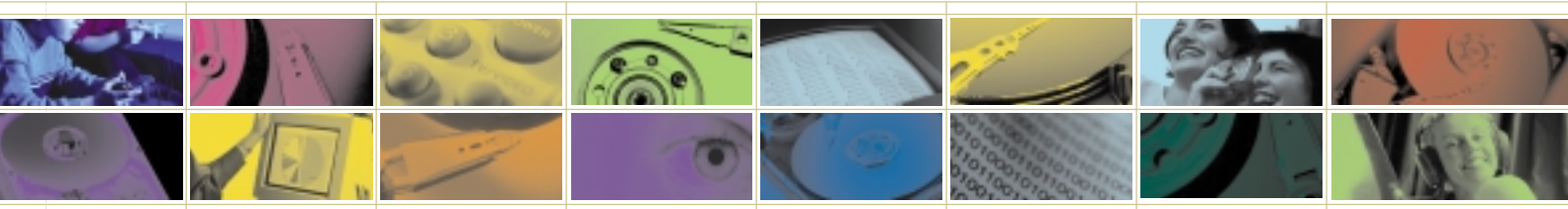




Western Digital

ANNUAL REPORT
AND FORM 10-K

2001





Western Digital's

M A N A G E M E N T T E A M



Left to right: Matt Milne, President, Cameo Technologies; David Fetah, Vice President, Human Resources; Jim Morris, Vice President, New Business Development; Bob Houghton, Vice President and Chief Information Officer; Arif Shakeel, Executive Vice President and Chief Operating Officer; Matt Massengill, President and Chief Executive Officer; Mike Cornelius, Vice President Law and Administration; Russ Krapf, President and Chief Executive Officer, Keen Personal Media; Cathy Scott, Vice President, Corporate Communications; Jerry Hill, President and Chief Operating Officer, SageTree; Bill Frank, Vice President Research and Development and Chief Technical Officer.

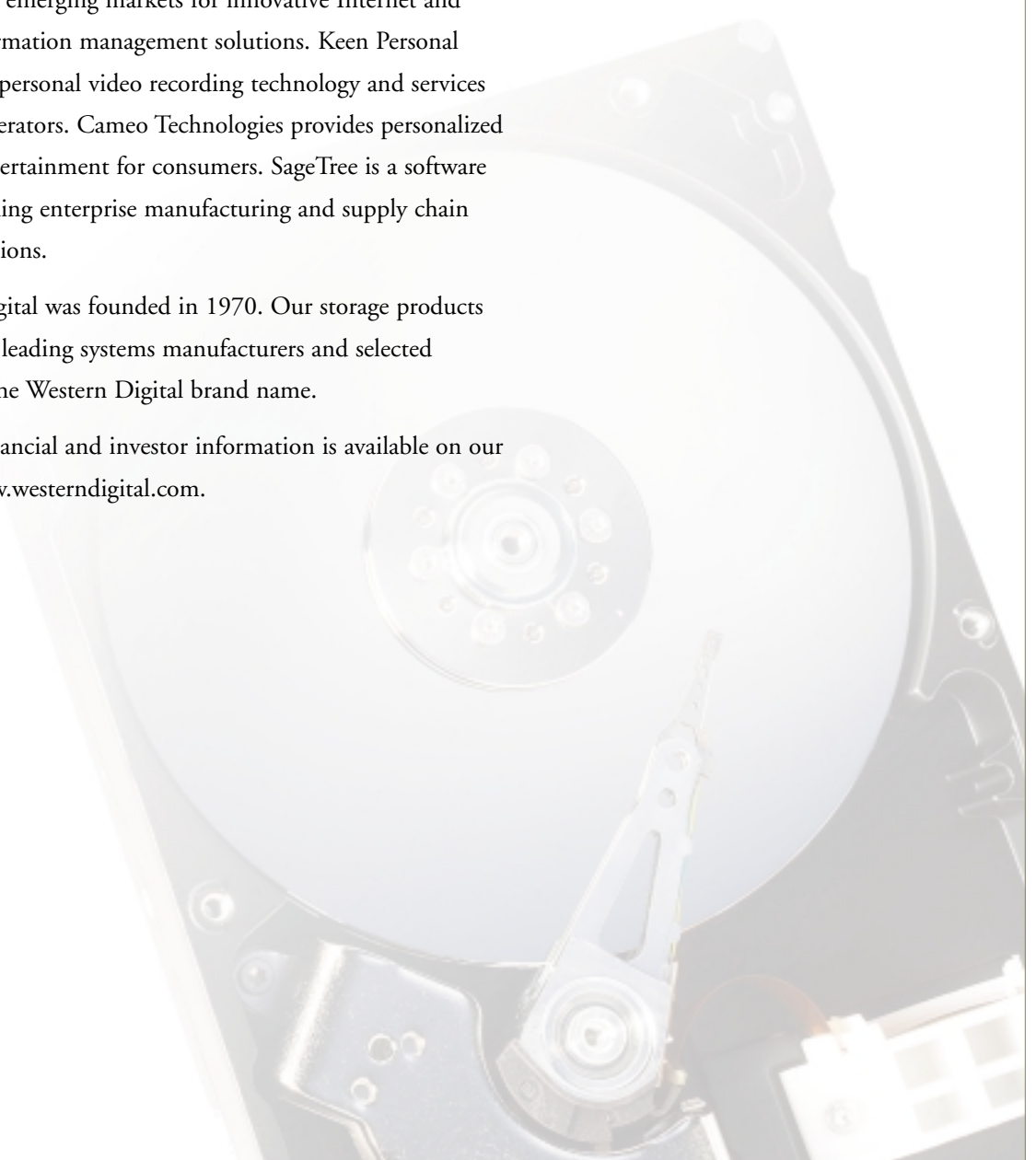
THE COMPANY

Western Digital, an information storage pioneer and long-time industry leader, provides products and services for people and organizations that collect, manage and use digital information. Our core business produces reliable, high-performance hard drives that keep users' data close at hand and secure from loss.

Western Digital's new ventures apply data storage core competencies to emerging markets for innovative Internet and broadband information management solutions. Keen Personal Media provides personal video recording technology and services for cable TV operators. Cameo Technologies provides personalized digital video entertainment for consumers. SageTree is a software company providing enterprise manufacturing and supply chain analytic applications.

Western Digital was founded in 1970. Our storage products are marketed to leading systems manufacturers and selected resellers under the Western Digital brand name.

Product, financial and investor information is available on our Web site at www.westerndigital.com.



FELLOW SHAREHOLDERS

Western Digital Corporation made tremendous progress in fiscal 2001. The entire organization has been focused on ensuring that our infrastructure and business model are tuned to remain healthy during difficult times and to deliver better returns to our shareholders in periods of stronger growth. We believe we are succeeding in this effort.

Noteworthy during the year were significant changes in the infrastructure of the hard drive industry. With growth in the PC industry slower than at any time since the industry's inception in the early 1980s, the hard drive business witnessed the privatization of industry giant Seagate Technologies, the merger of Quantum's hard drive business with Maxtor and, more recently, the decision by Fujitsu to exit the desktop hard drive business. These developments leave three leading desktop hard drive companies – Western Digital, Seagate, and Maxtor – with approximately 75 percent of the worldwide personal hard drive business, and provide an outstanding opportunity for more rational industry dynamics in the years ahead.

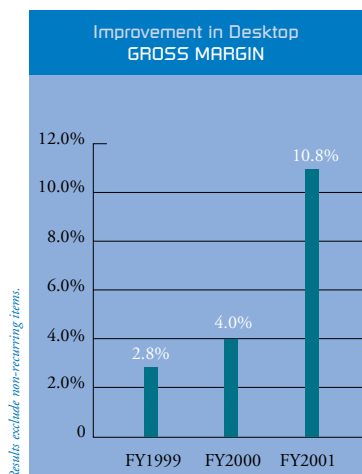
Although the PC industry's growth has been slowed by the worldwide cutback in information technology spending, we are convinced of its viability as a high volume, growing market, albeit at slower than earlier rates. Potential growth drivers for the EIDE hard drive industry in the next year are plentiful, including the launch of Microsoft's new Windows® XP operating system, the eventual corporate desktop PC refresh cycle, less expensive microprocessor chips that drive system performance, the increasing application of EIDE drives in entry-level servers, and the

reality of new consumer electronics products featuring hard drives. IDC forecasts a compound annual unit growth rate of over 120 percent from 2000 to 2004 for hard drives shipped into these non-traditional applications, with shipments exceeding 35 million in 2004.

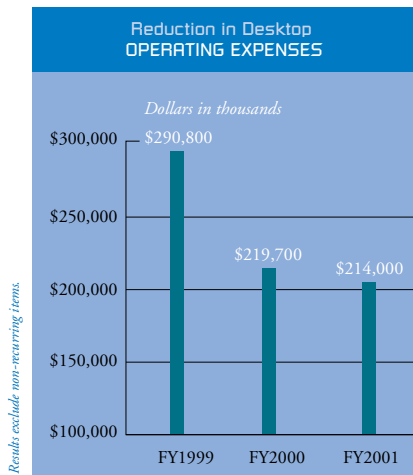
Even though financial results in fiscal 2001 failed to satisfy our longer-term goals for the company, Western Digital's core hard drive business made great strides. Unit volume grew 19 percent and revenues eight percent as our market share climbed above 15 percent, a significant improvement from our year-earlier share.



Matt Massengill
*President and
Chief Executive Officer*



New product leadership, low cost designs and consolidation of manufacturing facilities into one world-class factory have brought Western Digital's gross margin back to industry competitive levels.



Western Digital employs aggressive cost controls that result in an expense structure regarded as the most competitive in the hard drive industry.

This business turned profitable in the year's second quarter and remained in the black through year-end. Gross margins more than doubled, to 10.8 percent, and full-year operations produced a massive reduction in operating losses, from \$147 million to a near-brokeven \$3.6 million.

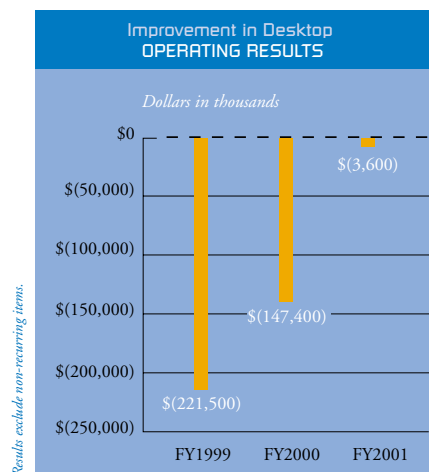
On a consolidated basis, operating expenses were cut by 13 percent and our net loss was reduced by nearly one-half. Before non-recurring items, the net loss fell 72 percent.

The improving financial performance flowed to Western Digital's balance sheet as well. Debt was cut in half, working capital increased six-fold, cash used in continuing operations was reduced by over 40 percent, and shareholders' equity moved back into positive

territory – a swing of \$117 million. Equity growth was aided by the sale, near year's end, of an additional nine million shares of WD common stock to the clients of one of our substantial institutional shareholders, Wellington Management, for \$38 million.

A company-wide focus on cost controls and efficiency advances enabled Western Digital to emerge from this period with the industry's leanest operating expense structure, well positioned to address the emerging opportunities for cost-efficient rotating magnetic storage.

In solidifying our place among the industry leaders, we worked closely with our recording-head and media suppliers to achieve time-to-market and time-to-volume leadership in the 7200 RPM segment of the hard drive business. Drives rotating at this higher speed are preferred by users who need top performance in high-capacity storage for music, video, Internet downloads and other demanding applications. Western Digital led the industry in these drives throughout the past year as we brought to market 7200 RPM desktop hard drives with peak capacities of 60, 80 and finally 100 gigabytes. The company's 7200 RPM drives grew to account for 58 percent of our fourth quarter revenue mix.



Western Digital's hard drive business achieved near break-even results for 2001, an improvement of over \$200 million in just two years.

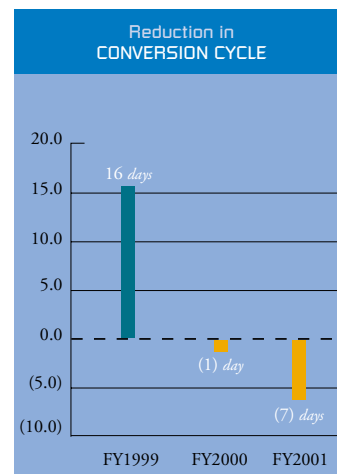
...business turned profitable in the year's second quarter and remained in the black through year-end.

Western Digital has been awarded a multi-year contract with Microsoft to supply hard drives for its Xbox™ video game system.

Western Digital continues to win accolades for quality and responsiveness from our major PC OEM customers and channel partners. Once again we were awarded the Channel Champions honor in the desktop hard drive category by Computer Reseller News magazine – the only hard drive manufacturer to be so recognized in the ten year history of these awards. We are confident that we can continue to earn business from reseller partners and from major PC OEMs such as Compaq, Hewlett-Packard, Dell, Apple, NEC and Gateway by consistently placing among the first to market and first to volume with reliable, high-quality hard drives backed by industry-leading service.

Also providing confidence in our future is the company's progress and the industry's promise with non-PC applications of hard drives, clearly the most promising incremental growth opportunity for the hard drive business since the integration of hard drives into PCs. Western Digital has been awarded a multi-year contract with Microsoft to supply hard drives for its Xbox™ video game system, expected to debut in the 2001 holiday season. We are also working with leaders in the cable, satellite and set-top box industries such as Scientific-Atlanta, DirecTV, Philips, Motorola and Sony as they design hard drive technology into their future products. The predicted rapid spread of hard drive applications in these and other consumer electronics products means tremendous new opportunities to diversify Western Digital's markets and revenue streams.

Western Digital is the sole independent hard drive supplier that focuses exclusively on EIDE products, so the company is uniquely positioned to capitalize on the rapidly growing application of EIDE drives in the entry-level server and workstation markets, previously the sole domain of SCSI drives. We also have extensive knowledge of the enterprise storage market. By 2004, IDC forecasts that EIDE drives sold into the enterprise market will exceed 7.5 million, versus less than 1.2 million in 2001. Several factors are driving this trend, including price, favorable client workload performance, emerging EIDE applications for workstations and servers, and advances of the Serial ATA interface that eliminate old barriers to SCSI replacement.



Western Digital's negative 7-day conversion cycle is among the best in the hard drive industry. Conversion cycle measures how quickly the company is able to turn its net investments in inventory, accounts receivable and accounts payable into cash.



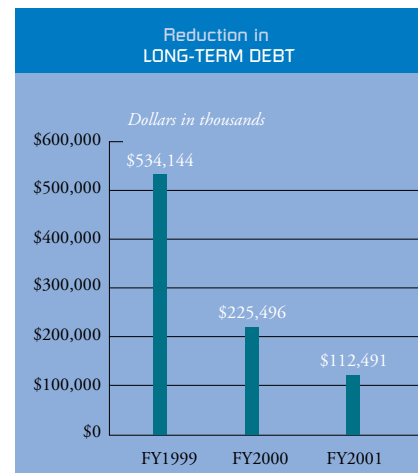
Although we are excited about the growth prospects in our core business and new emerging applications for hard drives, we continue to allocate resources carefully and selectively to leverage our core competencies into new ventures. For example, Keen Personal Media offers a new tier of TV service that allows cable companies to remain engaged with their customers as the providers of a convenient, personalized television experience. The company's system entered beta testing with two cable TV operators in July 2001, and has attracted \$6.5 million in third-party investment capital.

Two other new venture investments, SageTree and Cameo Technologies, apply Western Digital's capabilities in different ways. SageTree is providing packaged analytic applications and professional services for the supply chain intelligence market. The company, financed in part by an investment from data warehousing leader NCR, has bundled MicroStrategy's business intelligence platform in its supply chain, manufacturing and field performance suites.

Cameo Technologies has announced Universal Pictures as its first major customer for CameoCAST™, a consumer network that delivers and manages video entertainment and promotional content locally on consumers' personal computers. Universal is participating in a beta program with thousands of consumers in advance of a full business relationship with Cameo.

To reduce the investment risk associated with WD's new ventures, each of these businesses is required to attain a level of revenue or outside funding within a certain period of time, or be restructured or divested.

Shortly after the close of the fiscal year, we sold the assets of Connex, a developer of network storage devices, when our analysis indicated the need for a substantial further investment and an uncertain future for all but the biggest competitors in that market. Western Digital received \$11 million in cash and gained an important new customer through an agreement to supply hard drives to the buyer of Connex, Quantum Corporation's Snap Appliances business.



Western Digital has redeemed over \$400 million in long-term debt in the last two years.

Cameo Technologies has announced Universal Pictures as its first major customer for CameoCAST™...

...we will continue to make investments in promising technologies related to our own, within the limits of prudent risk-taking.

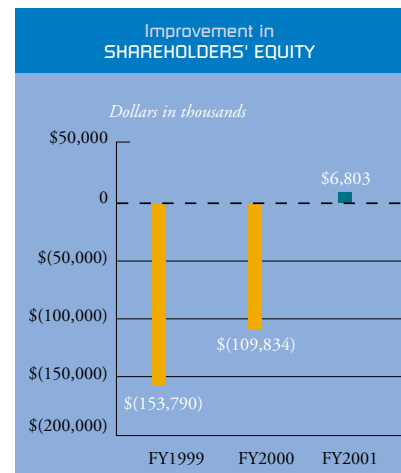
Also, after year's end, the assets of SANavigator were sold to McDATA Corporation for \$29.8 million in cash. The sale of this successful startup in the SAN software business resulted in a healthy return on our investment. Our experience with investments in fledgling businesses like these is mixed, as can be expected. Nevertheless, we believe Western Digital has a duty to pursue new business opportunities in order to advance technology, leverage our core competencies, open new markets and create a better-balanced business model for the long term. So, we will continue to make investments in promising technologies related to our own, within the limits of prudent risk-taking.

Our outlook is favorable. In our new, cost-effective corporate headquarters we have a capable new management team. They are supported by an enthusiastic and battle-tested team of 7,800 WD employees worldwide who have rebuilt Western Digital into one of the hard drive industry's most respected companies.

We have proven Western Digital's ability to weather difficult markets, intense competition and technological challenges, time after time. Our success under the most trying circumstances has given us confidence that further progress can be made in our financial performance. We are confident of Western Digital's ability to manufacture and market highly complex products requiring great precision in production and assembly, and of the strong market position these abilities give us in the newly consolidated and restructured hard drive industry. We will explore every way Western Digital's abilities can be employed productively and profitably.



