272
Weighted-average number of common shares outstanding during the period	576	479
Basic net income per share	$ 0.03	$ 0.57
Diluted net income per share		
Net income	$ 19	$ 272
Weighted-average number of common shares outstanding during the period	576	479
Shares issuable from assumed exercise of options and unvested nonvested shares using the treasury stock method	26	27
Total shares for purpose of calculating diluted net income per share	602	506
Diluted net income per share	$ 0.03	$ 0.54

The following potential common shares were excluded from the computation of diluted net income per share, as their effect would have been anti-dilutive:

	For the Three Months Ended	
	September 29, 2006	September 30, 2005
	(In millions)	
Stock options	16.1	19.6
Nonvested shares	1.8	
2.375% convertible senior notes	3.6	
6.8% convertible senior notes	4.1	

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. Balance Sheet Information

	September 29, 2006	June 30, 2006
	(in millions)	
Accounts Receivable:		
Accounts receivable	$ 1,408	$ 1,482
Allowance for doubtful accounts	(77)	(37)
	$ 1,331	$ 1,445
Inventories:		
Components	$ 201	$ 209
Work-in-process	100	126
Finished goods	638	556
	$ 939	$ 891
Property, equipment and leasehold improvements, net:		
Property, equipment and leasehold improvements	$ 4,512	$ 4,286
Accumulated depreciation and amortization	(2,333)	(2,180)
	$ 2,179	$ 2,106
Accrued Warranty:		
Short-term accrued warranty included in Accrued expenses, other on the balance sheet	$ 239	$ 249
Long-term accrued warranty included in Other non-current liabilities on the balance sheet	198	196
	$ 437	$ 445

Allowance for Doubtful Accounts

On November 6, 2006 the Company took steps to commence the process of terminating the Company s distributor relationships with eSys Technologies Pte. Ltd. and its related affiliate entities (eSys) and the Company has ceased shipments of its products to eSys. eSys was the largest distributor of Seagate products (including Maxtor products) for the fiscal year ended June 30, 2006 and for the quarter ended September 29, 2006, representing approximately 5% and 6% of the Company s revenues for those respective periods.

In early October 2006, the Company initiated an audit of eSys point of sale records pursuant to the Company s contractual rights to confirm the accuracy and completeness of eSys claims for program credits under the Company s distributor sales incentive programs. Discussions with eSys surrounding the timing, scope of work, and selection of third party auditors continued until last week when eSys officials informed the Company they would deny the Company s third party auditors access to eSys records to perform the requested audit notwithstanding the Company s contractual rights to do so. eSys officials also indicated to the Company that an audit would likely reveal irregularities in eSys compliance with the terms of the Company s incentive programs and other unspecified irregularities. In addition, eSys has failed to make full current payments on its obligations to the Company. Accordingly, on November 6, 2006, the Company notified eSys that the Company is terminating its commercial distributor relationships with eSys.

As of September 29, 2006, the Company had $103 million of outstanding accounts receivable related to eSys. Through November 5, 2006, eSys outstanding balance on these same accounts receivable has been reduced to approximately $50 million, largely as a result of payments received prior to the third week of October 2006. Although eSys officials have indicated that eSys intends to pay all amounts owed to the Company, the Company has recorded an additional $40 million of allowance for doubtful accounts in the quarter ended September 29, 2006, after consideration of existing allowances. The Company recorded this additional allowance due to the inherent uncertainties following the termination of the distribution relationships, eSys current delinquency in payments and failure to pay amounts when promised, and eSys failure to comply with the terms of its commercial agreements with the Company. Although the Company has recorded the additional $40 million allowance for doubtful accounts as described above, the Company intends to make every effort to collect all amounts owed by eSys as promptly as possible. Any amounts recovered on these receivables will be recorded in the period received.

While the Company is terminating its ongoing distributor relationships with eSys, the Company will continue to aggressively pursue its contractual audit rights as well as any claims that may be assertable against eSys as a result of material breaches of the distribution agreements and any intentionally wrongful conduct that may have occurred.

Long-Term Debt and Credit Facilities

On September 20, 2006, Seagate Technology HDD Holdings (HDD), the Company s wholly-owned direct subsidiary, issued senior notes totaling $1.5 billion comprised of $300 million of Floating Rate Senior Notes due October 2009 (the 2009 Notes), $600 million of 6.375% Senior Notes due October 2011 (the 2011 Notes) and $600 million of 6.8% Senior Notes due October 2016 (the 2016 Notes). The Company guarantees these notes on a full and unconditional basis (see Note 12). These notes are unsecured and will rank equally in right of payment with all of HDD s other existing and future senior unsecured indebtedness and senior to any present and future subordinated indebtedness of HDD.