Matthew E. Massengill
President and Chief Executive Officer
September 27, 2001



Timely conversion of its debentures and strategic use of its equity line have strengthened Western Digital's balance sheet and returned the company to positive shareholders' equity.

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-K

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended June 29, 2001

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to .

Commission File Number 1-8703

WESTERN DIGITAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
Incorporation or organization)

33-0956711
(I.R.S. Employer
Identification No.)

20511 Lake Forest Drive
Lake Forest, California
(Address of principal executive offices)

92630
(Zip Code)

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

Registrant's Web Site: <http://www.westerndigital.com>

Securities Registered Pursuant to Section 12(b) of the Act:

<u>Title of each class:</u>	<u>Name of each exchange on which registered:</u>
Common Stock, \$.01 Par Value	New York Stock Exchange
Rights to Purchase Series A Junior Participating Preferred Stock	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

As of August 24, 2001, the aggregate market value of the voting stock of the Registrant held by non-affiliates of the Registrant was \$673.2 million.

As of August 24, 2001, the number of outstanding shares of Common Stock, par value \$.01 per share, of the Registrant was 186,901,132.

Documents Incorporated by Reference

Information required by Part III is incorporated by reference to portions of the Registrant's Proxy Statement for the 2001 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2001 fiscal year.

WESTERN DIGITAL CORPORATION
INDEX TO ANNUAL REPORT ON FORM 10-K
For the Fiscal Year Ended June 29, 2001

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The Company has a 52 or 53-week fiscal year. In order to align its manufacturing and financial calendars, effective during the three months ended December 31, 1999, the Company changed its fiscal calendar so that each fiscal month ends on the Friday nearest to the last day of the calendar month. Prior to this change, the Company’s fiscal month ended on the Saturday nearest to the last day of the calendar month. The change did not have a material impact on the Company’s results of operations or financial position. The 1999, 2000 and 2001 fiscal years ended on July 3, June 30, and June 29, respectively, and consisted of 53 weeks for fiscal year 1999 and 52 weeks for fiscal years 2000 and 2001.

Unless otherwise indicated, references herein to specific years and quarters are to the Company’s fiscal years and fiscal quarters.

On April 6, 2001, the Company established a holding company organizational structure, under which Western Digital Corporation operates as the parent company of its hard drive business, Western Digital Technologies, Inc. (“WDT”), and other subsidiaries. Unless the context otherwise requires, the terms the “Company” and “Western Digital” refer to Western Digital Corporation and its predecessors and subsidiaries.

The Company’s principal executive offices are located at 20511 Lake Forest Drive, Lake Forest, California 92630. The Company’s telephone number is (949) 672-7000 and its web site is <http://www.westerndigital.com>. The information on the web site is not incorporated in this report.

PART I

Item 1. *Business*

General

Western Digital Corporation (the “Company” or “Western Digital”) operates as the parent company of Western Digital Technologies, Inc. (“WDT”) and other subsidiaries. WDT designs, develops, manufactures and markets hard drives, the Company’s core business, featuring leading-edge technology. A hard drive is a storage device found in most computers that stores data on one or more rotating magnetic disks that provide fast access to data that must be readily available to users of computers or other devices. The Company’s hard drives are used in desktop PC’s, entry level servers, network attached storage devices, video game consoles, digital video recording devices, digital cable set-top boxes, satellite television boxes and audio/visual juke boxes. The Company’s hard drive products currently include 1.0-inch high, 3.5-inch form factor drives with capacities ranging from 8 gigabytes (“GB”) to 100 GB, rotation speeds of 5400 and 7200 revolutions per minute (“rpm”) and the Enhanced Integrated Drive Electronics (“EIDE”) interface. The Company sells its products worldwide to computer manufacturers for inclusion in their computer systems or subsystems and to distributors, resellers and retailers. The Company’s hard drive products are currently manufactured in Malaysia. In January 2000, the Company announced its decision to cease production of Small Computer System Interface (“SCSI”) hard drives and closed its Rochester, Minnesota hard drive design center.

The Company continuously evaluates opportunities to apply its data storage core competencies to emerging markets and to expand beyond the traditional market for hard drives through new business ventures and market areas which meet certain predefined criteria. In February 1999, the Company acquired Connex, Inc. (“Connex”), a San Jose-based startup company that designed network attached storage products. During 2001 the Company formed SANavigator, Inc. (“SANavigator”) to develop and market storage area network (“SAN”) management. Subsequent to June 29, 2001, the Company sold substantially all of the assets of Connex and SANavigator and, accordingly, discontinued these operations.

In February 2000, the Company formed SageTree, Inc. (“SageTree”) to design and market packaged analytical software and related services for supply chain and product life cycle applications. In June 2000, SageTree received a direct investment from NCR Corporation in exchange for a minority interest in SageTree. For further discussion of SageTree, see under the heading “Products — Products Developed by SageTree” and Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

In February 2000, the Company also formed Cameo Technologies, Inc. (“Cameo”) to develop and market technologies and services for delivering high-quality digital video content to PC users. Cameo entered into an agreement with Universal Pictures in June 2001 to deliver Universal’s promotional materials to connected PC users. For further discussion of Cameo, see under the heading “Products — Products Developed by Cameo Technologies” and Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

In October 2000, the Company formed Keen Personal Media, Inc. (“Keen PM”) to develop and market interactive personal video recorder and set-top box software, services and hardware for broadband television content management and commerce. Keen PM entered into a joint development agreement during October 2000 to develop and license its digital video recorder storage management subsystem software to Scientific-Atlanta. For further discussion of Keen PM, see under the heading “Products — Products Developed by Keen PM” and Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

The Company monitors the development of new markets related to data or content storage and storage management, and communication of digital content and network intelligence, and may from time to time offer new products or services to address appropriate new markets. Conversely, depending on the development of such markets and the Company’s ability to achieve its goals, the Company may, from time to time withdraw from certain markets.

Industry

Desktop PC Market. According to International Data Corporation (“IDC”), the desktop computer segment is the largest segment of the worldwide personal computer market, accounting for approximately 79% of global personal computer shipments in calendar 2000. As a result, desktop computers were the leading source of demand for hard drives, accounting for more than 74% of all hard drive units shipped worldwide in calendar 2000, according to IDC. Over 90% of Western Digital’s hard drive unit shipments in 2001 were sold to this market. Desktop personal computers for entry level to experienced users are used in both commercial and consumer environments. The demand for hard drive capacity continues to grow in part due to:

- continued improvements in desktop computing price to performance ratios;
- continued growth of the sub-\$1,000 PC market;
- the rapid accumulation of data resulting from the digitization of information previously stored in paper form;
- larger file sizes created by multimedia-intensive applications such as high-fidelity audio and video; and
- the exchange of increasing volumes of digital content among users across the Internet and intranets with the proliferation of collaborative computing and sharing of audio and video content.

Future demand growth for desktop computer hard drives also may be driven by new and emerging hard drive markets. In September 2001, IDC forecasted that the worldwide desktop PC hard drive market would grow from approximately 139 million units in calendar 2001 to 193 million units in calendar 2005, reflecting a compound annual growth rate of approximately 8.5%. Revenue growth is expected to be lower due to the impact of severe price competition. However, in August 2001, IDC forecasted that the non-desktop PC hard drive market would grow from approximately 1.1 million units in calendar 2000 to 37.2 million units in calendar 2004, reflecting a compound annual growth rate of approximately 120%. See Part II, Item 7, under the heading “Risk factors related to the hard drive industry in which we operate.”

Desktop PCs are used in a number of environments, ranging from homes to businesses and multi-user networks. Software applications are used on desktop PCs primarily for word processing, spreadsheet, desktop publishing, database management, multimedia, entertainment and other related applications. Desktop PCs typically utilize the EIDE interface for hard drives. The Company believes the minimum storage requirement in the past year for entry-level PCs was generally 10 GB to 20 GB of formatted capacity.

The industry continues to supply increased capacity per unit as users’ system needs increase and technological and manufacturing advances continue to make higher capacity drives more affordable. In the mainstream desktop PC market, the Company believes that the rate of increase in storage capacity per unit has recently outpaced the rate of increase in demand for such capacity. This will result in the Company changing its product mix, with an increasing percentage of lower capacity hard drives manufactured with fewer heads and disks per unit. The Company believes that even though unit demand will increase, this changing product mix will reduce the average selling price per hard drive unit in the desktop PC market. In contrast, the emerging use of hard drives to record and play back audio and video content in the audio-visual market is expected to create demand for storage capacity that will exceed the growth in demand for increased capacity in the desktop PC market. Overall, industry sources believe that the current rate of increase in storage capacity per unit shipped will continue for the foreseeable future. Accordingly, the Company believes that time-to-market, time-to-volume and time-to-quality leadership with higher capacity drives at attractive price levels will continue to be critical to its future success in serving this market.

Users of desktop PCs, especially entry-level desktop PCs, have become increasingly price sensitive. In 1999 the market for desktop PC’s priced below \$1,000 grew significantly, and in 2000 the market for desktop PC’s priced below \$800 was the fastest growing segment of the market. Data for 2001 indicates that during the latter part of 2001, the growth in sales of entry-level PCs had abated. These systems typically do not contain high performance hard drives, but the growth of these segments in 1999 and 2000 has placed downward price pressure on higher cost systems as well, thereby contributing to the increasing price pressures on desktop hard

drives. See Part II, Item 7, under the heading “Risk factors related to the hard drive industry in which we operate.”

Emerging Audio-visual Markets. Audio-visual content stored for entertainment has historically been stored on removable media, such as compact disks (“CDs”), digital video disks (“DVDs”), and videotape. These media have also been used to transport and deliver content. The emergence of broadband communications as a means of delivering digital content makes it unnecessary to use the removable media itself for delivery. This allows hard drives to become the storage media for this digital, audio-visual content as it is delivered through broadband communications. This has led to the use of hard drives in products for consumer broadband communications networks, such as cable and satellite networks. Audio-visual applications such as digital video recording devices represent a developing market opportunity for the Company’s hard drive technologies. Hard drive technology makes it possible to simultaneously record and play back content; to pause and skip forward and backward during live broadcasts; and to rapidly access large amounts of audio-visual content.

Because the market for audio-visual products has not yet developed, it is too early to project the likely size and growth of such market. For further discussion of this product development effort, see Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

Products

The Company’s WD Caviar® and WD Protege™ hard drive products are designed to serve the advanced and value portions, respectively, of the desktop PC market, entry level server markets and game console markets, and its WD Performer™ hard drive products are designed to serve the emerging audio-visual portion of the hard drive market.

Desktop PC and Entry-Level Server Hard Drive Products. The WD Caviar and WD Protege families currently consists of 1.0” high, 3.5-inch form factor products with capacities ranging from 8 GB to 100 GB and rotation speeds of 5400 and 7200 rpm. In 1998 the Company introduced the Data Lifeguard™ feature, an exclusive data reliability feature which is now implemented in all of the Company’s hard drives. Data Lifeguard protects end-user data by automatically detecting, isolating, and repairing possible problem areas on the hard drive before data loss can occur. These products utilize the EIDE interface, providing high performance while retaining ease of use and overall low cost of connection. The type of EIDE interface currently used in substantially all of the Company’s hard drives is ATA/100, which signifies an internal data transfer rate of 100 megabytes per second, almost twice as fast as the previous generation of EIDE interface. The Company also sells a line of hard drives and related adapters which are designed to accommodate an interface known as “1394/Firewire/i.Link”, for use primarily in connecting digital consumer electronic devices, such as digital video camcorders.

The Western Digital product line generally leverages a common architecture or “platform” for various products with different capacities to serve the differing market needs. This platform strategy results in commonality of components across different products, which reduces exposure to changes in demand, facilitates inventory management and allows the Company to achieve lower costs through economies of scale purchasing. This platform strategy also enables computer manufacturer customers to leverage their qualification efforts onto successive product models. The Company expects to continue to utilize this platform strategy as it develops products for the emerging market for hard drives specifically designed for audio-visual applications, such as new digital video recording devices.

Audio-visual Hard Drive Products. The Company offers customized design capabilities and unique hard drive technologies for consumer applications; however, where practical, the Company intends to leverage its existing product line architectures for the various products for the audio-visual market. The Company is currently offering the WD Performer™ hard drive product line designed for use in consumer audio-video applications. It is also developing hard drives and products incorporating hard drive technology for consumer electronics products including digital cable set-top boxes, satellite television boxes, audio-visual jukeboxes and video game consoles.

Products Developed by Keen PM. Keen PM is a broadband products and services company, developing and marketing interactive personal video recorder technologies for television and Internet content management and television-based commerce. Keen PM offers TV4me™, a next-generation Personal Video Recorder (“PVR”) technology that is designed specifically for cable television system operators.

Products Developed by Cameo Technologies. Cameo is a new software and services company that provides personalized digital video entertainment for consumers. Cameo offers CameoCAST™, a consumer network that delivers and manages video entertainment and promotional content locally on consumers’ personal computers.

Products Developed by SageTree. SageTree offers analytical software and services for enterprise-wide supply chain intelligence, product lifecycle intelligence and decision support in the manufacturing industry. The SageTree software is a Web-based suite of packaged analytic applications designed for the manufacturing industry. The applications collect and synthesize dissimilar data across an enterprise and transform the data into customized, accurate reports that assist management in solving business and operational issues. This allows rapid analysis and management of a manufacturer’s products and components at all stages of the product lifecycle, including products in manufacturing and in the field. The applications use advanced analytics and data warehousing technology to create “supply chain intelligence”. The objectives of supply chain intelligence include improved manufacturing yield, product quality and reliability, and customer satisfaction.

SageTree also offers professional services for data warehousing and analytic applications, including manufacturing and supply chain consulting, implementation services, advanced analytics, training and post-implementation support.

Technology and Product Development

Hard drives are used to record, store and retrieve digital data. Their performance attributes are currently better than removable or floppy disks, optical disk drives and tape, and they are more cost effective than semiconductor technology. The primary measures of hard drive performance include:

“Storage capacity” — the amount of data that can be stored on the hard drive — commonly expressed in gigabytes.

“Average seek time” — the time needed to position the heads over a selected track on the disk surface — commonly expressed in milliseconds.

“Internal data transfer rate” — the rate at which data is transferred to and from the disk — commonly expressed in megabits per second.

“Spindle rotational speed” — the rotational speed of the disks inside the hard drive — commonly expressed in rpms or revolutions per minute.

All of the Company’s hard drive products employ similar technology. The main components of the hard drive are the head disk assembly and the printed circuit board. The head disk assembly includes the head, media (disks), head positioning mechanism (actuator) and spin motor. These components are contained in a hard base plate protective package in a contamination-free environment. The printed circuit board includes custom integrated circuits, an interface connector to the host computer and a power connector.

The head disk assembly is comprised of one or more disks positioned around a spindle hub that rotates the disks by a spin motor. Disks are made of a smooth substrate to which a thin coating of magnetic materials is applied. Each disk has a head suspended directly above it, which can read data from or write data to the spinning disk. The sensor element of the head, also known as the slider, is getting progressively smaller, resulting in reduced material costs.

The integrated circuits on the printed circuit board typically include a drive interface and a controller. The drive interface receives instructions from the computer, while the controller directs the flow of data to or from the disks and controls the heads. The location of data on each disk is logically maintained in concentric

tracks which are divided into sectors. The computer sends instructions to the controller to read data from or write data to the disks based on track and sector locations. Guided by instructions from the controller, the head stack assembly is pivoted and swung across the disk by a head actuator or motor until it reaches the selected track of a disk, where the data is recorded or retrieved.

Industry standard interfaces are utilized to allow the disk drive to communicate with the computer. Currently, the primary interface for desktop PCs is EIDE. Increasingly, work station computers are using the EIDE interface as well. As computer performance continues to improve, the hard drive will need to deliver information faster than this interface can handle. Accordingly the desktop PC industry plans to transition to higher speed interfaces to handle the higher data transfer rates. The Company is working to develop products that will support these higher speed interfaces.

Storage capacity of the hard drive is determined by the number of disks and each disk's areal density, which is a measure of the amount of data that can be stored on the recording surface of the disk. Areal density is generally measured in megabits per square inch of disk surface. The higher the areal density, the more information can be stored on a single platter. As the areal density increases, fewer disks and/or heads are required to achieve a given drive capacity, thus reducing product costs through reduced component requirements.

Head technology is one of the variables affecting areal density. The desktop hard drive industry has completed a transition to magnetoresistive head technology, which allows significantly higher storage capacities than the previously utilized thin-film head technology. Magnetoresistive heads have discrete read and write structures which provide more signal than the older thin-film inductive heads. This allows significantly higher areal densities, which increases storage capacity per disk and improves manufacturing margin and product reliability. The Company completed the transition to magnetoresistive head technology in 1999, and in 2000, completed the transition to the next generation of head technology, known as giant magnetoresistive, and currently all of the Company's hard drive product offerings employ giant magnetoresistive head technology.

Constant innovations in research and development are essential to the Company's ability to compete. Hard drive providers are evaluating or implementing a number of technological innovations designed to further increase hard drive performance and reduce product costs, including simplifying the electronic architecture by combining the traditional controller, channel, microprocessor and servo-interface management functions of traditional hard drive microprocessors on a single integrated circuit. Moreover, to consistently achieve timely introduction and rapid volume production of new products, some hard drive providers are striving to simplify their product design processes by focusing on creating extendible core technology platforms which utilize common firmware and mechanical designs and re-use of manufacturing tooling and application specific integrated circuits across various product generations and product lines.

Sales and Distribution

The Company sells its products globally to computer manufacturers, distributors, value-added resellers, dealers, system integrators, retailers and internet-based retailers. Manufacturers typically purchase components such as hard drives and assemble them into the computer systems they build. Distributors typically sell the Company's drives to small manufacturers, dealers, system integrators and other resellers.

Manufacturers. Sales to manufacturers accounted for 70%, 65% and 59% of consolidated revenues in 1999, 2000 and 2001, respectively. The Company's major computer manufacturer customers include Apple Computer, Compaq Computer, Dell Computer, Fujitsu, Gateway, Hewlett-Packard, IBM, Intel, Micron Electronics and NEC. During both 1999 and 2000 sales to Compaq accounted for 21% of revenues. During 2001 sales to Compaq and to Dell accounted for 12% and 17% of revenues, respectively. The Company believes that its success depends on its ability to maintain and improve its strong relationships with the leading

computer manufacturers. Western Digital, Quantum, Maxtor and Seagate have historically had the highest market share with these manufacturers. During 2001, Maxtor acquired the hard drive business of Quantum. However, the remaining number of qualified suppliers to the leading manufacturers, combined with the continued growth of the sub-\$1,000 PC market and a recent economic slowdown, has placed continuous downward pressure on hard drive prices. This pressure, in turn, has reduced average gross margins for hard drive suppliers.

The leading PC computer manufacturers have been gaining market share, which has increased their purchasing leverage over component suppliers. In calendar year 2000, the top ten desktop personal computer manufacturers accounted for more than 58% of all shipments and a significant amount of the growth in the desktop PC market. As a result, maintaining customer satisfaction with these leading computer manufacturers has become even more critical.

Computer manufacturers typically seek to qualify up to three or four providers for each generation of hard drives. Once a computer manufacturer has chosen its qualified hard drive vendors for a given product, it generally will purchase hard drives from those vendors for the life of that product. To achieve consistent success with computer manufacturers' qualifications, a hard drive supplier must be an early provider of next generation hard drives featuring leading technology and high capacity per disk. Suppliers must quickly achieve volume production of high quality and reliable hard drives. To quickly achieve high volume production, a hard drive supplier must have access to flexible, high-capacity, high-quality manufacturing capabilities. Factors on which computer manufacturers evaluate their hard drive suppliers include overall quality, storage capacities, performance characteristics, price, ease of doing business, and the supplier's long-term financial stability.

The business models of computer manufacturers have been changing, and these changes have impacted, and will continue to impact, Western Digital's sales, inventory and distribution patterns. Most of the computer industry has used a forecast-driven, long-production-run logistics model. This model limits the computer manufacturers' flexibility to react to rapid technology changes and component pricing fluctuations. Some of the Company's customers have implemented a supply chain logistics model that combines "build-to-order" (computer manufacturer does not build until there is an order backlog) and "contract manufacturing" (computer manufacturer contracts assembly work to a contract manufacturer who purchases components and assembles the computer based on the computer manufacturer's instructions.) The Company has adapted its logistics model to effectively align with these industry shifts. These changes require greater skill in managing finished goods inventory and more flexibility in manufacturing, both of which in turn require even closer relationships between the Company and its computer manufacturer and contract manufacturer customers. To help meet these challenges, the Company is expanding its use of Internet technology and web-based supply chain planning tools.

For an additional discussion of the changes in customer models, refer to Part II, Item 7, under the headings "Risk factors related to the hard drive industry in which we operate," and "Risk factors related to Western Digital particularly."

The Company maintains a base stock of two to three weeks of current, finished goods inventory for certain key computer manufacturer customers in facilities located adjacent to their operations. Inventory at these locations usually includes minor product customizations (such as labeling) for the related computer manufacturer. If subsequent to its initial order the computer manufacturer changes its requirements, inventory held at these facilities can be sold to other computer manufacturers or distributors as is or with minor modifications (such as a change in labeling) at little or no additional cost. Therefore, these arrangements, even if not fulfilled, have minimal impact on inventory valuation.

Distributors. The Company uses a select group of distributors to sell its products to small computer manufacturers, value-added resellers, resellers and systems integrators. The Company's major distributor customers include ASI, Decision Support Systems, ELD, Ingram Micro, Merisel, Servex, Synnex and Tech Data. Distributors and retailers combined accounted for approximately 30%, 35% and 41% of disk drive revenue for 1999, 2000 and 2001, respectively. Distributors generally enter into non-exclusive agreements with

the Company for purchase and redistribution of product on a quick turnover basis. Purchase orders are placed and revised on a weekly basis. The Company grants certain of its distributors price protection and limited rights to return product on a rotation basis.

Retailers. The Company sells its retail-packaged products directly to a select group of major retailers such as computer superstores, warehouse clubs and computer electronics stores and authorizes sales through distributors to smaller retailers. Major retailers to whom the Company sells directly include Best Buy, Circuit City, CompUSA, Office Depot, Vobis and Fry's Electronics. Retailers accounted for approximately 6%, 5% and 6% of revenue for 1999, 2000 and 2001, respectively. The Company's current retail customer base is primarily in the United States, Canada and Europe. The retail channel complements the Company's other sales channels while helping to build brand awareness for the Company and its products. Retailers supply the aftermarket "upgrade" sector in which end-users purchase and install products to upgrade their computers. The Company grants certain of its retailers price protection and limited rights to return product on a rotation basis. The Company also sells its retail-packaged products through the Internet, at its website, <http://www.westerndigital.com>.

The Company maintains sales offices throughout North America, Eastern and Western Europe, the Middle East, Japan and Southeast Asia. Field application engineering is provided to strategic computer manufacturer accounts, and end-user technical support services are provided within the United States and Europe. The Company's end-user technical support is supplied by both employees and qualified third-party support organizations through telephone support during business hours and via the Company's website.

The Company's international sales, which include sales to foreign subsidiaries of U.S. companies, represented 45%, 53% and 41% of revenues for fiscal years 1999, 2000 and 2001, respectively. Sales to international customers may be subject to certain risks not normally encountered in domestic operations, including exposure to tariffs, various trade regulations and fluctuations in currency exchange rates. See Part II, Item 7, under the heading "Risk factors relating to Western Digital particularly."

For information concerning revenue recognition, sales by geographic region and significant customer information, see Notes 1 and 9, respectively, of Notes to Consolidated Financial Statements.

The Company's marketing and advertising functions are performed both internally and through outside firms. Advertising, direct marketing, worldwide packaging and marketing materials are targeted to various end-user segments. Western Digital utilizes both consumer media and trade publications. The Company has programs under which qualifying manufacturers and resellers are reimbursed for certain advertising expenditures. Western Digital also invests in direct marketing and customer satisfaction programs. The Company maintains ongoing contact with end users through primary and secondary market research, focus groups, product registrations and technical support databases.

Competition

In the desktop hard drive market, the Company has competed primarily with Fujitsu, IBM, Maxtor, Quantum, Samsung and Seagate. During the last year, Maxtor acquired the hard drive business of Quantum and, recently, Fujitsu announced that it would exit the desktop hard drive market, decreasing the number of major competitors.

The hard drive industry is intensely competitive, with hard drive suppliers competing for a limited number of major customers. Hard drives manufactured by different competitors are highly substitutable due to the industry mandate of technical form, fit and function standards. Hard drive manufacturers compete on the basis of product quality and reliability, storage capacity, unit price, product performance, production volume capabilities, delivery capability, leadership in time-to-market, time-to-volume and time-to-quality and ease of doing business. The relative importance of these factors varies among different customer and market segments. The Company believes that it is generally competitive in all of these factors.

The Company believes that it cannot differentiate its hard drive products solely on attributes such as storage capacity; therefore, the Company also differentiates itself by designing and incorporating into its hard drives desirable product performance attributes and by emphasizing rapid response with its computer

manufacturer and distribution customers and brand equity with its end users. These product performance attributes include seek time, data transfer rates, intelligent caching, failure prediction, remote diagnostics, acoustics and data recovery. Rapid response requires accelerated design cycles, customer delivery and production flexibility, which contribute to customer satisfaction. Data storage has become strategically critical for computer end users. Consequently, the Company believes that trust in a manufacturer's reputation has become an important factor in the selection of a hard drive, particularly within such a rapidly changing technology environment. The Company believes it has strong brand equity with its end users.

The Company completed its transition to magnetoresistive technology in 1999 and completed its transition to giant magnetoresistive technology in 2000. During the first quarter of 2000, the Company lost market share as a result of a product recall; however, the Company recovered some of its market share as it regained a leadership position in quality and time-to-market during the remainder of 2000 and continued to regain market share during 2001.

The desktop hard drive market is characterized by many competitors and short product life cycles; therefore, it has traditionally been subject to periods of sustained and severe price competition, and factors such as time-to-market can have a pronounced effect on the success of any particular product.

Advances in magnetic, optical or other data storage technologies could result in competitive products that have better performance or lower cost per unit of capacity than the Company's hard drive products. High-speed semiconductor memory could compete with the Company's hard drive products in the future. Semiconductor memory is much faster than magnetic disk drives, but currently is volatile (i.e., subject to loss of data in the event of power failure) and much more costly. Flash memory, a nonvolatile semiconductor memory, is currently much more costly and, while it has higher "read" performance than hard drives, it has lower "write" performance. Flash memory could become competitive in the near future for applications requiring less storage capacity than that provided by hard drives.

For an additional discussion of competition, see Part II, Item 7, under the heading "Risk factors related to the hard drive industry in which we operate."

Service and Warranty

Western Digital generally warrants its newly manufactured hard drives against defects in materials and workmanship for a period of one to three years from the date of sale. The Company's warranty obligation is generally limited to repair or replacement of the hard drive. The Company has contracted with a third party in the United States to process and test returned hard drives for the Company's end users. The Company refurbishes or repairs its products at third-party service facilities located in Singapore and Germany.

Manufacturing

To be competitive, Western Digital must manufacture high quality hard drives with industry leading time-to-volume production at competitive unit costs. The Company strives to maintain manufacturing flexibility, high manufacturing yields and high-quality components at competitive prices. The critical elements of Western Digital's hard drive production are high volume, low cost assembly and testing, and establishment and maintenance of key vendor relationships in order to create "virtual vertical integration." By establishing partner relationships with its strategic component suppliers, the Company believes it is able to access "best-of-class" manufacturing quality without the substantial capital investment associated with actual vertical integration. In addition, the Company believes that its virtual vertical integration model enables it to have the business flexibility needed to select the highest quality low cost suppliers as product designs and technologies evolve.

Hard drive manufacturing is a complex process involving the assembly of precision components with narrow tolerances and extensive testing to ensure reliability. The assembly process occurs in a "clean room"

environment which demands skill in process engineering and efficient utilization of the “clean room” layout in order to reduce the high operating costs of this manufacturing environment. The Company’s clean room manufacturing process consists of modular production units, each of which contains a number of work cells. With increased areal density requirements of new products introduced, the ability to achieve historically high yields has decreased.

The Company produces hard drives in one plant in Malaysia. As a continuation of its virtual vertical integration model, the Company sold its media manufacturing division in 1999 to Komag, Inc. (“Komag”). With the sale of this division, the Company now purchases all of the standard mechanical components and micro controllers for its hard drives from external suppliers.

The Company continually evaluates its manufacturing processes in an effort to increase productivity and decrease manufacturing costs. In order to address inventory oversupply, the Company reduced excess manufacturing capacity by closing two manufacturing facilities in Singapore during 1999 and 2000 and relocating its hard drive production to Malaysia. The Company continually evaluates which steps in the manufacturing process would benefit from automation and how automated manufacturing processes support the Company’s business plans.

For an additional discussion of manufacturing, see Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

Research and Development

The Company devotes substantial resources to development of new products and improvement of existing products. The Company focuses its engineering efforts on coordinating its product design and manufacturing processes in order to bring its products to market in a cost-effective and timely manner. Research and development expenses for continuing operations totaled \$198.4, \$150.7 and \$122.5 million in 1999, 2000 and 2001, respectively. The decreases from 1999 to 2000 and from 2000 to 2001 were due to the Company’s exit from SCSI hard drive production during 2000 and expense reduction efforts in its remaining hard drive operations, partially offset by increased spending in the Company’s developing new business ventures.

For a discussion of product development, see Part II, Item 7, under the heading “Risk factors related to the hard drive industry in which we operate.”

Materials and Supplies

The principal components currently used in the manufacture of the Company’s hard drives are magnetic heads and related head stack assemblies, media, controllers, spindle motors and mechanical parts used in the head-disk assembly. In addition to its own proprietary semiconductor devices, the Company also uses standard semiconductor components such as logic, memory and microprocessor devices obtained from other manufacturers and a wide variety of other parts, including connectors, cables, and other interconnect technology.

Unlike some of its competitors, the Company acquires all of the components for its products from third-party suppliers. In general, the Company tries to have at least three suppliers for each of its component requirements. For example, the Company currently buys giant magnetoresistive heads from IBM, Read-Rite and SAE. Media requirements are purchased from several outside vendors including Komag, Fuji, Trace and Showa. In connection with the sale of its media manufacturing division to Komag in April 1999, the Company entered into a volume purchase agreement with Komag. Under this Agreement, which expires in April 2002, the Company is obligated to purchase a substantial percentage of its requirements for hard disk media from Komag as long as Komag’s prices, technology and quality remain competitive. Subsequent to June 29, 2001, Komag announced the voluntary filing for Chapter 11 reorganization. Komag further announced that it expects to continue its operations during the Chapter 11 process. Komag Malaysia, a separate subsidiary which did not file Chapter 11, is the manufacturing entity which supplies the Company’s media. The Company is in discussions with Komag concerning an extension of the Agreement beyond its April 2002 expiration date.

Some custom integrated circuits are currently sole-sourced from STMicroelectronics. Because of their custom nature, these products require significant design-in periods and long lead times. There has been a trend in integrated circuit design toward increased integration of various separate circuits. The Company expects this trend to continue in the area of custom integrated circuits for hard drives.

For an additional discussion of component supplies, see Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

Backlog

At August 24, 2001, the Company’s backlog, consisting of orders scheduled for delivery within the next twelve months, was approximately \$287 million, compared with a backlog at September 18, 2000 of approximately \$294 million. The Company expects this entire backlog to be delivered within the current fiscal year. Historically, a substantial portion of the Company’s orders has been for shipments within 30 to 60 days of the placement of the order. The Company generally negotiates pricing, order lead times, product support requirements and other terms and conditions prior to receiving a computer manufacturer’s first purchase order for a product. Manufacturers’ purchase orders typically may be canceled with relatively short notice to the Company, with little or no cost to the customer, or modified by customers to provide for delivery at a later date. Also, certain of the Company’s sales to computer manufacturers are made under “just-in-time” delivery contracts that do not generally require firm order commitments by the customer until the time of sale. Therefore, backlog information as of the end of a particular period is not necessarily indicative of future levels of the Company’s revenue and profit and may not be comparable to earlier periods.

Patents, Licenses and Proprietary Information

The Company owns numerous patents and has many patent applications in process. The Company believes that, although its patents and patent applications have significant value, the successful manufacturing and marketing of its products depends primarily upon the technical competence and creative ability of its personnel. Accordingly, the patents held and applied for do not assure the Company’s future success.

In addition to patent protection of certain intellectual property rights, the Company considers elements of its product designs and processes to be proprietary and confidential. The Company believes that its nonpatented intellectual property, particularly some of its process technology, is an important factor in its success. Western Digital relies upon employee, consultant, and vendor non-disclosure agreements and a system of internal safeguards to protect its proprietary information. Despite these safeguards, there is a risk that competitors may obtain and use such information. The laws of foreign jurisdictions in which the Company does business also may provide less protection for confidential information than the United States.

The Company relies on certain technology that is licensed from other parties in order to manufacture and sell its products. The Company has cross-licensing agreements with several competitors, customers and suppliers, and the Company believes that it has adequate licenses and other agreements in place in addition to its own intellectual property portfolio to compete successfully in the hard drive industry.

For additional discussion of intellectual property, see Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

Environmental Regulation

The Company is subject to a variety of regulations in connection with its operations. It believes that it has obtained or is in the process of obtaining all necessary permits for its domestic operations.

Employees

As of June 29, 2001, the Company employed a total of 7,909 full-time employees worldwide. This represents an increase in headcount of approximately 8% since June 30, 2000 and a reduction of approximately 25% since July 3, 1999, as the Company responded to the industry downturn and its decrease in sales by restructuring its hard drive business during 1999 and 2000. The Company employed 1,174 employees in the

United States, 6,630 employees in Malaysia, 27 employees in Singapore, and 78 employees at its international sales offices as of June 29, 2001.

Many of the Company's employees are highly skilled, and the Company's continued success depends in part upon its ability to attract and retain such employees. Accordingly, the Company offers employee benefit programs which it believes are at least equivalent to those offered by its competitors. Despite these programs, the Company has, along with most of its competitors, experienced difficulty at times in hiring and retaining certain skilled personnel. In critical areas, the Company has utilized consultants and contract personnel to fill these needs until full-time employees could be recruited. The Company has never experienced a work stoppage, none of its domestic employees are represented by a labor organization, and the Company considers its employee relations to be good.

Item 2. *Properties*

During December 2000, the Company relocated its corporate headquarters from Irvine, California to Lake Forest, California, signing a 10-year lease agreement for the Lake Forest facility. The lease for the Irvine facility expired in January 2001. The Company's corporate headquarters houses management, research and development, administrative and sales personnel. The Company leases one facility in San Jose, California and one facility in Irvine, California, for research and development and new venture activities. The San Jose lease expires in July 2006 and the Irvine research and development facility lease expires in September 2010. Western Digital owns a manufacturing facility in Kuala Lumpur, Malaysia. The Company also leases office space in various other locations throughout the world primarily for sales and technical support.

The Company's present facilities are adequate for its current needs, although the process of upgrading its facilities to meet technological and market requirements is expected to continue. The hard drive industry does not generally require long lead time to develop and begin operations in new manufacturing facilities.

During 2000 the Company sold approximately 34 acres of land in Irvine, California, upon which it had previously planned to build a new corporate headquarters, for \$26 million (the approximate cost of the land). The Company also sold its enterprise drive manufacturing facility in Tuas, Singapore for \$11.0 million (for a gain of \$3.1 million) and its Rochester, Minnesota enterprise research and development facility for \$29.7 million (for a loss of \$1.9 million).

Item 3. *Legal Proceedings*

The following discussion contains forward-looking statements within the meaning of the federal securities laws. These statements relate to the Company's legal proceedings described below. Litigation is inherently uncertain and may result in adverse rulings or decisions. Additionally, the Company may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity. In addition, the costs of defending such litigation, individually or in the aggregate, may be material, regardless of the outcome. Accordingly, actual results could differ materially from those projected in the forward-looking statements.

In 1992 Amstrad plc ("Amstrad") brought suit against the Company in California State Superior Court, County of Orange, alleging that disk drives supplied to Amstrad by the Company in 1988 and 1989 were defective and caused damages to Amstrad of not less than \$186 million. The suit also sought punitive damages. The Company denied the material allegations of the complaint and filed cross-claims against Amstrad. The case was tried, and in June 1999 the jury returned a verdict in favor of Western Digital. Amstrad has appealed the judgment. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

In 1994 Papst Licensing ("Papst") brought suit against the Company in federal court in California alleging infringement by the Company of five of its patents relating to disk drive motors that the Company purchased from motor vendors. Later that year Papst dismissed its case without prejudice, but it has notified the Company that it intends to reinstate the suit if the Company does not enter into a license agreement with Papst. Papst has also put the Company on notice with respect to several additional patents. The Company does

not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

In June 2000 Discovision Associates (“Discovision”) notified the Company in writing that it believes certain of the Company’s hard disk drive products may infringe certain of Discovision’s patents. Discovision has offered to provide the Company with a license under its patent portfolio. The Company is in discussion with Discovision regarding its claims. There is no litigation pending. The Company does not believe that the outcome of this matter will have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity.