$300 Million Floating Rate Senior Notes due October 2009. The 2009 Notes bear interest at a floating rate equal to three-month LIBOR plus 0.84% per year, payable quarterly on January 1, April 1, July 1 and October 1 of each year commencing January 1, 2007. The 2009 Notes will mature on October 1, 2009. The Company may not redeem the 2009 Notes prior to maturity.

SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. Balance Sheet Information (continued)

$600 Million Fixed Rate Senior Notes due October 2011. The 2011 Notes bear interest at the rate of 6.375% per year, payable semi-annually on April 1 and October 1 of each year. The 2011 Notes will be redeemable at the option of the Company in whole or in part, on not less than 30 nor more than 60 days notice at a make-whole premium redemption price. The make-whole redemption price will be equal to the greater of (1) 100% of the principal amount of the notes being redeemed, or (2) the sum of the present values of the remaining scheduled payments of principal and interest on the 2011 Notes being redeemed, discounted at the redemption date on a semi-annual basis at a rate equal to the sum of the applicable Treasury rate plus 50 basis points.

$600 Million Fixed Rate Senior Notes due October 2016. The 2016 Notes bear interest at the rate of 6.8% per year, payable semi-annually on April 1 and October 1 of each year. The 2016 Notes will be redeemable at the option of the Company in whole or in part, on not less than 30 nor more than 60 days notice at a make-whole premium redemption price. The make-whole redemption price will be equal to the greater of (1) 100% of the principal amount of the notes being redeemed, or (2) the sum of the present values of the remaining scheduled payments of principal and interest on the 2016 Notes being redeemed, discounted at the redemption date on a semi-annual basis at a rate equal to the sum of the applicable Treasury rate plus 50 basis points.

$400 Million 8% Senior Notes due May 2009. As of September 29, 2006, HDD had outstanding $400 million aggregate principal amount of 8.0% Senior Notes due May 2009 (the 8% Notes). The Company had guaranteed HDD s obligations under the 8% Notes on a full and unconditional basis (see Note 12). The indenture governing the outstanding 8% Notes imposed financial and operational restrictions on the Company and its subsidiaries. On September 20, 2006, the Company announced that it had called for full redemption of the 8% Notes. The redemption price for the 8% Notes is $1,040 per $1,000 principal amount of Notes, plus accrued interest to, but excluding, the Redemption Date. Accordingly, interest ceased to accrue on the 8% Notes after the close of business on October 24, 2006 and the notes were redeemed on October 25, 2006 (see Note 13).

Revolving Credit Facility. HDD has a senior unsecured $500 million revolving credit facility that matures in September 2011. The $500 million revolving facility, which was entered into in September 2006, replaced the then-existing $100 million revolving credit facility.

The credit agreement that governs the Company s revolving credit facility contains covenants that must be satisfied in order to remain in compliance with the agreement. The credit agreement contains three financial ratios: (1) minimum cash, cash equivalents and marketable securities; (2) a fixed charge coverage ratio; and (3) a net leverage ratio. As of September 29, 2006, the Company is in compliance with all covenants.

The $500 million revolving credit facility is available for cash borrowings and for the issuance of letters of credit up to a sub-limit of $100 million. Although no borrowings have been drawn under this revolving credit facility to date, the Company had utilized $43 million for outstanding letters of credit and bankers guarantees as of September 29, 2006, leaving $457 million for additional borrowings, subject to compliance with financial covenants and other customary conditions to borrowing.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. Balance Sheet Information (continued)

The credit agreement governing the revolving credit facility includes limitations on the ability of the Company to pay dividends, including a limit of $300 million in any four consecutive quarters. The Company s declaration of dividends is also subject to Cayman Islands law and the discretion of its board of directors.

As a result of its acquisition of Maxtor on May 19, 2006, the Company assumed $135 Million 6.8% Convertible Senior Notes due April 2010, $326 Million 2.375% Convertible Senior Notes due August 2012, $55 Million 5.75% Subordinated Debentures due March 2012 and $60 million LIBOR Based China Manufacturing Facility Loans.

Upon the closing of the Merger, the Company and Maxtor entered into a supplemental indenture whereby the Company agreed to guarantee the 2.375% Notes and the 6.8% Notes on a full and unconditional basis (see Note 12).