On June 9, 2000, a suit was brought against the Company in California Superior Court for the County of Orange on behalf of a class of former employees of the Company who were terminated as a result of a reduction in force in December 1999. The complaint asserted claims for unpaid wages, fraud, breach of fiduciary duty, breach of contract, and unfair business practices. The Company removed the suit to United States District Court, Central District of California, on the ground that all of the claims were preempted by the Employee Retirement Income Security Act of 1974. On January 26, 2001, the Company filed a motion to dismiss plaintiffs’ complaint under Federal Rule of Civil Procedure 12(b). The Court granted the Company’s motion with leave to amend on April 2, 2001. Plaintiffs filed an amended complaint on April 6, 2001, and the Company filed a motion to dismiss the amended complaint under Federal Rule of Civil Procedure 12(b) on June 4, 2001. The Court granted the Company’s motion and dismissed plaintiffs’ amended complaint with prejudice on August 6, 2001. On September 5, 2001, the Court entered a stipulated order according to which plaintiffs agreed to waive their right to appeal the Court’s order dismissing their claims in exchange for the Company’s agreeing to waive its right to costs and fees as the prevailing party under ERISA.

On May 22, 2001, Cambrian Consultants, Inc. (“Cambrian”) filed a complaint against the Company in the United States District Court, Central District of California. The suit alleges infringement by the Company of a Cambrian patent. On July 20, 2001, the Company filed an answer denying the allegations contained in Cambrian’s complaint and a counterclaim asserting that Cambrian’s patent was invalid. The Court ordered that a Markman hearing to construe the claims of Cambrian’s patent be held on April 15, 2002 and set a briefing schedule leading up to the hearing. Both parties are engaged in discovery and expect that such discovery will continue for at least the next several months. Based on its initial investigation and the limited discovery done to date, the Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

On July 5, 2001, the Company (and its Malaysian subsidiary) filed suit against Cirrus Logic, Inc. (“Cirrus”) in California Superior Court for the County of Orange for breach of contract and other claims resulting from Cirrus’ role as a strategic supplier of read channel chips for the Company’s hard drives. The Company also stopped making payments to Cirrus for past deliveries of chips and terminated all outstanding purchase orders from Cirrus for such chips. The Company’s complaint alleges that Cirrus’ unlawful conduct caused damages in excess of any amounts that may be owing on outstanding invoices or arising out of any alleged breach of the outstanding purchase orders. On August 20, 2001, Cirrus filed an answer and cross-complaint. Cirrus denied the allegations contained in the Company’s complaint and asserted counterclaims against the Company for, among other things, the amount of the outstanding invoices and the Company’s alleged breach of the outstanding purchase orders. The parties have begun discovery and expect that such discovery will continue for the next several months. Based on its initial investigation and the limited discovery done to date, the Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

In the normal course of business, the Company receives and makes inquiries regarding possible intellectual property matters, including alleged patent infringement. Where deemed advisable, the Company may seek or extend licenses or negotiate settlements. Although patent holders often offer such licenses, no assurance can be given that in a particular case a license will be offered or that the offered terms will be acceptable to the Company. The Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

From time to time the Company receives claims and is a party to suits and other judicial and administrative proceedings incidental to its business. Although occasional adverse decisions (or settlements) may occur, the Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2001.

Executive Officers of the Registrant

The names, ages and positions of all the executive officers of the Company as of September 25, 2001 are listed below, followed by a brief account of their business experience during the past five years. Executive officers are normally elected annually by the Board of Directors at a meeting of the directors immediately following the Annual Meeting of Shareholders. There are no family relationships among these officers nor any arrangements or understandings between any officer and any other person pursuant to which an officer was selected.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Matthew E. Massengill	40	President and Chief Executive Officer
Arif Shakeel	46	Executive Vice President, Chief Operating Officer
Teresa A. Hopp	42	Senior Vice President, Chief Financial Officer
Charles W. Frank, Jr.....	53	Vice President, Chief Technical Officer
Michael A. Cornelius	59	Vice President, Law and Administration, and Secretary
Steven M. Slavin	50	Vice President, Taxes and Treasurer
David C. Fetah	41	Vice President, Human Resources

Messrs. Massengill, Cornelius, Frank and Slavin have been employed by the Company for more than five years and have served in various executive capacities with the Company before being appointed to their present positions.

Mr. Shakeel joined the Company in 1985 as Product Manager, Integrated Drive Electronics. Mr. Shakeel served in various executive capacities, including Vice President, Materials — Asia, until October 1997, when he left the Company to become Managing Director of Mah Lin Associates, a supplier of electromechanical components in Singapore. Mr. Shakeel rejoined the Company in April 1999 as Senior Vice President of Operations, Drive Products Division. He became Senior Vice President of Worldwide Operations in July 1999. In February 2000 he became Executive Vice President and General Manager of Hard Drive Solutions. He was promoted to his current position in April 2001.

Ms. Hopp joined the Company in 1998 as Vice President, Finance. Prior to joining the Company, she was an audit partner at Ernst & Young, her employer for 17 years. She was promoted to Senior Vice President, Chief Financial Officer in December 1999. On June 12, 2001 the Company announced Ms. Hopp's resignation. Her resignation was effective September 26, 2001.

Mr. Fetah joined the Company in March 2000 as Vice President of Human Resources. Prior to joining the Company, he served as Executive Director, Human Resources, for PeopleSoft, Inc. Prior to joining PeopleSoft in 1996, he was Manager, Human Resources, for Fluor Corporation where he served for 5 years.

PART II

Item 5. *Market for Registrant's Common Equity and Related Stockholder Matters*

Western Digital's common stock is listed on the New York Stock Exchange ("NYSE") under the symbol "WDC." The approximate number of holders of record of common stock of the Company as of August 24, 2001 was 3,504.

On April 6, 2001, Western Digital Corporation adopted a holding company organizational structure. In connection with the establishment of the holding company, each share of Western Digital Technologies, Inc. (f/k/a Western Digital Corporation) was converted on a share for share basis, into a share of Western Digital Corporation.

The Company has not paid any cash dividends on its common stock and does not intend to pay any cash dividends on common stock in the foreseeable future.

The high and low sales prices of the Company's common stock, as reported by the NYSE, for each quarter of 2000 and 2001 are as follows:

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
2000				
High	\$7.56	\$4.50	\$8.81	\$7.88
Low	3.50	2.75	3.94	3.94
2001				
High	\$6.44	\$6.81	\$5.94	\$5.58
Low	3.56	2.19	2.31	2.98

As mandated by Congress and ordered by the Securities and Exchange Commission ("SEC"), all securities industry systems were converted from fractional to decimal (dollars and cents) pricing. The Decimals Implementation Plan for the Equities and Options Market submitted to the SEC stipulated that the conversion for all securities occur by April 9, 2001. Along with most stocks listed on the NYSE, the Company's stock was converted on January 29, 2001.

Item 6. *Selected Financial Data*

Financial Highlights

The following selected consolidated financial data should be read in conjunction with Part II, Item 7.

	Years Ended				
	June 28, 1997	June 27, 1998	July 3, 1999	June 30, 2000	June 29, 2001
	(in millions, except per share and employee data)				
Revenues, net	\$4,177.9	\$3,541.5	\$2,767.2	\$1,957.2	\$1,953.4
Gross profit (loss)	650.3	100.1	(2.8)	9.6	207.7
Income (loss) from continuing operations ..	267.6	(290.2)	(472.5)	(329.5)	(87.1)
Per share income (loss) from continuing operations:					
Basic	\$ 3.07	\$ (3.32)	\$ (5.28)	\$ (2.69)	\$ (.52)
Diluted	\$ 2.86	\$ (3.32)	\$ (5.28)	\$ (2.69)	\$ (.52)
Working capital	\$ 364.2	\$ 463.5	\$ 133.5	\$ 6.9	\$ 45.4
Total assets	\$1,307.1	\$1,442.7	\$1,022.0	\$ 613.0	\$ 507.7
Long-term debt	\$ —	\$ 519.2	\$ 534.1	\$ 225.5	\$ 112.5
Shareholders' equity (deficiency)	\$ 620.0	\$ 317.8	\$ (153.8)	\$ (109.8)	\$ 6.8
Number of employees	13,384	13,286	10,503	7,321	7,909

No cash dividends were paid for the years presented.

During 1999 and 2000 the Company initiated significant restructuring programs (see Item 7, under the heading “Overview” and Note 8 of Notes to Consolidated Financial Statements). Also, subsequent to June 29, 2001, the Company sold the assets of its Connex and SANavigator subsidiaries (see Item 7, under the heading “Results of Operations — Discontinued Operations” and Note 10 of Notes to Consolidated Financial Statements).

Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This report contains forward-looking statements within the meaning of federal securities laws. The statements that are not purely historical should be considered forward-looking statements. Often they can be identified by the use of forward-looking words, such as “may,” “will,” “could,” “project,” “believe,” “anticipate,” “expect,” “estimate,” “continue,” “potential,” “plan,” “forecasts,” and the like. Statements concerning current conditions may also be forward-looking if they imply a continuation of current conditions. These statements appear in a number of places in this report and include statements regarding the intentions, plans, strategies, beliefs or current expectations of the Company with respect to, among other things:

- the financial prospects of the Company;
- the Company’s financing plans;
- litigation and other contingencies potentially affecting the Company’s financial position, operating results or liquidity;
- trends affecting the Company’s financial condition or operating results;
- the Company’s strategies for growth, operations, product development and commercialization; and
- conditions or trends in or factors affecting the computer, data storage, home entertainment or hard drive industry.

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. Readers are urged to carefully review the disclosures made by the Company concerning risks and other factors that may affect the Company’s business and operating results, including those made under the captions “Risk factors related to the hard drive industry in which we operate” and “Risk factors relating to Western Digital particularly”, in this report, as well as the Company’s other reports filed with the Securities and Exchange Commission. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. The Company undertakes no obligation to publish revised forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Overview

Western Digital is a longtime leader and one of the pioneers of the data storage industry. Through significant reorganization of its hard drive business the Company has established a framework to apply its data storage core competencies to emerging markets and expand beyond the traditional market for hard drives through new business ventures and market areas, while maintaining its core business.

The hard drive industry, the Company’s core and primary business, is intensely competitive and has experienced a great deal of growth, entry and exit of competitors, and technological change over recent years. This industry is characterized by short product life cycles, dependence upon highly skilled engineering and other personnel, significant expenditures for product development and recurring periods of oversupply. During 1999 and 2000 the Company initiated restructuring programs to reduce costs and improve operating efficiency of its hard drive business. During 1999, the Company combined its Personal Storage Division and Enterprise Storage Group into a single hard drive operating unit, closed its Tuas, Singapore facility and moved production of its SCSI drives to the Company’s nearby manufacturing facility in Chai-Chee, Singapore. The combination resulted in a \$41.0 million charge to operations. Also during 1999, the Company sold its Santa Clara disk media operations to Komag, Inc. (“Komag”), recording a charge to operations of \$20.0 million. During 2000,

the Company transferred all of its hard drive production to one highly efficient manufacturing facility in Malaysia, closed its Singapore manufacturing facilities, discontinued its SCSI drive product line, closed its Rochester, Minnesota design facility, and made significant changes to its worldwide management structure and sales organization. These actions resulted in net restructuring and other charges to operations of \$125.5 million.

The Company continuously evaluates opportunities to apply its data storage core competencies to emerging markets and to expand beyond traditional markets for hard drives through new business ventures meeting certain predefined criteria. The Company's new business ventures have included Connex, Inc. ("Connex"), SANavigator, Inc. ("SANavigator"), SageTree, Inc. ("SageTree"), Keen Personal Media, Inc. ("Keen PM") and Cameo Technologies, Inc. ("Cameo"). Subsequent to June 29, 2001, the Company discontinued the operations of both Connex and SANavigator, selling substantially all the assets of the two companies. The Company's other new businesses have not yet generated significant revenue and the Company continues to evaluate their progress.

Results of Operations

Summary of 1999, 2000 and 2001 Comparison

The following table sets forth, for the periods indicated, items in the Company's statements of operations expressed as a percentage of total revenue. This table and the following discussion exclude the results of the discontinued Connex and SANavigator businesses.

	Years ended		
	July 3, 1999	June 30, 2000	June 29, 2001
Revenues, net	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenues	100.1	99.5	89.4
Research and development	7.2	7.7	6.3
Selling, general and administrative	7.0	6.5	6.1
Restructuring charges	<u>2.2</u>	<u>4.4</u>	<u>—</u>
Total costs and expenses	<u>116.5</u>	<u>118.1</u>	<u>101.8</u>
Operating loss	(16.5)	(18.1)	(1.8)
Net interest and other income (expense)	<u>(0.6)</u>	<u>0.3</u>	<u>(2.7)</u>
Loss from continuing operations before income taxes	(17.1)	(17.8)	(4.5)
Income tax benefit	<u>—</u>	<u>1.0</u>	<u>—</u>
Loss from continuing operations	<u>(17.1)%</u>	<u>(16.8)%</u>	<u>(4.5)%</u>

The Company reported losses from continuing operations of \$472.5, \$329.5 and \$87.1 million in 1999, 2000 and 2001, respectively. The 1999 loss included charges of approximately \$77.0 million for incremental thin-film warranty provisions, approximately \$7.5 million in Malaysian currency losses and restructuring charges of \$61.0 million for the consolidation of the Company's personal storage and enterprise storage divisions and the sale of its media operation. The 2000 loss included net restructuring charges totaling \$85.8 million for the closure of the Company's Singapore operations and SCSI hard drive operations. The 2000 loss also included charges to cost of revenues of \$34.8 million for vendor settlements, incremental warranty, and inventory write-downs associated with exiting the SCSI hard drive product line and \$37.7 million for costs to repair recalled drives. The 2001 loss included nonoperating charges of \$52.4 million to adjust the carrying value of equity investments in and notes receivable from Komag, Inc. ("Komag") and accruals of contingent guarantees. Excluding the aforementioned restructuring and other charges, losses from continuing operations were \$327.0, \$171.2 and \$34.7 million in 1999, 2000 and 2001, respectively. The decrease in losses from 1999 to 2000, excluding restructuring and special charges, was due primarily to a \$107.6 million, or 27.9%, decrease in operating expenses and a \$20.8 million decrease in interest and other nonoperating expense. The decrease in losses from 2000 to 2001 resulted from a \$125.6 million increase in gross profit and a

\$36.1 million decrease in operating expenses, partially offset by a \$5.7 million increase in interest and other nonoperating expense.

Net Revenues

Consolidated net revenues of \$2.0 billion in 2000, decreased \$0.8 billion or 29.3% from 1999, due to the Company's decision in the third quarter of 2000 to cease production of SCSI hard drives (1999 revenue included \$435.0 million for SCSI hard drives compared to \$141.8 million in 2000), a decline in the average selling prices ("ASP's") of EIDE hard drive products due to an intensely competitive market, and a decline in EIDE drive unit shipments of approximately 6%, due largely to the product recall in the first quarter of 2000.

During the first quarter of 2000, the Company announced a recall of its 6.8GB per platter series of WD Caviar® EIDE hard drives because of a reliability problem resulting from a faulty power driver chip manufactured by a third-party supplier. As a result, revenues of approximately \$100 million were reversed and production was shut down for approximately two weeks, eliminating approximately \$70 million of forecasted revenue.

Consolidated net revenues in 2001 were flat with 2000, at approximately \$2.0 billion. Excluding the revenue from SCSI drive sales in 2000, revenue increased \$138.0 million or 7.6% in 2001. This improvement was due to an increase in EIDE drive unit shipments of approximately 19%, offset by a decline in ASP's. Revenues from new business ventures were not material for the periods presented. In 2001, the Company adopted Staff Accounting Bulletin 101 "Revenue Recognition in Financial Statements" ("SAB 101"), which defers the recognition of revenue on sales made under certain shipping terms. The implementation of SAB 101 resulted in an increase to revenues for 2001 of \$13.1 million.

Gross Profit

Gross profit (loss) was (\$2.8) million, or (0.1)% of revenue in 1999, \$9.6 million, or 0.5% of revenue in 2000 and \$207.7 million, or 10.6% of revenue in 2001. Gross profit for 1999 included \$77.0 million of special charges for incremental thin-film warranty provision related to a change in the estimated lifetime return rate applied to an installed base of products. Gross profit for 2000 included \$72.5 million of special charges related to exiting the SCSI hard drive product line and the product recall. Excluding special charges, gross profit was \$74.2 million, or 2.7% of revenue, and \$82.1 million, or 4.2% of revenue, for 1999 and 2000, respectively. The increase in gross profit from 1999 to 2000 (excluding special charges) was primarily the result of lower manufacturing costs due to the consolidation of drive production to a single, highly utilized facility in Malaysia, offset by lower volumes and lower ASPs. The increase in gross profit from 2000 to 2001 (excluding special charges) was the result of higher volume, offset by lower ASP's, lower manufacturing costs due to 2000 expense reduction efforts and lower warranty costs due to the discontinuance of the SCSI hard drive product line in 2000 and the expiration of the warranty period for thin-film products in 2001. The net impact of SAB 101 on gross profit in 2001 was insignificant.

Operating Expenses

Research and development expense was \$198.4, \$150.7 and \$122.5 million for 1999, 2000 and 2001, respectively. The \$47.7 and \$28.1 million decreases from 1999 to 2000 and from 2000 to 2001, respectively, were due to the Company's exit from SCSI hard drive production during 2000 and expense reduction efforts in its remaining hard drive operations, partially offset by increased spending in the Company's developing new business ventures.

Selling, general and administrative ("SG&A") expense was \$194.4, \$127.0 and \$119.1 million for 1999, 2000 and 2001, respectively. The decrease of \$67.4 million from 1999 to 2000 was primarily due to the Company's exit from SCSI hard drive production, expense reductions in its remaining hard drive operations, an \$11.0 million accrual reduction in the fourth quarter of 2000 and the nonrecurrence of a \$7.5 million charge on the terminated hedging contracts recorded in 1999. The decrease was partially offset by increased spending in the Company's developing new business ventures. The decrease of \$7.9 million from 2000 to 2001 was

primarily due to the Company's exit from SCSI hard drive production in 2000 and the expense reduction efforts in its remaining hard drive operations, partially offset by increased spending in the Company's developing new business ventures.

Interest and Other Income/Expense, Tax Benefit and Extraordinary Item

Net interest and other (expense) income was (\$15.9), \$4.9 and (\$53.2) million in 1999, 2000 and 2001, respectively. The \$20.8 million decrease in expense in 2000 was due to a \$14.8 million gain on the disposition of certain investment securities and to lower interest expense on lower average debt balances resulting from the payment in 2000 of an outstanding term loan of \$50.0 million and redemptions during 2000 of the Company's 5.25% zero coupon convertible debentures (the "Debentures"), offset by a reduced amount of interest income due to lower cash and cash equivalent balances.

During the fourth quarter of 2001, the Company recorded nonoperating charges of \$52.4 million to adjust the carrying value of equity investments in and notes receivable from Komag and accruals of Komag contingent guarantees. The assets were received as a component of the total consideration from the sale of the Company's disk media operations to Komag in 1999. Also in conjunction with the sale, Komag assumed certain liabilities, mainly leases related to production equipment and facilities, for which the Company remained contingently liable. Due to recent market conditions and the announcement by Komag that it would not pay its senior debt when it became due in June and an interest payment on its convertible bonds due in July, the Company recorded the charges. On August 24, 2001, Komag announced its voluntary Chapter 11 reorganization filing.

The \$58.1 million increase in net interest and other expense in 2001 was due primarily to the nonrecurring charges related to Komag of \$52.4 million, a \$15.1 million decrease in gains from the disposition of investment securities and a reduced amount of interest income due to lower cash and cash equivalent balances, offset slightly by lower accrued interest expense due to Debenture redemptions.

The Company recorded an income tax benefit of \$19.5 million in 2000 to adjust its current and deferred tax accruals. The accruals were previously established over time and primarily related to unremitted income of foreign subsidiaries. However, due to the significant increase of net operating loss carryforwards in recent years and reevaluation of the accruals after the substantial international restructurings in 2000, the Company believed the accruals were no longer necessary. In 1999 and 2001, no tax benefit was recorded because additional loss carrybacks were not available and management believed it was "more likely than not" that the deferred tax benefits generated would not be realized (see Note 5 of Notes to Consolidated Financial Statements).

During 2000, the Company issued 26.7 million shares of common stock in exchange for \$735.6 million in face value of its convertible debentures (with a book value of \$284.1 million). During 2001 the Company issued 16.0 million shares of common stock in exchange for \$295.7 million in face value of its convertible debentures (with a book value of \$120.3 million). These redemptions were private, individually negotiated non-cash transactions with certain institutional investors. As a result of the redemptions, the Company recognized extraordinary gains of \$166.9 million and \$22.4 million in 2000 and 2001, respectively.

Discontinued Operations

Subsequent to June 29, 2001, the Company decided to discontinue the operations of Connex and SANavigator and sold substantially all of the assets of these two businesses. Accordingly, the operating results of Connex and SANavigator have been segregated from continuing operations and reported separately on the statements of operations as discontinued operations for all periods presented.

Liquidity and Capital Resources

The Company had cash and cash equivalents of \$184.0 million at June 30, 2000 and \$167.6 million at June 29, 2001. Net cash used for continuing operations was \$126.7 million during 2000 as compared to \$71.3 million during 2001. The decrease in cash used for continuing operations reflects a significant improvement in the Company's operating results, net of non-cash items, offset by a higher level of cash used to fund net operating asset growth. The improvement in continuing operating results, net of non-cash items, of \$204.3 million was due to significantly better performance by the Company's hard drive business, as a result of higher sales volume and improved cost management, the discontinuance in 2000 of the Company's SCSI drive product line and the inclusion in 2000 of significant charges relating to the product recall. The improved operating results of the hard drive business were offset somewhat by increased spending on continuing new business ventures. Cash used to fund net operating asset growth for continuing operations increased in 2001 by \$148.9 million due primarily to the impact in the prior year of the product recall on net operating assets. Specifically, there was a sharp contraction during 2000 in the Company's cash conversion cycle which represents the sum of the number of days sales outstanding ("DSO") and days inventory outstanding ("DIO") less days payable outstanding ("DPO"). As the following chart indicates, the Company's cash conversion cycle was reduced by 17 days during 2000, and another 6 days during 2001.

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Cash Conversion Cycle:			
Days Sales Outstanding	44	28	25
Days Inventory Outstanding	22	23	18
Days Payables Outstanding	<u>(50)</u>	<u>(52)</u>	<u>(50)</u>
	<u>16</u>	<u>(1)</u>	<u>(7)</u>

The decrease in the cash conversion cycle from 1999 to 2000 was due primarily to a reduction in DSO's, due in large part to the product recall during the first quarter of 2000 and a sustained improvement in the linearity of shipments during the remainder of 2000. The decrease from 2000 to 2001 was due to a reduction in DSO's and DIO's, due primarily to improved sales and production linearity, offset partially by a slight decrease in DPO's. The Company seeks to maintain a negative cash conversion cycle.

Other uses of cash during 2000 included the repayment of bank debt of \$50.0 million, cost-method investments of \$12.9 million and net capital expenditures of \$21.4 million. Other sources of cash during 2000 included proceeds of \$111.8 million received upon issuance of 24.6 million shares of the Company's stock under the Company's equity facility, \$10.0 million received by SageTree upon issuance of preferred stock, \$6.2 million received in connection with stock option exercises and Employee Stock Purchase Plan purchases, and \$66.8 million received from sales of real property.

Other uses of cash during 2001 included net capital expenditures of \$50.7 million, primarily to upgrade the Company's hard drive production capabilities and for normal replacement of existing assets. Other sources of cash during 2001 included proceeds of \$15.0 million received upon the sale of marketable equity securities, \$110.5 million received upon issuance of 23.5 million shares of the Company stock under the Company's equity facility, \$7.1 million received in connection with the stock option exercises and Employee Stock Purchase Plan purchases and \$5.0 million received by Keen upon issuance of an investor note.

The Company anticipates that capital expenditures in 2002 will not be more than \$65.0 million and will relate to normal replacement of existing assets.

During 1998 the Company issued zero coupon convertible subordinated debentures due February 18, 2018 (the "Debentures"). The Debentures are subordinated to all senior debt; are redeemable at the option of the Company any time after February 18, 2003 at the issue price plus accrued original issue discount to the date of redemption; and at the holder's option, will be repurchased by the Company, as of February 18, 2003, February 18, 2008 or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of repurchase. The payment on those dates, with the exception of a Fundamental Change, can be in cash, stock or any combination, at the

Company's option. The Debentures are convertible into shares of the Company's common stock at the rate of 14.935 shares per \$1,000 principal amount at maturity. The principal amount at maturity of the Debentures when issued was \$1.3 billion. During 2000, the Company issued 26.7 million shares of common stock in exchange for Debentures with a book value of \$284.1 million and an aggregate principal amount at maturity of \$735.6 million. During 2001, the Company issued 16.0 million shares of common stock in exchange for Debentures with a book value of \$120.3 million and an aggregate principal amount at maturity of \$295.7 million. These redemptions were private, individually negotiated transactions with certain institutional investors and resulted in extraordinary gains of \$166.9 million and \$22.4 million during 2000 and 2001, respectively. As of June 29, 2001, the book value of the remaining outstanding Debentures was \$112.5 million, the aggregate principal amount at maturity was \$265.9 million and the market value was \$85.1 million.

During 2001 the Company entered into a three-year Senior Credit Facility for its hard drive business, Western Digital Technologies, Inc. ("WDT"), replacing a previous facility that had matured on March 31, 2000. The Senior Credit Facility provides up to \$125 million in revolving credit (subject to a borrowing base calculation), matures on September 20, 2003 and is secured by WDT's accounts receivable, inventory, 65% of the stock in its foreign subsidiaries and other assets. At the option of WDT, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base.

The Senior Credit Facility requires WDT to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. As of the date hereof, there were no borrowings under the facility.

Under an existing shelf registration statement (the "equity facility"), the Company may issue shares of common stock to institutional investors for cash. Shares sold under the facility are at the market price of the Company's common stock less a discount ranging from 2.75% to 4.25%. During 2000, the Company issued 24.6 million shares of common stock under the equity facility for net cash proceeds of \$111.8 million. During 2001, the Company issued 23.5 million shares of common stock under the equity facility for net cash proceeds of \$110.5 million. As of June 29, 2001, the Company had \$167.7 million remaining under the equity facility.

The Company may continue to incur operating losses during 2002. However, at June 29, 2001, the Company had a cash and cash equivalent balance of \$167.6 million, working capital of \$45.4 million and shareholders' equity of \$6.8 million. The Company has achieved significant reductions in manufacturing labor and overhead and operating expenses resulting from the sale in late 1999 of the Company's media operations, the closure in 2000 of the Company's two Singapore based manufacturing facilities and its Rochester design center, the disposal of its Connex and SANavigator businesses, and an overall reduction in worldwide headcount. In addition, the Company had the following additional sources of liquidity available as of September 26, 2001; \$167.7 million remaining available under the equity facility and a Senior Credit Facility providing up to \$125 million in revolving credit (subject to a borrowing base calculation).

Based on the above factors, the Company believes its current cash and cash equivalent balances and its existing equity and credit facilities will be sufficient to meet its working capital needs through the foreseeable future. There can be no assurance that the Senior Credit Facility or the equity facility will continue to be available to the Company. Also, the Company's ability to sustain its working capital position is dependent upon a number of factors that are discussed below under the headings "Risk factors related to the hard drive industry in which we operate" and "Risk factors relating to Western Digital particularly."

New Accounting Pronouncements

During July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Effective June 30, 2001, the Company adopted SFAS 141. SFAS 141 addresses financial accounting and reporting for business combinations and requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. The adoption of SFAS 141 did not have a material impact on the Company's financial position or results of operations.

SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment. The Company is required to adopt SFAS 142 on June 29, 2002. However, goodwill and intangible assets acquired after June 30, 2001 are subject to the amortization provisions of SFAS 142. The Company does not expect the adoption of SFAS 142 to have a material impact on the Company's financial position or results of operations.

Risk factors related to the hard drive industry in which we operate

Our operating results depend on our being among the first-to-market and first-to-volume with our new products.

To achieve consistent success with computer manufacturer customers we must be an early provider of next generation hard drives featuring leading technology and high quality. If we fail to:

- consistently maintain or improve our time-to-market performance with our new products
- produce these products in sufficient volume within our rapid product cycle
- qualify these products with key customers on a timely basis by meeting our customers' performance and quality specifications, or
- achieve acceptable manufacturing yields and costs with these products

then our market share would be adversely affected, which would harm our operating results.

Short product life cycles make it difficult to recover the cost of development.

Over the past few years hard drive areal density (the gigabytes of storage per disk) has increased at a much more rapid pace than previously experienced. The technical challenges of maintaining this pace are becoming more formidable, and the risk of not achieving the targets for each new generation of drives increases, which could adversely impact product manufacturing yields and schedules, among other impacts. Higher areal densities mean that fewer heads and disks are required to achieve a given drive capacity. This has significantly shortened product life cycles, since each generation of drives is more cost effective than the previous one. Shorter product cycles make it more difficult to recover the cost of product development.

Short product life cycles force us to continually qualify new products with our customers.

Due to short product life cycles, we must regularly engage in new product qualification with our customers. To be considered for qualification we must be among the leaders in time-to-market with our new products. Once a product is accepted for qualification testing, any failure or delay in the qualification process can result in our losing sales to that customer until the next generation of products is introduced. The effect of missing a product qualification opportunity is magnified by the limited number of high volume computer manufacturers, most of which continue to consolidate their share of the PC market. These risks are magnified because we expect cost improvements and competitive pressures to result in declining sales and gross margins on our current generation products.

Unexpected technology advances in the hard drive industry could harm our competitive position.

If one of our competitors were able to implement a significant advance in head or disk drive technology that enables a step-change increase in areal density allowing greater storage of data on a disk, it would harm our operating results.

Advances in magnetic, optical, semiconductor or other data storage technologies could result in competitive products that have better performance or lower cost per unit of capacity than our products. If these products prove to be superior in performance or cost per unit of capacity, we could be at a competitive disadvantage to the companies offering those products.

Our average selling prices are declining.

We expect that our average selling prices for hard drives will continue to decline. Rapid increases in areal density mean that the average drive we sell has fewer heads and disks, and is therefore lower cost. Because of the competitiveness of the hard drive industry, lower costs generally mean lower prices. This is true even for those products that are competitive and introduced into the market in a timely manner. Our average selling prices decline even further when competitors lower prices to absorb excess capacity, liquidate excess inventories, restructure or attempt to gain market share.

The hard drive industry is highly competitive and characterized by rapid shifts in market share among the major competitors.

The price of hard drives has fallen over time due to increases in supply, cost reductions, technological advances and price reductions by competitors seeking to liquidate excess inventories or gain market share. In addition, rapid technological changes often reduce the volume and profitability of sales of existing products and increase the risk of inventory obsolescence. These factors, taken together, result in significant and rapid shifts in market share among the industry's major participants. For example, during 1998 and 1999, we lost significant share of the desktop market. During the first quarter of 2000, the Company lost market share as a result of a previously announced product recall; however, we recovered some market share during the remainder of 2000 and during the first half of 2001, but our share is still significantly below its 1997 level.

Our prices and margins are subject to declines due to unpredictable end-user demand and oversupply of hard drives.

Demand for our hard drives depends on the demand for computer systems manufactured by our customers and on storage upgrades to existing systems. The demand for computer systems has been volatile in the past and often has had an exaggerated effect on the demand for hard drives in any given period. As a result, the hard drive market tends to experience periods of excess capacity, which typically lead to intense price competition. Recently several competitor manufacturers and industry analysts have forecasted softening PC demand in the U.S. If intense price competition occurs as a result of softening demand, we may be forced to lower prices sooner and more than expected and transition to new products sooner than expected.

Changes in the markets for hard drives require us to develop new products.

Over the past few years the consumer market for desktop computers has shifted significantly towards lower priced systems, especially those systems priced below \$1,000. We were late to market with a value line hard drive to serve that market, and we lost market share. If we are not able to offer a competitively priced value line hard drive for the low-cost PC market our market share will likely fall, which could harm our operating results.

The PC market is fragmenting into a variety of computing devices and products. Some of these products, such as Internet appliances, may not contain a hard drive. On the other hand, many industry analysts expect, as do we, that as broadcasting and communications are increasingly converted to digital technology from the older, analog technology, the technology of computers and consumer electronics and communication devices will converge, and hard drives will be found in many consumer products other than computers. If we are not successful in using our hard drive technology and expertise to develop new products for these emerging markets, it will likely harm our operating results.

We depend on our key personnel.

Our success depends upon the continued contributions of our key employees, many of whom would be extremely difficult to replace. Worldwide competition for skilled employees in the hard drive industry is intense. We have lost a number of experienced hard drive engineers over the past two years as a result of the loss of retention value of their employee stock options (because of the decrease in price of our common stock) and aggressive recruiting of our employees. If we are unable to retain our existing employees or hire and integrate new employees, our operating results would likely be harmed.

Risk factors relating to Western Digital particularly

Loss of market share with a key customer could harm our operating results.

A majority of our revenue comes from a few customers. For example, during 2001, sales to our top 10 customers accounted for approximately 60% of revenues. These customers have a wide variety of suppliers to choose from and therefore can make substantial demands on us. Even if we successfully qualify a product with a customer, the customer generally is not obligated to purchase any minimum volume of products from us and is able to terminate its relationship with us at any time. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, or if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, our operating results would likely be harmed. For example, this occurred with our enterprise hard drive product line early in the third quarter of 2000 and is one of the factors which led to our decision to exit the enterprise hard drive market.

Dependence on a limited number of qualified suppliers of components could lead to delays or increased costs.

Because we do not manufacture any of the components in our hard drives, an extended shortage of required components or the failure of key suppliers to remain in business, adjust to market conditions, or to meet our quality, yield or production requirements could harm us more severely than our competitors, some of whom manufacture certain of the components for their hard drives. A number of the components used by us are available from only a single or limited number of qualified outside suppliers. If a component is in short supply, or a supplier fails to qualify or has a quality issue with a component, we may experience delays or increased costs in obtaining that component. This occurred in September 1999 when we had to shut down our Caviar product line production for approximately two weeks as a result of a faulty power driver chip which was sole-sourced from a third-party supplier.

To reduce the risk of component shortages, we attempt to provide significant lead times when buying these components. As a result, we may have to pay significant cancellation charges to suppliers if we cancel orders, as we did in 1998 when we accelerated our transition to magnetoresistive recording head technology, and as we did in 2000 as a result of our decision to exit the enterprise hard drive market.

In April 1999, we entered into a three-year volume purchase agreement with Komag under which we buy a substantial portion of our media components from Komag. This strategic relationship has reduced our media component costs; however, it has increased our dependence on Komag as a supplier. Our future operating results may depend substantially on Komag's ability to timely qualify its media components in our new development programs and to supply us with these components in sufficient volume to meet our production requirements. A significant disruption in Komag's ability to manufacture and supply us with media could harm our operating results. Subsequent to June 29, 2001, Komag announced the voluntary filing for Chapter 11 reorganization. Komag further announced that it expects to continue its operations during the Chapter 11 process.

To develop new products we must maintain effective partner relationships with our strategic component suppliers.

Under our "virtual vertical integration" business model, we do not manufacture any of the parts used in our hard drives. As a result, the success of our products depends on our ability to gain access to and integrate parts that are "best in class" from reliable component suppliers. To do so we must effectively manage our relationships with our strategic component suppliers. We must also effectively integrate different products from a variety of suppliers and manage difficult scheduling and delivery problems.

We have only one manufacturing facility, which subjects us to the risk of damage or loss of the facility.

Our volume manufacturing operations currently are based in one facility in Malaysia. A fire, flood, earthquake or other disaster or condition affecting our facility or the geographic area in which it is located would almost certainly result in a loss of substantial sales and revenue and harm our operating results.

Manufacturing our products abroad subjects us to numerous risks.

We are subject to risks associated with our foreign manufacturing operations, including:

- obtaining requisite United States and foreign governmental permits and approvals
- currency exchange rate fluctuations or restrictions
- political instability and civil unrest
- transportation delays or higher freight rates
- labor problems
- trade restrictions or higher tariffs
- exchange, currency and tax controls and reallocations
- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

We have attempted to manage the impact of foreign currency exchange rate changes by, among other things, entering into short-term, forward exchange contracts. However, those contracts do not cover our full exposure and can be canceled by the issuer if currency controls are put in place, as occurred in Malaysia during the first quarter of 1999. As a result of the Malaysian currency controls, we are no longer hedging the Malaysian currency risk.

Our plan to broaden our business takes us into new markets.