3. Income Taxes

The Company is a foreign holding company incorporated in the Cayman Islands with foreign and U.S. subsidiaries that operate in multiple taxing jurisdictions. As a result, its worldwide operating income either is subject to varying rates of tax or is exempt from tax due to tax holidays or tax incentive programs in China, Malaysia, Singapore, Switzerland and Thailand. These tax holidays or incentives are scheduled to expire in whole or in part at various dates through 2015. The income tax benefit recorded for the three months ended September 29, 2006 differs from the provision for income taxes that would be derived by applying a notional U.S. 35% rate to income before income taxes primarily due to the net effect of (i) the tax benefit related to the aforementioned tax holiday and tax incentive programs, (ii) an increase in the Company s valuation allowance for U.S. deferred tax assets, and (iii) foreign tax benefits recorded during the quarter relating to reductions in previously accrued taxes and reductions in valuation allowances for certain foreign deferred tax assets. The Company s provision for income taxes recorded for the three months ended September 30, 2005 differed from the provision for income taxes that would be derived by applying a notional U.S. 35% rate to income before income taxes primarily due to the net effect of (i) the tax benefit related to the aforementioned tax holiday and tax incentive programs, and (ii) a decrease in the Company s valuation allowance recorded for certain foreign deferred tax assets. Based on the Company s foreign ownership structure, participation in tax holiday and tax incentive programs in the Far East, and subject to potential future increases in its valuation allowance for U.S. and certain foreign deferred tax assets, the Company anticipates that its effective tax rate in future periods will generally be less than the U.S. federal statutory rate. Dividend distributions received from the Company s U.S. subsidiaries may be subject to U.S. withholding taxes when, and if distributed. Deferred tax liabilities have not been recorded on unremitted earnings of certain foreign subsidiaries, as these earnings will not be subject to tax in the Cayman Islands or U.S. federal income tax if remitted to the Company s foreign parent holding company.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

3. Income Taxes (continued)

As of September 29, 2006, the Company has recorded net deferred tax assets of $81 million, the realization of which is primarily dependent on its ability to generate sufficient U.S. and certain foreign taxable income in fiscal years 2007 and 2008 and the first quarter of fiscal year 2009. Although realization is not assured, the Company s management believes that it is more likely than not that these deferred tax assets will be realized. The amount of deferred tax assets considered realizable, however, may increase or decrease in subsequent quarters, when the Company reevaluates the underlying basis for its estimates of future U.S. and certain foreign taxable income.

As a result of the Maxtor acquisition, Maxtor underwent a change in ownership within the meaning of Section 382 of the Internal Revenue Code (IRC Sec. 382) on May 19, 2006. In general, IRC Sec. 382 places annual limitations on the use of certain tax attributes such as net operating losses and tax credit carryovers in existence at the ownership change date. The annual limitation for this change is $110 million. Certain amounts may be accelerated into the first five years following the acquisition pursuant to IRC Section 382 and published notices. On January 3, 2005, the Company underwent a change in ownership under IRC Sec. 382 due to the sale of common shares to the public by its then largest shareholder, New SAC. Based on an independent valuation as of January 3, 2005, the annual limitation for this change is $44.8 million. To the extent management believes it is more likely than not that the deferred tax assets associated with tax attributes subject to this IRC Sec. 382 limitation will not be realized, a valuation allowance has been provided.

The Internal Revenue Service is currently examining the Company s federal income tax returns for fiscal years ending in 2001-2004. The timing of the settlement of these examinations is uncertain. The Company believes that adequate amounts of tax have been provided for any final assessment that may result.

4. Restructuring Costs

Ongoing Restructuring Activities

During the three months ended September 29, 2006, the Company reversed $4 million of restructuring accruals relating to the sale of a surplus building previously impaired in a prior restructuring.

Liabilities Recognized in Connection with Business Combinations

In connection with the Maxtor acquisition, the Company accrued certain exit costs (see Note 5).

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Acquisitions

Maxtor Corporation

On December 20, 2005, the Company entered into an Agreement and Plan of Merger (the Merger Agreement) with Maxtor Corporation, a Delaware corporation, and MD Merger Corporation, a Delaware corporation and direct wholly-owned subsidiary of Seagate, by which Seagate agreed to acquire Maxtor (the Merger), and whereby Maxtor would become a wholly owned subsidiary of Seagate. On May 19, 2006, the Company completed the acquisition of Maxtor in a stock for stock transaction. The acquisition was structured to qualify as a tax-free reorganization and the Company has accounted for the acquisition in accordance with SFAS 141. The combination of the two companies brands and the related product lines represent the most differentiated storage offering to customers and enhance Seagate s scale and capacity to better drive technology advances and accelerate delivery of a wide range of differentiated products and cost-effective solutions to a growing base of customers.

Under the terms of the Merger Agreement, each share of Maxtor common stock was exchanged for 0.37 of Company s common shares. The Company issued approximately 96.9 million common shares to Maxtor s shareholders, assumed and converted Maxtor options (based on the 0.37 exchange ratio) into options to purchase approximately 7.1 million of the Company s common shares and assumed and converted all outstanding Maxtor nonvested stock into approximately 1.3 million of the Company s nonvested shares. The purchase consideration comprising the fair value of the common shares, stock options and nonvested shares assumed and including transaction costs was approximately $2.0 billion.

Purchase Price Allocation

The application of purchase accounting under SFAS 141 requires that the total purchase price be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date, with amounts exceeding the fair values being recorded as goodwill. The allocation process requires an analysis and valuation of acquired assets, including fixed assets, technologies, customer contracts and relationships, trade names and liabilities assumed, including contractual commitments and legal contingencies.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Acquisitions (continued)

The Company has identified and recorded the assets, including specifically identifiable intangible assets, and liabilities assumed from Maxtor at their preliminary estimated fair values as at May 19, 2006, the date of acquisition and allocated the residual value of approximately $2.5 billion to goodwill. During the quarter ended September 29, 2006, we adjusted the purchase price allocation and increased the fair values of two owned facilities based on contracted sales prices. We also adjusted and increased certain exit plan liabilities and pre-acquisition contingencies. The net effect of these and other adjustments, based on information available as of September 29, 2006, resulted in a net increase of $13 million to Goodwill. The fair values of acquired assets and liabilities may be further adjusted as additional information becomes available during the allocation period of up to 12 months from the acquisition date (in accordance with SFAS 141). Additional information that may become available subsequently and may result in changes in the values allocated to various assets and liabilities includes, but is not limited to, changes in the timing and actual number of employees terminated and the location of these employees, the period it takes to vacate and successfully market owned and leased facilities and the selling prices or sublet rental rates secured, the net resale values of plant and equipment, previously unidentified claims from suppliers or other contingent obligations, including warranty liabilities, and the amounts required to settle them, the progress or outcomes of various litigation, and the outcomes of previously identified or unidentified customer claims. Any changes in the values allocated to tangible and specifically identified intangible assets acquired and liabilities assumed during the allocation period may result in material adjustments to goodwill.

Recognition of Liabilities in Connection with Maxtor Acquisition

Under Emerging Issues Task Force (EITF) 95-3, *Recognition of Liabilities in Connection with a Business Combination,* the Company accrued certain exit costs aggregating $260 million, of which $113 million is related to employee severance, $44 million relates to the planned exit of leased or owned excess facilities and $103 million relates to the cancellation or settlement of contractual obligations that will not provide any future economic benefit. The severance and associated benefits liability relates to the employment termination of approximately 4,950 Maxtor employees, primarily in the U.S. and Far East, of which 3,305 employees had been terminated as of September 29, 2006. In the three months ended September 29, 2006, the Company paid $108 million of the accrued exit costs. The Company expects payments for severance and related benefits and for contractual settlements to be substantially completed by the end of fiscal year 2007, while the costs associated with the exit of certain facilities will continue to the end of fiscal year 2016.

The following table summarizes the Company s exit activities in connection with the Maxtor acquisition:

	Severance and Benefits	Excess Facilities	Contract Cancellations	Total
		(in millions)		
Accrual exit costs, May 19, 2006	$ 117	$ 43	$ 91	$ 251
Cash payments	(8)		(10)	(18)
Accrual exit costs, June 30, 2006	109	43	81	233
Purchase accounting adjustments	(4)	1	12	9
Cash payments	(36)	(5)	(67)	(108)
Accrual exit costs, September 29, 2006	$ 69	$ 39	$ 26	$ 134

Accrued exit costs are included in short-term and long-term Accrued Restructuring on the balance sheet.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

5. Acquisitions (continued)

Stock-Based Compensation

Stock-based compensation related to the unearned stock options and nonvested shares assumed from Maxtor were valued at approximately $70 million, of which, approximately $31 million has been amortized through the three months ended September 29, 2006. The remaining $39 million will be amortized on a straight-line basis over the remaining estimated service (vesting) periods of the underlying stock options or nonvested shares.

Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of the Company and the results of Maxtor prior to the Merger, on a pro forma basis, as though the companies had been combined as of the beginning of the period presented. Pro forma financial information for our other acquisitions have not been presented, as the effects were not material to our historical consolidated financial statements either individually or in aggregate. The pro forma financial information presented includes the business combination accounting effect on conforming Maxtor s revenue recognition policy to the Company s, adjustments related to the fair value of acquired inventory and fixed assets, amortization charges from acquired intangible assets, stock-based compensation charges for unvested stock options assumed and nonvested shares exchanged and related tax effects of these adjustments. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved had the acquisition taken place at the beginning of the period presented, nor does it intend to be a projection of future results.