We are developing storage devices and content management software for the emerging broadband television market through our Keen PM subsidiary. We will be facing the challenge of developing products for a market that is still evolving and subject to rapid changes and shifting consumer preferences. There are several competitors which have also entered this emerging market, and there is no assurance that the market for digital storage devices for television and other audio-visual content will materialize or support all of these competitors.

We have entered the data warehouse software and services market through our SageTree subsidiary and are considering other initiatives related to data and content management, storage and communication. In any of these initiatives we will be facing the challenge of developing products and services for markets that are still evolving and which have many current and potential competitors. If we are not successful in these new initiatives it will likely harm our operating results.

We have developed technologies and services for integrating high-quality digital video into everyday computing through our Cameo subsidiary. We will be facing the challenge of developing products for a market that is still evolving and subject to rapid changes and shifting consumer preferences. There is no assurance that the market for these products will materialize or that the products we produce will be acceptable to that market.

Our reliance on intellectual property and other proprietary information subjects us to the risk of significant litigation.

The hard drive industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. We are currently evaluating notices of alleged patent infringement or notices of patents from patent holders. We also are a party to several judicial and other proceedings relating to patent and other intellectual property rights. If

we conclude that a claim of infringement is valid, we may be required to obtain a license or cross-license or modify our existing technology or design a new non-infringing technology. Such licenses or design modifications can be extremely costly. We may also be liable for any past infringement. If there is an adverse ruling against us in an infringement lawsuit, an injunction could be issued barring production or sale of any infringing product. It could also result in a damage award equal to a reasonable royalty or lost profits or, if there is a finding of willful infringement, treble damages. Any of these results would likely increase our costs and harm our operating results.

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

Our success depends, in significant part, on the proprietary nature of our technology, including non-patentable intellectual property such as our process technology. Despite safeguards, to the extent that a competitor is able to reproduce or otherwise capitalize on our technology, it may be difficult, expensive or impossible for us to obtain necessary legal protection. Also, the laws of some foreign countries may not protect our intellectual property to the same extent as do the laws of the United States. In addition to patent protection of intellectual property rights, we consider elements of our product designs and processes to be proprietary and confidential. We rely upon employee, consultant and vendor non-disclosure agreements and a system of internal safeguards to protect our proprietary information. However, any of our registered or unregistered intellectual property rights may be challenged or exploited by others in the industry, which might harm our operating results.

Inaccurate projections of demand for our product can cause large fluctuations in our quarterly results.

If we do not forecast total quarterly demand accurately, it can have a material adverse effect on our quarterly results. We typically book and ship a high percentage of our total quarterly sales in the third month of the quarter, which makes it difficult for us to match our production plans to customer demands. In addition, our quarterly projections and results may be subject to significant fluctuations as a result of a number of other factors including:

- the timing of orders from and shipment of products to major customers
- our product mix
- changes in the prices of our products
- manufacturing delays or interruptions
- acceptance by customers of competing products in lieu of our products
- variations in the cost of components for our products
- limited access to components that we obtain from a single or a limited number of suppliers, such as Komag
- competition and consolidation in the data storage industry
- seasonal and other fluctuations in demand for computers often due to technological advances.

Rapidly changing market conditions in the hard drive industry make it difficult to estimate actual results.

We have made and continue to make a number of estimates and assumptions relating to our consolidated financial reporting. The rapidly changing market conditions with which we deal means that actual results may differ significantly from our estimates and assumptions. Key estimates and assumptions for us include:

- accruals for warranty against product defects
- price protection adjustments on products sold to resellers and distributors
- inventory adjustments for write-down of inventories to fair value
- reserves for doubtful accounts
- accruals for product returns.

The market price of our common stock is volatile.

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

- actual or anticipated fluctuations in our operating results
- announcements of technological innovations by us or our competitors which may decrease the volume and profitability of sales of our existing products and increase the risk of inventory obsolescence
- new products introduced by us or our competitors
- periods of severe pricing pressures due to oversupply or price erosion resulting from competitive pressures
- developments with respect to patents or proprietary rights
- conditions and trends in the hard drive, data and content management, storage and communication industries
- changes in financial estimates by securities analysts relating specifically to us or the hard drive industry in general.

In addition, the stock market in recent months has experienced extreme price and volume fluctuations that have particularly affected the stock price of many high technology companies. These fluctuations are often unrelated to the operating performance of the companies.

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

We may be unable to raise future capital through debt or equity financing.

Due to our recent financial performance and the risks described in this Report, in the future we may be unable to maintain adequate financial resources for capital expenditures, working capital and research and development. We have a credit facility for our WDT subsidiary, which matures on September 20, 2003. If we decide to increase or accelerate our capital expenditures or research and development efforts, or if results of operations do not meet our expectations, we could require additional debt or equity financing. However, we cannot ensure that additional financing will be available to us or available on favorable terms. An equity financing could also be dilutive to our existing stockholders.

Power outages resulting from energy shortages in California may have an adverse impact on our facilities located in California.

We conduct substantial operations at our headquarters located in Lake Forest, California and at our facilities located in San Jose, California and Irvine, California. We rely on a continuous power supply in order to conduct those operations. California's current energy crisis could disrupt our operations and increase our expenses. In the event of an acute power shortage, that is, when energy reserves for the state fall below 1.5%, California has on some occasions implemented, and may in the future implement, rolling blackouts across the state. Although the Governor and state legislators are working to prevent them in the future, and although the Company has back-up energy reserves to last a short period, rolling blackouts could interrupt our power supply and might temporarily render us unable to continue operations at our California facilities. Any such interruption in our ability to continue our operations at our California facilities could delay the development of products or disrupt communications with our customers, suppliers or manufacturing operations, either of which could harm our business and results of operations. In addition, if wholesale prices for electricity continue to increase, our operating expenses would likely increase which might negatively affect our operating results.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Disclosure About Foreign Currency Risk

Although the majority of the Company's transactions are in U.S. Dollars, some transactions are based in various foreign currencies. From time to time, the Company purchases short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses denominated in foreign currencies. The purpose for entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on the results of operations. To date, a majority of the increases or decreases in the Company's local currency operating expenses are offset by gains and losses on the hedges. The contracts have maturity dates that do not exceed twelve months. The Company does not purchase short-term forward exchange contracts for trading purposes.

Historically, the Company has focused on hedging its foreign currency risk related to the Singapore Dollar, the British Pound and the Malaysian Ringgit. With the establishment of currency controls and the prohibition of purchases or sales of the Malaysian Ringgit by offshore companies, the Company discontinued hedging its Malaysian Ringgit currency risk in 1999. Future hedging of this currency will depend on currency conditions in Malaysia. The imposition of exchange controls by the Malaysian government resulted in a \$7.5 million realized loss on terminated hedging contracts in the first quarter of 1999. As a result of the closure of the Company's Singapore operations in 2000, the Company has also discontinued its hedging program related to the Singapore Dollar.

As of June 29, 2001, the Company had outstanding the following purchased foreign currency forward exchange contracts (in millions, except average contract rate):

	June 29, 2001		
	<u>Contract Amount</u>	<u>Weighted Average Contract Rate</u>	<u>Unrealized Gain (Loss)</u>
	(U.S. Dollar equivalent amounts)		
Foreign currency forward contracts:			
British Pound Sterling	2.8	1.42	—

In 1999, 2000, and 2001 total realized transaction and forward exchange contract currency gains and losses (excluding the \$7.5 million realized loss on the Malaysian Ringgits realized in 1999), were not material to the consolidated financial statements. Based on historical experience, the Company does not expect that a significant change in foreign exchange rates would materially affect the Company's consolidated financial statements.

Disclosure About Other Market Risks

Fixed Interest Rate Risk

At June 29, 2001, the market value of the Company's 5.25% zero coupon convertible subordinated debentures due in 2018 was approximately \$85.1 million, compared to the related book value of \$112.5 million. The convertible debentures will be repurchased by the Company, at the option of the holder, as of February 18, 2003, February 18, 2008, or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of redemption. The payment on those dates, with the exception of a Fundamental Change, can be in cash, stock or any combination, at the Company's option.

The Company has a note receivable from another company that carries a fixed rate of interest. Therefore, a significant change in interest rates would not cause these notes to impact the Company's consolidated financial statements.

Variable Interest Rate Risk

At the option of WDT, borrowings under the Senior Credit Facility would bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. This is the only debt which does not have a fixed-rate of interest.

The Senior Credit Facility requires WDT to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. As of the date hereof, there were no borrowings under the Senior Credit Facility.

Fair Value Risk

The Company owns approximately 1.2 million shares of Vixel common stock. As of June 29, 2001, the market value of the Vixel shares was \$3.1 million. The Company determines, on a quarterly basis, the fair market value of the Vixel shares and records an unrealized gain or loss resulting from the difference in the fair market value of the shares as of the previous quarter end and the fair market value of the shares on the measurement date. As of June 29, 2001, a \$3.1 million total accumulated unrealized gain has been recorded in accumulated other comprehensive income (loss). If the Company sells all or a portion of this common stock, any unrealized gain or loss on the date of sale will be recorded as a realized gain or loss in the Company's results of operations. As a result of market conditions, the market value of the shares had declined from \$3.1 million as of June 29, 2001 to \$2.4 million as of August 17, 2001. Due to market fluctuations, an additional decline in the stock's fair market value could occur.

Item 8. *Financial Statements and Supplementary Data*

Index to Financial Statements and Financial Statement Schedule

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Western Digital Corporation:

We have audited the consolidated financial statements of Western Digital Corporation and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Western Digital Corporation and subsidiaries as of June 30, 2000 and June 29, 2001, and the results of their operations and their cash flows for each of the years in the three-year period ended June 29, 2001, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of revenue recognition with respect to certain sales commencing on July 1, 2000.

KPMG LLP

Orange County, California
July 25, 2001, except as to Notes 4 and 10,
which are as of September 21, 2001

WESTERN DIGITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Years ended		
	July 3, 1999	June 30, 2000	June 29, 2001
Revenues, net (Notes 1 and 9)	\$2,767,206	\$1,957,199	\$1,953,392
Costs and expenses:			
Cost of revenues (Note 8)	2,770,054	1,947,594	1,745,654
Research and development	198,386	150,658	122,514
Selling, general and administrative	194,358	126,986	119,121
Restructuring charges (Note 8)	61,000	85,837	—
Total costs and expenses	3,223,798	2,311,075	1,987,289
Operating loss	(456,592)	(353,876)	(33,897)
Net interest and other income (expense) (Note 2)	(15,898)	4,874	(53,195)
Loss from continuing operations before income taxes, extraordinary gains, and cumulative effect of change in accounting principle	(472,490)	(349,002)	(87,092)
Income tax benefit (Note 5)	—	19,500	—
Loss from continuing operations before extraordinary gains and cumulative effect of change in accounting principle	(472,490)	(329,502)	(87,092)
Loss from discontinued operations (Note 10)	(20,200)	(25,413)	(32,667)
Extraordinary gains from redemption of debentures (Note 3) ..	—	166,899	22,400
Cumulative effect of change in accounting principle (Note 1) ...	—	—	(1,504)
Net loss	\$ (492,690)	\$ (188,016)	\$ (98,863)
Basic and diluted loss per common share:			
Loss from continuing operations before extraordinary gains and cumulative effect of change in accounting principle ...	\$ (5.28)	\$ (2.69)	\$ (.52)
Discontinued operations	(.23)	(.20)	(.19)
Extraordinary gains	—	1.36	.13
Cumulative effect of change in accounting principle	—	—	(.01)
	\$ (5.51)	\$ (1.53)	\$ (.59)
Common shares used in computing per share amounts:			
Basic and diluted	89,478	122,624	168,715

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands)

	<u>June 30, 2000</u>	<u>June 29, 2001</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 184,021	\$ 167,582
Accounts receivable, less allowance for doubtful accounts of \$13,261 in 2000 and \$13,298 in 2001	148,916	127,767
Inventories (Note 2)	83,709	78,905
Prepaid expenses and other assets	<u>32,719</u>	<u>11,455</u>
Total current assets	449,365	385,709
Property and equipment at cost, net (Note 2)	98,360	106,166
Other assets, net (Note 8)	<u>65,227</u>	<u>15,777</u>
Total assets	<u><u>\$ 612,952</u></u>	<u><u>\$ 507,652</u></u>
 LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current liabilities:		
Accounts payable	\$ 264,476	\$ 224,544
Accrued compensation	14,559	11,778
Accrued warranty	40,354	30,943
Other accrued expenses	121,713	70,963
Net liabilities of discontinued operations (Note 10)	<u>1,358</u>	<u>2,118</u>
Total current liabilities	442,460	340,346
Other liabilities	44,830	38,629
Convertible debentures (Note 3)	225,496	112,491
Minority interest	10,000	9,383
Commitments and contingent liabilities (Notes 3, 4 and 8)		
Shareholders' equity (deficiency) (Notes 2 and 6):		
Preferred stock, \$.01 par value; Authorized — 5,000 shares; Outstanding — None		
Common stock, \$.01 par value; Authorized — 225,000 shares; Outstanding — 153,335 shares in 2000 and 192,800 in 2001	1,534	1,928
Additional paid-in capital	549,932	735,439
Accumulated deficit	(482,857)	(581,720)
Accumulated other comprehensive income (Note 1)	1,367	3,112
Deferred compensation (Note 6)	—	(3,745)
Treasury stock — common shares at cost; 9,773 shares in 2000 and 6,420 shares in 2001	<u>(179,810)</u>	<u>(148,211)</u>
Total shareholders' equity (deficiency)	<u>(109,834)</u>	<u>6,803</u>
Total liabilities and shareholders' equity (deficiency)	<u><u>\$ 612,952</u></u>	<u><u>\$ 507,652</u></u>

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIENCY)
(in thousands)

	Common Stock	Treasury Stock	Additional	Retained	Accumulated	Deferred	Total	Total		
	Shares	Shares	Paid-in	Earnings	Comprehensive	Compensation	Shareholders'	Comprehensive		
	Amount	Amount	Capital	(Accumulated	Income		Equity	Income		
				Deficit)	(Loss)		(Deficiency)	(Loss)		
Balance at June 27, 1998	101,332	\$1,013	(13,039)	\$(207,348)	\$326,244	—	\$ 197,849	—	\$ 317,758	\$ (290,217)
ESPP shares issued	—	—	1,002	8,222	—	—	—	—	9,854	—
Exercise of stock options	—	—	740	6,084	(590)	—	—	—	5,494	—
Shares issued in connection with Connex acquisition	576	6	—	—	7,911	—	—	—	7,917	—
Net loss	—	—	—	—	—	—	(492,690)	—	(492,690)	(492,690)
Unrealized loss on investment securities	—	—	—	—	—	—	—	(2,123)	(2,123)	(2,123)
Balance at July 3, 1999	101,908	\$1,019	(11,297)	\$(193,042)	\$335,197	—	\$(294,841)	—	\$(153,790)	\$(494,813)
ESPP shares issued	—	—	1,236	10,660	(5,622)	—	—	—	5,038	—
Exercise of stock options	—	—	288	2,572	(1,427)	—	—	—	1,145	—
Shares issued in debenture redemptions	26,725	268	—	109,841	—	—	—	—	110,108	—
Shares issued in equity facility sales	24,611	246	—	111,556	—	—	—	—	111,803	—
Other shares issued	91	1	—	387	—	—	—	—	388	—
Net loss	—	—	—	—	—	—	(188,016)	—	(188,016)	(188,016)
Unrealized gain on investment securities	—	—	—	—	—	—	—	3,490	3,490	3,490
Balance at June 30, 2000	153,335	\$1,534	(9,773)	\$(179,810)	\$549,932	—	\$(482,857)	—	\$(109,834)	\$(184,526)
ESPP shares issued	—	—	1,199	11,232	(6,780)	—	—	—	4,452	—
Exercise of stock options	—	—	854	8,546	(5,885)	—	—	—	2,661	—
Shares issued in debenture redemption	15,970	159	—	95,315	—	—	—	—	95,474	—
Shares issued in equity facility sales	23,495	235	—	110,239	—	—	—	—	110,474	—
Issuance of restricted stock awards	—	—	1,300	11,821	(7,382)	—	—	(4,439)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	—	694	694	—
Net loss	—	—	—	—	—	—	(98,863)	—	(98,863)	(98,863)
Unrealized gain on investment securities	—	—	—	—	—	—	—	1,745	1,745	1,745
Balance at June 29, 2001	192,800	\$1,928	(6,420)	\$(148,211)	\$735,439	—	\$(581,720)	—	\$ 6,803	\$ (97,118)

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Years ended		
	July 3, 1999	June 30, 2000	June 29, 2001
Cash flows from operating activities			
Net loss	\$(492,690)	\$(188,016)	\$(98,863)
Adjustments to reconcile net loss to net cash used for operating activities of continuing operations:			
Extraordinary gains (Note 3)	—	(166,899)	(22,400)
Loss from discontinued operations (Note 10)	20,200	25,413	32,667
Depreciation and amortization	131,066	78,283	51,905
Interest on convertible debentures	24,956	15,447	7,483
Non-cash portion of restructuring charges (Note 8)	42,386	56,301	—
Investment gains (Note 2)	—	(14,767)	—
Other non-cash charges (Note 2)	—	—	39,283
Changes in assets and liabilities:			
Accounts receivable	107,693	124,649	31,149
Inventories	22,069	46,639	1,804
Prepaid expenses and other assets	(9,823)	5,376	(134)
Accrued warranty	31,052	(3,099)	(18,095)
Accounts payable, accrued compensation and accrued expenses	(5,233)	(104,911)	(90,463)
Other	(436)	(1,137)	(5,685)
Net cash used by continuing operations	<u>(128,760)</u>	<u>(126,721)</u>	<u>(71,349)</u>
Cash flows from investing activities			
Capital expenditures, net	(106,400)	(21,442)	(50,683)
Proceeds from sales of property and equipment	—	66,756	—
Other investment activity	—	(12,867)	14,979
Net cash provided by (used for) investing activities of continuing operations	<u>(106,400)</u>	<u>32,447</u>	<u>(35,704)</u>
Cash flows from financing activities			
Proceeds from ESPP shares issued and stock option exercises	15,348	6,183	7,113
Debt issuance costs	(2,925)	—	—
Repayment of bank debt (Note 3)	—	(50,000)	—
Common stock issued for cash (Note 6)	—	111,803	110,474
Proceeds from minority investment in SageTree (Note 1)	—	10,000	—
Proceeds from subsidiary investor note	—	—	5,000
Net cash provided by financing activities of continuing operations	12,423	77,986	122,587
Cash used for discontinued operations (Note 10)	<u>(10,946)</u>	<u>(25,838)</u>	<u>(31,973)</u>
Net decrease in cash and cash equivalents	(233,683)	(42,126)	(16,439)
Cash and cash equivalents at beginning of year	<u>459,830</u>	<u>226,147</u>	<u>184,021</u>
Cash and cash equivalents at end of year	<u>\$ 226,147</u>	<u>\$ 184,021</u>	<u>\$167,582</u>

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

Western Digital Corporation (“Western Digital” or the “Company”) has prepared its consolidated financial statements in accordance with accounting principles generally accepted in the United States and has adopted accounting policies and practices which are generally accepted in the industry in which it operates. Following are the Company’s significant accounting policies:

Fiscal Year

The Company has a 52 or 53-week fiscal year. In order to align its manufacturing and financial calendars, effective during the three months ended December 31, 1999, the Company changed its fiscal calendar so that each fiscal month ends on the Friday nearest to the last day of the calendar month. Prior to this change, the Company’s fiscal month ended on the Saturday nearest to the last day of the calendar month. The change did not have a material impact on the Company’s results of operations or financial position. The 1999, 2000 and 2001 fiscal years ended on July 3, June 30, and June 29, respectively, and consisted of 52 weeks for the fiscal years 2000 and 2001, and 53 weeks for the fiscal year 1999. All general references to years relate to fiscal years unless otherwise noted.