The unaudited pro forma financial information for the three months ended September 30, 2005 combines the Company s historical results for the three months ended September 30, 2005 and, due to differences in our reporting periods, the historical results of Maxtor for the three months ended October 1, 2005.

(in millions, except for share data)	Three Months Ended September 30, 2005 (Unaudited)	
Revenue	$	2,957
Net income	$	221
Basic net income per share	$	0.38
Diluted net income per share	$	0.37

Other Acquisitions

The Company acquired two other companies for cash in fiscal year 2006 for a purchase price of $15 million and $14 million, respectively, which resulted in residual values of approximately $12 million and $5 million, respectively, being recorded to goodwill after the allocation of fair value to tangible and intangible assets acquired and liabilities assumed. These acquisitions did not have a material impact on the Company s results of operations.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

6. Goodwill and Other Intangible Assets

Goodwill

In accordance with SFAS 141, the Company allocated the excess of the cost of the acquired entities over the net amounts of assets acquired and liabilities assumed to goodwill. As at September 29, 2006, the composition of the amounts recorded to goodwill are as follows (in millions):

Balance as of June 30, 2006	$ 2,475
Adjustment to goodwill acquired through Maxtor acquisition (see Note 5)	13
Balance as of September 29, 2006	$ 2,488

In accordance with the guidance in SFAS 142, goodwill is not amortized. Instead, it is tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill may be impaired. The Company did not record any impairment of goodwill during the three months ended September 29, 2006 and September 30, 2005.

Other Intangible Assets

Other intangible assets consist primarily of existing technology, customer relationships and trade names acquired in business combinations. Acquired intangibles are amortized on a straight-line basis over the respective estimated useful lives of the assets. Accumulated amortization of intangibles was $68 million and $33 million at September 29, 2006 and June 30, 2006, respectively. The carrying value of intangible assets at September 29, 2006 is set forth in the table below.

(in millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Existing technology	$ 150	$ (42)	$ 108
Customer relationships	140	(15)	125
Trade names	33	(3)	30
Patents and licenses	17	(8)	9
Total acquired identifiable intangible assets	$ 340	$ (68)	$ 272

In the three months ended September 29, 2006 and September 30, 2005, amortization expense for other intangible assets was $35 million and $1 million, respectively. Amortization of the existing technology intangible is charged to Cost of revenue while the amortization of the other intangible assets is included in Operating expenses in the Consolidated Statements of Operations.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Stock-Based Compensation

Stock-Based Benefit Plans

Seagate Technology 2001 Share Option Plan In December 2000, the Company s board of directors adopted the Seagate Technology 2001 Share Option Plan (the 2001 Plan). Under the terms of the 2001 Plan, eligible employees, directors, and consultants can be awarded options to purchase up to 100 million common shares of the Company under vesting terms to be determined at the date of grant. Options granted to exempt employees generally vest as follows: 25% of the shares will vest on the first anniversary of the vesting commencement date and the remaining 75% will vest proportionately each month over the next 36 months. Options granted to non-exempt employees vest on the first anniversary of the vesting commencement date. Except for certain options granted below deemed fair value shortly prior to the Company s initial public offering in fiscal year 2003 (see Deferred Stock Compensation), all other options granted under the 2001 Plan were granted at fair market value. Options granted up through September 5, 2004 expire ten years from the date of grant and options granted subsequent to September 5, 2004 expire seven years from the date of grant. As of September 29, 2006, there were approximately 32,000 common shares available for issuance under the 2001 Plan.

Seagate Technology 2004 Stock Compensation Plan On August 5, 2004, the Company s board of directors adopted the Seagate Technology 2004 Stock Compensation Plan (the 2004 Plan), and on October 28, 2004, the Company s shareholders approved the 2004 Plan. The purpose of the 2004 Plan is to promote the Company s long-term growth and financial success by providing incentives to its employees, directors, and consultants through grants of share-based awards. The provisions of the 2004 Plan, which allows for the grant of various types of equity-based awards up to 63.5 million shares (see Note 13), are also intended to provide greater flexibility to maintain the Company s competitive ability to attract, retain and motivate participants for the benefit of the Company and its shareholders. Options granted to exempt employees generally vest as follows: 25% of the shares will vest on the first anniversary of the vesting commencement date and the remaining 75% will vest proportionately each month over the next 36 months. Options granted to non-exempt employees vest on the first anniversary of the vesting commencement date. As of September 29, 2006, there were approximately 3.4 million common shares available for issuance under the 2004 Plan (see Note 13).

Assumed Maxtor Stock Options In connection with the Company s acquisition of Maxtor, the Company assumed all outstanding options to purchase Maxtor common stock with a weighted-average exercise price of $16.10 on an as-converted basis. Each stock option assumed was converted into a stock option to purchase the Company s common shares after applying the exchange ratio of 0.37 Company common shares for each share of Maxtor common stock. In total, the Company assumed and converted Maxtor stock options into stock options to purchase approximately 7.1 million of the Company s common shares. In addition, the Company assumed and converted all outstanding Maxtor nonvested stock into approximately 1.3 million of the Company s nonvested shares, based on the 0.37 exchange ratio. The assumed options and nonvested shares exchanged retained all applicable terms and vesting periods. As of September 29, 2006, approximately 5.8 million of the assumed stock options and 1.2 million of the exchanged nonvested shares were outstanding.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Stock-Based Compensation (continued)

Maxtor Corporation 1996 Stock Plan On May 19, 2006, as a result of the acquisition of Maxtor, the Company assumed all outstanding stock options and nonvested stock under Maxtor s Amended and Restated 1996 Stock Option Plan (the 1996 Plan). Stock options under the 1996 Plan generally vest over a four-year period from the date of grant with 25% vesting at the first anniversary date of the vest date and 6.25% each quarter thereafter, expiring ten years from the date of grant. Nonvested shares generally vest over a three-year period from the date of grant with 1/3 vesting at the first anniversary date of the vest date and 1/3 each year thereafter, and are subject to forfeiture if employment is terminated prior to the time the shares become fully vested and non-forfeitable.

Maxtor Corporation 2005 Performance Incentive Plan On May 19, 2006, as a result of the acquisition of Maxtor, the Company assumed all outstanding stock options and nonvested stock under Maxtor s 2005 Performance Incentive Plan (the 2005 Plan). Stock options granted under the 2005 Plan generally vest over a four-year period with 25% vesting at the first anniversary date of the vest date and 6.25% each quarter thereafter, expiring ten years from the date of grant. Nonvested shares generally vest over a three-year period from the date of grant with 1/3 vesting at the first anniversary date of the vest date and 1/3 each year thereafter, and are subject to forfeiture if employment is terminated prior to the time the shares become fully vested and non-forfeitable.

Maxtor (Quantum HDD) Merger Plan On May 19, 2006, as a result of the acquisition of Maxtor, the Company assumed all outstanding options under Maxtor s (Quantum HDD) Merger Plan. Options granted under this plan are completely vested and exercisable.

Stock Purchase Plan The Company established an Employee Stock Purchase Plan (ESPP) in December 2002. At that time, a total of 20 million common shares had been authorized for issuance under the ESPP (see Note 13). This number of common shares authorized for issuance automatically increases annually on the first day of the Company s fiscal year beginning in 2003 equal to the lesser of 2.5 million shares or 0.5% of the outstanding shares on the last day of the immediately preceding fiscal year, subject to approval by the Company s board of directors. In no event shall the total number of shares issued under the ESPP exceed 75 million shares. The ESPP permits eligible employees who have completed thirty days of employment prior to the commencement of any offering period to purchase common shares through payroll deductions generally at 85% of the fair market value of the common shares. On July 31, 2006, the Company issued approximately 1.7 million common shares under the ESPP, with a weighted-average purchase price of $16.45. As of September 29, 2006, there were approximately 4.2 million common shares available for issuance under the ESPP (see Note 13).

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Stock-Based Compensation (continued)

Determining Fair Value of Stock Options

The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option-pricing formula and a single option award approach. This fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period or the remaining service (vesting) period. The fair value of the Company s stock options granted to employees for the three months ended September 29, 2006 and September 30, 2005 was estimated using the following weighted-average assumptions:

	For the Three Months Ended	
	September 29, 2006	September 30, 2005
Option Plan Shares		
Expected term (in years)	4.0	3.5
Volatility	39%	43%
Expected dividend	1.3 1.6%	1.7 2.2%
Risk-free interest rate	4.7	4.1%
Estimated annual forfeitures	4.5%	4.8%
Weighted-average fair value	$7.26	$4.74
ESPP Plan Shares		
Expected term (in years)	0.5	0.5 1.0
Volatility	34%	41%
Expected dividend	1.4%	1.7%
Risk-free interest rate	5.0%	3.6 3.8%
Weighted-average fair value	$5.35	$5.33

Stock Compensation Expense

Deferred Stock Compensation In connection with certain stock options granted shortly prior to the Company s initial public offering in fiscal year 2003, the Company, in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, recorded deferred stock compensation aggregating $9.7 million, net of subsequent cancellations, representing the difference between the exercise price of the options and the deemed fair value of the Company s common shares on the dates the options were granted. The Company has substantially completed the amortization of such compensation expense through September 29, 2006.