On April 6, 2001, the Company established a holding company organizational structure, under which Western Digital Corporation operates as the parent company to its hard drive business, Western Digital Technologies (“WDT”), and other subsidiaries. This administrative and legal change had no material impact to the accounting and reporting structure of the Company or to the Company’s results of operations or financial position.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its majority owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The accounts of foreign subsidiaries have been remeasured using the U.S. dollar as the functional currency. As such, foreign exchange gains or losses resulting from remeasurement of these accounts are reflected in the results of operations. These foreign exchange gains and losses were immaterial to the consolidated financial statements. Monetary and nonmonetary asset and liability accounts have been remeasured using the exchange rate in effect at each year end and using historical rates, respectively. Income statement accounts have been remeasured using average monthly exchange rates.

Cash Equivalents

The Company’s cash equivalents represent highly liquid investments, primarily money market funds and commercial paper, with original maturities of three months or less.

Concentration of Credit Risk

The Company designs, develops, manufactures and markets hard drives to personal computer manufacturers, resellers and retailers throughout the world. The Company performs ongoing credit evaluations of its customers’ financial condition and generally requires no collateral. The Company maintains reserves for potential credit losses, and such losses have historically been within management’s expectations. The Company also has cash equivalent policies that limit the amount of credit exposure to any one financial institution or investment instrument, and require that investments be made only with financial institutions or in investment instruments evaluated as highly credit-worthy.

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

Inventory Valuation

Inventories are valued at the lower of cost or net realizable value. Cost is on a first-in, first-out basis for raw materials and is computed on a currently adjusted standard basis (which approximates first-in, first-out) for work in process and finished goods.

The Company maintains a base stock of two to three weeks of current finished goods inventory for certain key original equipment manufacturer (“OEM”) customers in facilities located adjacent to their operations. Inventory at these locations usually includes minor product customizations (such as labeling) for the related OEM. If subsequent to its initial order the OEM changes its requirements, inventory held at these facilities can generally be sold to other OEM’s or distributors as is or with minor modifications (such as a change in labeling) at little or no additional cost.

Property and Equipment

The cost of property and equipment is depreciated over the estimated useful lives of the respective assets. Depreciation is computed on a straight-line basis. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the related lease terms.

Intangible Assets

Intangible assets are included in other assets and amortized over their expected useful lives or the lives of the related products. The Company reviews identifiable intangibles and other long-lived assets for impairment whenever events or circumstances indicate the carrying amounts may not be recoverable. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of an asset, an impairment loss is recognized (See Note 1, New Accounting Pronouncements).

Revenue Recognition

The Company generally recognizes revenue at the time of shipment, net of pricing adjustments and estimated sales returns. In December 1999, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin 101 (“SAB 101”), “Revenue Recognition in Financial Statements”. The Company adopted SAB 101 during its quarter ended June 29, 2001. As a result, the Company changed its revenue recognition policy effective July 1, 2000 to recognize revenue on certain product shipments upon delivery rather than shipment. The accounting change resulted in an increase to revenues for 2001 of \$13.1 million, of which \$16.9 million had been recognized in 2000 and \$3.8 million will be recognized in 2002. The cumulative effect on prior years of this accounting change was \$1.5 million and had an immaterial impact on reported operating losses in 2001.

In accordance with standard industry practice, the Company’s agreements with certain resellers provide price protection for inventories held by the resellers at the time of published list price reductions and, under certain circumstances, stock rotation for slow-moving items. Either party may terminate these agreements upon written notice. In the event of termination, the Company may be obligated to repurchase a certain portion of the resellers’ inventory. The Company recognizes revenue at the time of shipment on sales to resellers who have inventory repurchase agreements due to the Company’s ability to reasonably estimate future returns as well as the historically low levels of actual repurchases. Revenue recognized on sales to resellers with inventory repurchase agreements was \$841, \$683 and \$806 million for fiscal years 1999, 2000 and 2001, respectively. Repurchases of inventory under such agreements were not material in 1999, 2000 and 2001.

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

Warranty

The Company records an accrual for estimated warranty costs when revenue is recognized. Warranty covers cost of repair or replacement of the hard drive and the warranty periods range from 1 to 3 years for all hard drives, except enterprise drives, which had a warranty period of 5 years. The Company has comprehensive processes with which to estimate accruals for warranty, which include specific detail on hard drives in the field by product type, historical field return rates and costs to repair. Although the Company believes that it has the continued ability to reasonably estimate warranty reserves, unforeseeable changes in factors used to estimate the accrual for warranty could occur. These unforeseeable changes could cause a material change in the Company's warranty accrual estimate. Such a change would be recorded in the period in which the change was identified.

The Company transitioned from thin-film to magnetoresistive head technology in its desktop product line during 1998. Due to the expiration of the warranty period for the thin-film products during 2001 and to the discontinuance of its SCSI drive product line during 2000, warranty accruals decreased significantly from 2000 to 2001.

Advertising Expense

Advertising costs are expensed as incurred. Selling, general and administrative expenses of the Company include advertising costs of \$14.3, \$9.0 and \$7.4 million in 1999, 2000 and 2001, respectively.

Income Taxes

The Company accounts for income taxes using the liability method under Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). This method generally provides that deferred tax assets and liabilities be recognized for temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities and expected benefits of utilizing net operating loss ("NOL") carryforwards. The Company records a valuation allowance for certain temporary differences for which it is more likely than not that it will not receive future tax benefits. The impact on deferred taxes of changes in tax rates and laws, if any, are applied to the years during which temporary differences are expected to be settled and reflected in the consolidated financial statements in the period of enactment (See Note 5).

Per Share Information

The Company computes basic loss per share using the net loss and the weighted average number of common shares outstanding during the period. Dilutive loss per share is computed using the net loss and the weighted average number of common shares and dilutive potential common shares outstanding during the period. Dilutive common shares include outstanding employee stock options, employee stock purchase plan shares and common shares issuable upon conversion of the convertible debentures. The effects of these items were not included in the computation of diluted loss per share for each period presented as their effect would have been anti-dilutive.

As of July 3, 1999, June 30, 2000 and June 29, 2001, 17.8 million, 20.9 million shares and 23.3 million shares, respectively, relating to the possible exercise of outstanding stock options were not included in the computation of diluted loss per share. Also, for the same periods, an additional 19.4 million, 8.4 million and 4.0 million shares, respectively, issuable upon conversion of the Debentures were excluded from the computation of diluted loss per share. The effects of these items were not included in the computation of diluted loss per share as their effect would have been anti-dilutive.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Stock-Based Compensation

The Company applies the provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). SFAS 123 establishes the financial accounting and reporting standards for stock-based compensation plans. The Company elected to continue accounting for stock-based employee compensation plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations ("APB Opinion No. 25"), as SFAS 123 permits, and to follow the pro forma net income (loss), pro forma earnings (loss) per share, and stock-based compensation plan disclosure requirements set forth in SFAS 123. (See Note 6).

During 2001, the Company adopted the FASB issued Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation — an interpretation of APB Opinion No. 25" ("FIN 44"). This Interpretation clarifies the definition of an employee for purposes of applying Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequence of various modifications to the terms of a previously fixed stock option or award, and the accounting for an exchange of stock compensation awards in a business combination. The adoption of FIN 44 did not result in a material impact to the Company's consolidated financial position, results of operations or liquidity.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents approximates fair value for all periods presented because of the short-term maturity of these financial instruments. The fair value of the Company's convertible debentures is estimated by reference to quoted information from market sources. At June 30, 2000, the market value of the Company's convertible debentures was approximately \$111.6 million, compared to the related carrying value of \$225.5 million. At June 29, 2001, the market value of the Company's convertible debentures was approximately \$85.1 million, compared to the related carrying value of \$112.5 million. The carrying amounts of all other financial instruments in the consolidated balance sheets approximate fair values.

Investments

The Company's investments in unrestricted, marketable equity securities have been classified as "available for sale", are included in other current assets, and are carried at fair value. The classification of a security is determined at the acquisition date and reviewed periodically. The Company reviews, on a monthly basis, the fair market value of the available for sale securities and records an unrealized gain or loss resulting from the difference between the fair market value at the time of the acquisition and the fair market value on the measurement date. The unrealized gains or losses are shown as a component of accumulated comprehensive income (loss) in shareholders' equity (deficiency). Securities that are not classified as "available for sale" are carried at cost. The Company periodically reviews its cost-basis investments for instances where fair value is less than cost to determine if the decline in value is other than temporary. If the decline in value is judged to be other than temporary, the cost basis of the security is written down to fair value. The amount of any write-down would be included in the results of operations as a realized loss. Realized gains and losses resulting from the sale of securities are determined using the specific identification method.

The Company received approximately 10.8 million shares of Komag common stock during April 1999, upon the sale of its disk media operations to Komag (See Note 8). The common stock had a fair market value of \$34.9 million at the time of the transaction. During the three months ended September 29, 2000, the Company sold 4.9 million shares of the stock for \$15.0 million. The 5.9 million remaining Komag shares owned by the Company were restricted to sale until the following dates: 1.6 million shares on October 8, 2000; 3.2 million shares on October 8, 2001; and 1.1 million shares on October 8, 2002. The 1.6 million shares and the 3.2 million shares, available for sale on October 8, 2000 and October 8, 2001, respectively, have been classified as current assets and "available for sale" under the provisions of Statement of Financial Accounting

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Standards No. 115, "Investments in Certain Debt and Equity Securities" ("SFAS 115"). These shares were marked to market using published closing prices of Komag stock on a monthly basis and a related accumulated unrealized gain or loss was included in accumulated other comprehensive income (loss). During the fourth quarter of 2001, due to market conditions of Komag's common stock and a public announcement by Komag that it would not make current payments on its debt, the decline in market value of the 4.8 million shares held as current and the remaining 1.1 million shares held as long term was deemed "other than temporary" and an impairment loss of \$19.2 million was recognized.

The Company owns approximately 1.2 million shares of Vixel Corporation ("Vixel") common stock. The Company has identified these shares as "available for sale" under the provisions of SFAS 115. At June 29, 2001 an unrealized gain of \$3.1 million is included in accumulated other comprehensive income (loss). The aggregate book value of the shares was \$3.1 million as of June 29, 2001, and the investment was classified as current.

Other Comprehensive Income (Loss)

The Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"), beginning with the Company's fourth quarter of 1999. Prior to the fourth quarter of 1999, the Company did not possess any components of other comprehensive income as defined by SFAS 130. Adjustments to net income to arrive at other comprehensive income (loss) include revenue, expenses, gains and losses that are recorded as an element of shareholders' equity (deficiency) but are excluded from net income (loss). While SFAS 130 establishes new rules for the reporting and display of comprehensive income (loss), SFAS 130 has no impact on the Company's net loss or total shareholders' equity (deficiency). The Company's components of other comprehensive income (loss) are unrealized gains and losses on marketable securities categorized as "available for sale" under SFAS 115.

Minority Interest in Subsidiary

In June 2000, the Company's subsidiary, SageTree, Inc. ("SageTree"), received cash proceeds of \$10.0 million from NCR Corporation in exchange for a minority voting interest in SageTree at June 30, 2000. The Company reflects the portion of the earnings or losses of SageTree, which are applicable to the minority interest as an adjustment to minority interest on the consolidated balance sheets, and as a component of other income (expense) on the consolidated statements of operations. The amount of minority interest in SageTree's losses was not material to the Company's consolidated financial statements for the years ended June 30, 2000 and June 29, 2001.

Foreign Exchange Contracts

Although the majority of the Company's transactions are in U.S. Dollars, some transactions are based in various foreign currencies. From time to time, the Company purchases short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on the results of operations. A majority of the increase or decreases in the Company's local currency operating expenses are offset by gains and losses on the hedges. The contracts have maturity dates that do not exceed twelve months. The Company does not purchase short-term forward exchange contracts for trading purposes. In response to the Company's underlying foreign currency exposures, the Company may, from time to time, adjust its foreign currency hedging position by taking out additional contracts or by terminating or offsetting existing foreign currency forward exchange contracts.

During 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended by Statement of Financial

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment of FASB Statement No. 133". SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments embedded in other contracts and for hedging activities.

The Company had outstanding forward exchange contracts with commercial banks with nominal values of \$66.4, \$13.5 and \$2.8 million, at July 3, 1999, June 30, 2000 and June 29, 2001, respectively. Upon adoption of SFAS 133, the Company elected not to designate these forward exchange contracts as accounting hedges and any changes in fair value have been recorded through the results of operations for the year ended June 29, 2001. Such changes in fair value were minor for the year ended June 29, 2001. Unrealized gains and losses on outstanding forward exchange contracts and foreign currency transactions are recorded in the consolidated statements of operations at each quarter end and were not material to the consolidated financial statements as of and for the year ended June 30, 2000. For the year ended July 3, 1999, the total net loss on foreign currency transactions and forward exchange contracts was \$10.3 million. Of this amount, a realized loss of \$7.5 million on terminated hedging contracts was recorded due to the imposition of exchange controls by the Malaysian government. Historically, the Company has focused on hedging its foreign currency risk related to the Malaysian Ringgit, the Singapore Dollar and the British Pound. With the establishment of currency controls and the prohibition of purchases or sales of the Malaysian Ringgit by offshore companies, the Company discontinued hedging its Malaysian Ringgit currency risk in 1999. Future hedging of this currency will depend on currency conditions in Malaysia. As a result of the closure of the Company's Singapore operations in 2000, the Company discontinued its hedging program related to the Singapore Dollar.

Use of Estimates

Company management has made estimates and assumptions relating to the reporting of certain assets and liabilities in conformity with generally accepted accounting principles. Actual results could differ from these estimates.

Reclassifications

Certain prior years' amounts have been reclassified to conform to the current year presentation.

New Accounting Pronouncements

During July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). Effective June 30, 2001, the Company adopted SFAS 141. SFAS 141 addresses financial accounting and reporting for business combinations and requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. The adoption of SFAS 141 did not have a material impact on the Company's financial position or results of operations.

SFAS 142 requires that goodwill and intangible assets that have indefinite useful lives not be amortized but rather be tested at least annually for impairment. The Company is required to adopt SFAS 142 on June 29, 2002. However, goodwill and intangible assets acquired after June 30, 2001 are subject to the amortization provisions of SFAS 142. The Company does not expect the adoption of SFAS 142 to have a material impact on the Company's financial position or results of operations.

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

Note 2. Supplemental Financial Statement Data (in thousands)

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Net Interest and Other Income (Expense)			
Interest income	\$ 16,906	\$ 9,260	\$ 7,274
Interest expense	(32,804)	(19,153)	(8,943)
Realized investment gains (losses)	—	14,767	(337)
Minority interest in losses of consolidated subsidiary	—	—	1,215
Other charges(1)	—	—	(52,404)
Net interest and other income (expense)	<u>\$ (15,898)</u>	<u>\$ 4,874</u>	<u>\$ (53,195)</u>
Cash paid for interest	<u>\$ 4,819</u>	<u>\$ 2,100</u>	<u>\$ 568</u>
Inventories			
Finished goods		\$ 68,080	\$ 48,123
Work in process		11,253	8,888
Raw materials and component parts		<u>4,376</u>	<u>21,894</u>
		<u>\$ 83,709</u>	<u>\$ 78,905</u>
Property and Equipment			
Land and buildings		\$ 53,373	\$ 54,060
Machinery and equipment		309,689	305,966
Furniture and fixtures		9,170	7,219
Leasehold improvements		<u>16,858</u>	<u>10,818</u>
		389,090	378,063
Accumulated depreciation and amortization		<u>(290,730)</u>	<u>(271,897)</u>
Net property and equipment		<u>\$ 98,360</u>	<u>\$ 106,166</u>
Supplemental disclosure of non-cash investing and financing activities:			
Proceeds from sale of Santa Clara disk media operations	<u>\$ 77,100</u>		
Common stock issued and liabilities assumed in connection with acquisition of Connex	<u>\$ 10,000</u>		
Common stock issued for redemption of convertible debentures		<u>\$ 110,108</u>	<u>\$ 95,474</u>
Redemption of convertible debentures for Company common stock, net of capitalized issuance costs		<u>\$ 277,008</u>	<u>\$ 117,874</u>
Settlement of accounts payable by transfer of cost method investments		<u>\$ 26,242</u>	
Transfer of Service Center assets in exchange for promissory note		<u>\$ 11,655</u>	

(1) During the fourth quarter of 2001, as a result of Komag's public announcement regarding its intentions to not pay certain debt and interest amounts when due and market conditions of its common stock, the carrying amount of the equity investment in Komag was determined to have suffered an "other than temporary" decline in market value and the Company recorded nonoperating charges totaling \$52.4 million to adjust the carrying values of the equity investment and the notes receivable from Komag and to accrue for the contingent guarantees of the Komag equipment and facility leases. On August 24, 2001, Komag announced its voluntary Chapter 11 reorganization filing.

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

Note 3. Long-Term Debt

Line of Credit

During 2001, the Company's hard drive business, Western Digital Technologies ("WDT"), entered into a three-year Senior Credit Facility which provides up to \$125 million in revolving credit (subject to a borrowing base calculation), matures on September 20, 2003 and is secured by WDT's accounts receivable, inventory, 65% of its stock in its foreign subsidiaries and other assets. At the option of WDT, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. The Senior Credit Facility requires WDT to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. The Senior Credit facility replaced a previous facility that matured on March 31, 2000. Outstanding borrowings at July 3, 1999 from this previous facility amounted to \$50.0 million and were paid in full during 2000. As of the date hereof, there were no borrowings under the Senior Credit Facility.