Stock Compensation Expense The Company recorded approximately $38 million and $16 million of stock-based compensation during the three months ended September 29, 2006 and September 30, 2005, respectively. Of the $38 million recorded in the three months ended September 29, 2006, $14 million related to assumed stock options and nonvested shares exchanged in the Maxtor acquisition (see Note 5).

As required by SFAS 123(R), management made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. Guarantees

Indemnifications to Officers and Directors

We have entered into indemnification agreement, a form of which is incorporated by reference in the exhibits of this report, with the members of our board of directors to indemnify them to the extent permitted by law against any and all liabilities, costs, expenses, amounts paid in settlement and damages incurred by the directors as a result of any lawsuit, or any judicial, administrative or investigative proceeding in which the directors are sued as a result of their service as members of our board of directors.

Intellectual Property Indemnification Obligations

The Company has entered into agreements with customers and suppliers that include limited intellectual property indemnification obligations that are customary in the industry. These guarantees generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party intellectual property claims arising from these transactions. The nature of the intellectual property indemnification obligations prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to its customers and suppliers. Historically, the Company has not made any significant indemnification payments under such agreements and no amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

Product Warranty

The Company estimates probable product warranty costs at the time revenue is recognized. The Company generally warrants its products for a period of one to five years. The Company warrants all internal desktop and notebook disc drives shipped through the distribution and retail channels for a period of five years. The Company uses estimated repair or replacement costs and uses statistical modeling to estimate product return rates in order to determine its warranty obligation. Changes in the Company s product warranty liability during the three months ended September 29, 2006 and September 30, 2005 were as follows:

	For the Three Months Ended	
	September 29, 2006	September 30, 2005
	(in millions)	
Balance, beginning of period	$ 445	$ 243
Warranties issued	57	34
Repairs and replacements	(73)	(24)
Changes in liability for pre-existing warranties, including expirations	8	2
Balance, end of period	$ 437	$ 255

The Company offers extended warranties on certain of its products. Deferred revenue related to extended warranties has not been material to date.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

9. Equity

Repurchases of Equity Securities

The Company s board of directors has authorized the use of up to $2.5 billion for the repurchase of the Company s outstanding shares of common stock. During the three months ended September 29, 2006, the Company repurchased approximately 6.7 million shares worth approximately $150 million, all of which were cancelled and are no longer outstanding. The Company has approximately $2.35 billion available under the current authorized stock repurchase program. The Company did not repurchase any shares during the three months ended September 30, 2005.

Share repurchases during the three months ended September 29, 2006 were as follows:

	Total Number of Shares Purchased (in millions)	Average Price Paid per Share	Total Number of Shares Purchased Under Publicly Announced Plans or Programs (in millions)	Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs (in millions)
July 2006		$		$ 2,500
August 2006		$		$ 2,500
September 2006	6.7	$ 22.47	6.7	$ 2,350
Total	6.7	$ 22.47	6.7	$ 2,350

10. Litigation

See Part II, Item 1, Legal Proceedings.

11. Recently Adopted Accounting Pronouncements

In February 2006, the FASB, issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments*, which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.* SFAS No. 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the entire instrument on a fair value basis. SFAS No. 155 also clarifies and amends certain other provisions of SFAS No. 133 and SFAS No. 140. SFAS No. 155 is effective for all financial instruments acquired, issued, or subject to a remeasurement event occurring in fiscal years beginning after September 15, 2006. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. We do not expect the adoption of SFAS No. 155 to have a material impact on our consolidated financial position, results of operations, or cash flows.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

11. Recently Adopted Accounting Pronouncements (continued)

In June 2006, the FASB issued FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109*. This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation is effective for fiscal years beginning after December 15, 2006 and will be adopted by the Company in the first quarter of fiscal year 2008. The Company is currently evaluating the effect that the adoption of FIN 48 will have on its consolidated results of operations and financial condition.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements, the Board having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the effect that the adoption of SFAS No. 157 will have on its consolidated results of operations and financial condition.

12. Condensed Consolidating Financial Information

The Company has guaranteed HDD s obligations under the 8% Notes, the 2009 Notes, the 2011 Notes and the 2016 Notes (the Senior Notes), on a full and unconditional basis. The following tables present parent guarantor, subsidiary issuer and combined non-guarantors condensed consolidating balance sheets of the Company and its subsidiaries at September 29, 2006 and June 30, 2006 and the condensed consolidating results of operations and consolidating cash flows for the three months ended September 29, 2006 and September 30, 2005. The information classifies the Company s subsidiaries into Seagate Technology-parent company guarantor, HDD-subsidiary issuer, and the combined non-guarantors based upon the classification of those subsidiaries. Up to October 25, 2006 when the 8% Notes were redeemed, the Company was restricted in its ability to obtain funds from its subsidiaries by dividend or loan under both the indenture governing the 8% Notes and the credit agreement governing the senior unsecured revolving line of credit. Under each of these instruments, dividends paid by HDD or its restricted subsidiaries would constitute restricted payments and loans between the Company and HDD or its restricted subsidiaries would constitute affiliate transactions.

From the date of acquisition (May 19, 2006) through June 30, 2006, Maxtor was a wholly-owned direct subsidiary of Seagate Technology. The accompanying condensed consolidating balance sheet as of June 30, 2006 reflects the corporate legal structure of Seagate Technology, HDD, and the Combined Non-Guarantors, as they existed at that time. On July 3, 2006, through a corporate organizational change and realignment, Maxtor became a wholly-owned indirect subsidiary of HDD and of Seagate Technology. As a result, beginning July 3, 2006, the investment in Maxtor is accounted for on an equity method basis in the financial information of HDD.

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Condensed Consolidating Financial Information (continued)

Consolidating Balance Sheet

September 29, 2006

(In millions)

	Seagate Technology Parent Company Guarantor	HDD Subsidiary Issuer	Combined Non-Guarantors	Eliminations	Seagate Technology Consolidated
Cash and cash equivalents	$ 12	$ 558	$ 1,286	$	$ 1,856
Short-term investments		85	712		797
Accounts receivable, net			1,331		1,331
Intercompany receivable	35			(35)	
Intercompany loan receivable		230		(230)	
Inventories			939		939
Other current assets	1		314		315
Total Current Assets	48	873	4,582	(265)	5,238
Property, equipment and leasehold improvements, net			2,179		2,179
Other intangible assets			272		272
Other assets, net		23	320		343
Goodwill			2,488		2,488
Equity investment in HDD	5,415			(5,415)	
Equity investments in Non-Guarantors		6,096		(6,096)	
Intercompany note receivable		337	221	(558)	
Total Assets	$ 5,463	$ 7,329	$ 10,062	$ (12,334)	$ 10,520
Accounts payable	$	$	$ 1,448	$	$ 1,448
Intercompany payable		1	34	(35)	
Accrued employee compensation			237		237
Accrued expenses	2	17	802		821
Accrued income taxes			67		67
Intercompany loan payable			230	(230)	
Current portion of long-term debt		400	331		731
Total Current Liabilities	2	418	3,149	(265)	3,304
Other liabilities			355		355
Intercompany note payable	337		221	(558)	

Long-term debt, less current portion		1,496	241		1,737
Total Liabilities	339	1,914	3,966	(823)	5,396
Shareholders Equity	5,124	5,415	6,096	(11,511)	5,124
Total Liabilities and Shareholders Equity	$ 5,463	$ 7,329	$ 10,062	$ (12,334)	$ 10,520

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SEAGATE TECHNOLOGY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Condensed Consolidating Financial Information (continued)

Consolidating Balance Sheet

June 30, 2006

(In millions)

	Seagate Technology Parent Company Guarantor	HDD Subsidiary Issuer	Combined Non-Guarantors	Eliminations	Seagate Technology Consolidated
Cash and cash equivalents	$	$ 1	$ 909	$	$ 910
Short-term investments			823		823
Accounts receivable, net			1,445		1,445
Intercompany receivable	2		10	(12)	
Intercompany loan receivable		464	4	(468)	
Inventories			891		891
Other current assets			264		264
Total Current Assets	2	465	4,346	(480)	4,333
Property, equipment and leasehold improvements, net			2,106		2,106
Other intangible assets			307		307
Other assets, net		4	395	(76)	323
Goodwill			2,475		2,475
Equity investment in HDD	3,331			(3,331)	
Equity investments in Non-Guarantors	2,023	4,101		(6,124)	
Intercompany note receivable			835	(835)	
Total Assets	$ 5,356	$ 4,570	$ 10,464	$ (10,846)	$ 9,544
Accounts payable	$	$	$ 1,692	$	$ 1,692
Intercompany payable	3		8	(11)	
Accrued employee compensation			385		385
Accrued expenses	1	4	853		858
Accrued income taxes			72		72
Intercompany loan payable	140		329	(469)	
Current portion of long-term debt			330		330
Total Current Liabilities	144	4	3,669	(480)	3,337
Other liabilities			355		355
Intercompany note payable		835	76	(911)	

Long-term debt, less current portion				400		240				640
Total Liabilities		144		1,239		4,340		(1,391)		4,332
Shareholders Equity		5,212		3,331		6,124		(9,455)		5,212
Total Liabilities and Shareholders Equity	$	5,356	$	4,570	$	10,464	$	(10,846)	$	9,544