Convertible Debentures

During 1998 the Company issued zero coupon convertible subordinated debentures due February 18, 2018 (the "Debentures"). The Debentures are subordinated to all senior debt; are redeemable at the option of the Company any time after February 18, 2003 at the issue price plus accrued original issue discount to the date of redemption; and at the holder's option, will be repurchased by the Company, as of February 18, 2003, February 18, 2008 or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of repurchase. The payment on those dates, with the exception of a Fundamental Change, can be in cash, stock or any combination, at the Company's option. The Debentures are convertible into shares of the Company's common stock at the rate of 14.935 shares per \$1,000 principal amount at maturity. The principal amount at maturity of the Debentures when issued was \$1.3 billion. During 2000, the Company issued 26.7 million shares of common stock in exchange for Debentures with a book value of \$284.1 million and an aggregate principal amount at maturity of \$735.6 million. During 2001, the Company issued 16.0 million shares of common stock in exchange for Debentures with a book value of \$120.3 million and an aggregate principal amount at maturity of \$295.7 million. These redemptions were private, individually negotiated, non-cash transactions with certain institutional investors and resulted in extraordinary gains of \$166.9 million and \$22.4 million during 2000 and 2001, respectively. As of June 29, 2001, the book value of the remaining outstanding Debentures was \$112.5 million and the aggregate principal amount at maturity was \$265.9 million. Included in other assets is the amount of unamortized Debenture issuance costs. The Debenture issuance costs totaled approximately \$14.5 million at origination and are being amortized over 10 years. During 2000 and 2001, approximately \$7.1 million and \$2.4 million, respectively, of unamortized costs were netted against the extraordinary gain in connection with the redemptions. As of June 29, 2001 the balance of unamortized Debenture issuance costs was approximately \$1.9 million and is included in other assets.

Note 4. Commitments, Agreements and Contingent Liabilities

Operating Leases

The Company leases certain facilities and equipment under long-term, non-cancelable operating leases which expire at various dates through 2010. Rental expense under these leases, including month-to-month rentals, was \$36.2, \$17.8 and \$15.4 million in 1999, 2000 and 2001, respectively. Leases with terms through 2003 for which the Company is contingently liable are included in the table below. See Note 8 for further discussion.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Future minimum rental payments under non-cancelable operating leases as of June 29, 2001 are as follows (in thousands):

2002	\$19,368
2003	8,614
2004	7,116
2005	6,144
2006	6,034
Thereafter	<u>19,855</u>
Total future minimum rental payments	<u>\$67,131</u>

Legal Proceedings

In 1992 Amstrad plc (“Amstrad”) brought suit against the Company in California State Superior Court, County of Orange, alleging that disk drives supplied to Amstrad by the Company in 1988 and 1989 were defective and caused damages to Amstrad of not less than \$186 million. The suit also sought punitive damages. The Company denied the material allegations of the complaint and filed cross-claims against Amstrad. The case was tried, and in June 1999 the jury returned a verdict in favor of Western Digital. Amstrad has appealed the judgment. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

In 1994 Papst Licensing (“Papst”) brought suit against the Company in federal court in California alleging infringement by the Company of five of its patents relating to disk drive motors that the Company purchased from motor vendors. Later that year Papst dismissed its case without prejudice, but it has notified the Company that it intends to reinstate the suit if the Company does not enter into a license agreement with Papst. Papst has also put the Company on notice with respect to several additional patents. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

In June 2000 Discovision Associates (“Discovision”) notified the Company in writing that it believes certain of the Company’s hard disk drive products may infringe certain of Discovision’s patents. Discovision has offered to provide the Company with a license under its patent portfolio. The Company is in discussion with Discovision regarding its claims. There is no litigation pending. The Company does not believe that the outcome of this matter will have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity.

On June 9, 2000, a suit was brought against the Company in California Superior Court for the County of Orange on behalf of a class of former employees of the Company who were terminated as a result of a reduction in force in December 1999. The complaint asserted claims for unpaid wages, fraud, breach of fiduciary duty, breach of contract, and unfair business practices. The Company removed the suit to United States District Court, Central District of California, on the ground that all of the claims are preempted by the Employee Retirement Income Security Act of 1974. On January 26, 2001, the Company filed a motion to dismiss plaintiffs’ complaint under Federal Rule of Civil Procedure 12(b). The Court granted the Company’s motion with leave to amend on April 2, 2001. Plaintiffs filed an amended complaint on April 6, 2001, and the Company filed a motion to dismiss the amended complaint under Federal Rule of Civil Procedure 12(b) on June 4, 2001. The Court granted the Company’s motion and dismissed plaintiffs’ amended complaint with prejudice on August 6, 2001. On September 5, 2001, the Court entered a stipulated order according to which plaintiffs agreed to waive their right to appeal the Court’s order dismissing their claims in exchange for the Company’s agreeing to waive its right to costs and fees as the prevailing party under ERISA.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

On May 22, 2001, Cambrian Consultants, Inc. (“Cambrian”) filed a complaint against the Company in the United States District Court, Central District of California. The suit alleges infringement by the Company of a Cambrian patent. On July 20, 2001, the Company filed an answer denying the allegations contained in Cambrian’s complaint and a counter claim asserting that Cambrian’s patent was invalid. The Court ordered that a Markman hearing to construe the claims of Cambrian’s patent be held on April 15, 2002 and set a briefing schedule leading up to the hearing. Both parties are engaged in discovery and expect that such discovery will continue for at least the next several months. Based on its initial investigation and the limited discovery done to date, the Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

On July 5, 2001, the Company (and its Malaysian subsidiary) filed suit against Cirrus Logic, Inc. (“Cirrus”) in California Superior Court for the County of Orange for breach of contract and other claims resulting from Cirrus’ role as a strategic supplier of read channel chips for the Company’s hard drives. The Company also stopped making payments to Cirrus for past deliveries of chips and terminated all outstanding purchase orders from Cirrus for such chips. The Company’s complaint alleges that Cirrus’ unlawful conduct caused damages in excess of any amounts that may be owing on outstanding invoices or arising out of any alleged breach of the outstanding purchase orders. On August 20, 2001, Cirrus filed an answer and cross-complaint. Cirrus denied the allegations contained in the Company’s complaint and asserted counterclaims against the Company for, among other things, the amount of the outstanding invoices and the Company’s alleged breach of the outstanding purchase orders. The parties have begun discovery and expect that such discovery will continue for the next several months. Based on its initial investigation and the limited discovery done to date, the Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

In the normal course of business, the Company receives and makes inquiries regarding possible intellectual property matters, including alleged patent infringement. Where deemed advisable, the Company may seek or extend licenses or negotiate settlements. Although patent holders often offer such licenses, no assurance can be given that in a particular case a license will be offered or that the offered terms will be acceptable to the Company. The Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

From time to time the Company receives claims and is a party to suits and other judicial and administrative proceedings incidental to its business. Although occasional adverse decisions (or settlements) may occur, the Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

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

Note 5. Income Taxes

The domestic and international components of net income (loss) before income taxes are as follows (in thousands):

	<u>1999</u>	<u>2000</u>	<u>2001</u>
United States	\$(399,006)	\$(214,316)	\$(114,817)
International	<u>(93,684)</u>	<u>6,800</u>	<u>15,954</u>
Net loss excluding income taxes	<u><u>\$(492,690)</u></u>	<u><u>\$(207,516)</u></u>	<u><u>\$(98,863)</u></u>

The components of the provision (benefit) for income taxes are as follows (in thousands):

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Current			
United States	\$ (3,519)	\$ (15,302)	\$ (1,800)
International	3,352	2,623	1,620
State	<u>167</u>	<u>179</u>	<u>180</u>
	—	(12,500)	—
Deferred, net	<u>—</u>	<u>(7,000)</u>	<u>—</u>
Provision (benefit) for income taxes	<u><u>\$ —</u></u>	<u><u>\$ (19,500)</u></u>	<u><u>\$ —</u></u>

The tax benefits associated with employee exercises of non-qualified stock options, disqualifying dispositions of stock acquired with incentive stock options, and disqualifying dispositions of stock acquired under the employee stock purchase plan reduced taxes currently payable. However, no tax benefits were recorded to additional paid-in capital in 1999, 2000 and 2001 because their realization was not more likely than not to occur and, consequently, a valuation allowance was recorded against the entire benefit.

During 2000, the Company reversed \$19.5 million of tax accruals and certain deferred tax amounts. These accruals were previously established over time and primarily related to unremitted income of foreign subsidiaries. However, based upon a review of the Company's tax positions after the substantial international operations restructurings in 2000, and due to the significant balances of net operating losses in recent years, the Company believed these accruals were no longer necessary.

Income tax payments amounted to \$5.5 million, \$4.6 million and \$1.5 million in 1999, 2000 and 2001, respectively.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Temporary differences and carryforwards which give rise to a significant portion of deferred tax assets and liabilities at June 30, 2000 and June 29, 2001 are as follows (in thousands):

	<u>2000</u>	<u>2001</u>
Deferred tax assets:		
NOL carryforward	\$ 309,315	\$ 340,150
Business credit carryforward	35,374	42,680
Reserves and accrued expenses not currently deductible . . .	98,695	101,189
All other	<u>4,274</u>	<u>7,909</u>
	447,658	491,928
Valuation allowance	<u>(447,658)</u>	<u>(491,928)</u>
Total deferred tax assets	<u>\$ —</u>	<u>\$ —</u>
Deferred tax liabilities:		
Unremitted income of foreign subsidiaries	\$ 7,995	\$ 8,429
All other	<u>4,146</u>	<u>1,333</u>
Total deferred tax liabilities	<u>\$ 12,141</u>	<u>\$ 9,762</u>

Reserves and accrued expenses not currently deductible include the following:

	<u>2000</u>	<u>2001</u>
Sales related reserves and adjustments	\$ 49,487	\$ 46,263
Accrued compensation and benefits	10,232	5,841
Inventory reserves and adjustments	2,675	3,552
Other accrued liabilities	<u>36,301</u>	<u>45,533</u>
Total deferred tax assets	<u>\$ 98,695</u>	<u>\$ 101,189</u>

SFAS 109 requires deferred taxes to be determined for each tax paying component of an enterprise within each tax jurisdiction. The deferred tax assets indicated above are attributable primarily to tax jurisdictions where a history of earnings has not been established. The taxable earnings in these tax jurisdictions are also subject to volatility. Therefore, the Company believes a valuation allowance is needed to reduce the deferred tax asset to an amount that is more likely than not to be realized.

Reconciliation of the United States Federal statutory rate to the Company's effective tax rate is as follows:

	<u>1999</u>	<u>2000</u>	<u>2001</u>
U.S. Federal statutory rate	(35.0)%	(35.0)%	(35.0)%
State income taxes, net	0.0	0.0	0.2
Tax rate differential on international income	0.9	8.7	(2.6)
Effect of valuation allowance	34.1	12.5	36.4
Other	<u>0.0</u>	<u>4.5</u>	<u>1.0</u>
Effective tax rate	<u>0.0%</u>	<u>(9.3)%</u>	<u>0.0%</u>

Certain income of selected subsidiaries is taxed at substantially lower income tax rates as compared to local statutory rates. The lower rates reduced income taxes and reduced the net loss by \$25.2 million (\$.28 per share, diluted), \$19 million (\$.15 per share, diluted), and \$30.0 million (\$.18 per share, diluted) in 1999, 2000 and 2001, respectively. These lower rates are in effect through fiscal year 2004.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Net undistributed earnings from international subsidiaries at June 29, 2001, on which no U.S. tax has been provided, amounted to approximately \$460 million. The net undistributed earnings are intended to finance local operating requirements. Accordingly, an additional United States tax provision has not been made on these earnings.

At June 29, 2001, the Company had Federal and state net operating loss carryforwards of approximately \$900 million and \$386 million, respectively. In addition, the Company had various Federal and state tax credit carryforwards of approximately \$42.7 million. The loss carryforwards expire in fiscal years 2008 through 2021 and the credit carryforwards begin to expire in fiscal year 2002.

Note 6. Shareholders' Equity

Equity Facility

Under an existing shelf registration ("equity facility"), the Company may issue shares of common stock to institutional investors for cash. Shares sold under the equity facility are at the market price of the Company's common stock less a discount ranging from 2.75% to 4.25%. During 2000, the Company issued 24.6 million shares of common stock under the equity facility for net cash proceeds of approximately \$111.8 million. During 2001, the Company issued 23.5 million shares of common stock under the equity facility for net cash proceeds of approximately \$110.5 million. As of June 29, 2001, the Company had \$167.7 million remaining under the equity facility.

Stock Reserved for Issuance

The following table summarizes all shares of common stock reserved for issuance at June 29, 2001 (in thousands):

	<u>Number of Shares</u>
Issuable in connection with:	
Convertible debentures	3,971
Exercise of stock options, including options available for grant	44,255
Employee stock purchase plan	<u>2,935</u>
	<u>51,161</u>

Employee Stock Purchase Plan

The Company has an employee stock purchase plan ("ESPP") that operates in accordance with Section 423 of the Internal Revenue Code whereby eligible employees may authorize payroll deductions of up to 10% of their salary to purchase shares of the Company's common stock at 85% of the fair market value of common stock on the date of grant or the exercise date, whichever is less.

Approximately 2.9 million shares of common stock remain reserved for issuance under this plan. Approximately 1,002,000, 1,236,000 and 1,199,000 shares were issued under this plan during 1999, 2000 and 2001, respectively.

Stock Option Plans

Western Digital's Employee Stock Option Plan ("Employee Plan") is administered by the Compensation Committee of the Board of Directors ("Compensation Committee"), which determines the vesting provisions, the form of payment for the shares and all other terms of the options. Terms of the Employee Plan require that the exercise price of options be not less than the fair market value of the common stock on the date of grant. Options granted generally vest 25% one year from the date of grant and in twelve quarterly

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

increments thereafter and have a ten-year term. As of June 29, 2001 options to purchase 7,532,746 and 13,423,861 shares of common stock were exercisable and available for grant, respectively, under this plan. Pursuant to the terms of the Employee Plan, participants are permitted to utilize previously purchased common stock as consideration to purchase additional common stock upon exercise of options or to exercise on a cashless basis.

On September 30, 1999, the Company's Board of Directors approved the Broad-Based Stock Incentive Plan (the "Broad-Based Plan") under which options to purchase shares of common stock and stock awards may be granted to employees of the Company and others. This plan is intended to qualify as "broadly-based" under the New York Stock Exchange shareholder approval policy. The Compensation Committee determines the vesting provisions and other terms of the options and stock. To date, the options granted vest either 100% one year from the date of grant or 25% every six months beginning six months from the date of grant. During 2001, the Company issued 1.3 million shares of restricted stock under the Broad-Based Plan to certain employees. The stock vests on the second and third anniversary dates of the grant provided that the recipient is still employed by the Company. The aggregate market value of the restricted stock at the dates of issuance of \$4.4 million has been recorded as deferred compensation, a separate component of shareholder's equity (deficiency), and is being amortized over the three-year vesting period. As of June 29, 2001, options to purchase 3,641,118 shares of common stock were exercisable and 6,354,583 shares were available for grant as options or stock awards, under this plan.

The Company has a Stock Option Plan for Non-Employee Directors ("Director Plan") and has reserved 2.6 million shares for issuance thereunder. The Director Plan provides for initial option grants to new directors of 75,000 shares per director and additional grants of options to purchase 10,000 shares of common stock per director each year upon their reelection as a director at the annual shareholders' meeting. Terms of the Director Plan require that options have a ten-year term and that the exercise price of options be not less than the fair market value at the date of grant. Options granted generally vest 25% one year from the date of grant and in twelve quarterly increments thereafter and have a ten-year term. As of June 29, 2001, options to purchase 527,192 shares of common stock were exercisable and options to purchase 1,125,964 shares of common stock were available for grant.

The following table summarizes activity under the Employee, Broad-Based and Director Plans (in thousands, except per share amounts):

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price Per Share</u>
Options outstanding at June 27, 1998	12,351	\$16.92
Granted	9,119	11.10
Exercised	(740)	7.30
Canceled or expired	<u>(3,004)</u>	<u>23.63</u>
Options outstanding at July 3, 1999	17,726	13.19
Granted	13,485	3.82
Exercised	(288)	4.10
Canceled or expired	<u>(10,022)</u>	<u>9.92</u>
Options outstanding at June 30, 2000	20,901	8.83
Granted	7,843	5.45
Exercised	(854)	3.14
Canceled or expired	<u>(4,539)</u>	<u>10.02</u>
Options outstanding at June 29, 2001	<u>23,351</u>	<u>\$ 7.69</u>

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The significant increase in the number of shares canceled or expired in 2000 was the result of terminations relating to restructuring and other attrition.

The following tables summarize information about options outstanding and exercisable under the Employee, Broad-Based and Director Plans at June 29, 2001 (in thousands, except per share amounts):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Shares	Weighted Average Contractual Life (in years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$ 1.44	10	0.38	\$ 1.44	10	\$ 1.44
1.62 – 2.81	2,623	7.75	2.75	1,810	2.76
3.25 – 4.31	2,687	5.97	3.76	1,208	3.45
4.37 – 4.56	3,327	8.45	4.47	1,339	4.45
4.68 – 5.62	1,587	8.08	5.05	384	4.94
5.81 – 6.00	4,630	9.31	6.00	332	6.00
6.12 – 8.81	3,110	5.84	7.45	2,394	7.68
8.87 – 12.87	3,450	6.36	11.88	2,535	11.88
13.50 – 48.25	<u>1,927</u>	6.01	24.54	<u>1,689</u>	25.48
Total	<u>23,351</u>	7.37	7.69	<u>11,701</u>	9.45

Some of the Company's new venture subsidiaries maintain stock option plans for their own employees and directors and for directors of the Company. The terms of these plans are similar to those of the Company's Employee Plan. These new ventures have reserved up to approximately 17% of their stock for existing and future option grants to their employees and directors.

Pro Forma Information

Pro forma information regarding net income (loss) and earnings (loss) per share is required by SFAS 123. This information is required to be determined as if the Company had accounted for its stock options (including shares issued under the Stock Option Plans, the ESPP and new venture option plans collectively called "options") granted subsequent to July 1, 1995, under the fair value method of that statement.

The fair value of options granted in 1999, 2000 and 2001 reported below has been estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	Stock Option Plans			ESPP Plan		
	1999	2000	2001	1999	2000	2001
Option life (in years)	5.0	4.0	2.5	2.0	2.0	2.0
Risk-free interest rate	5.75%	6.15%	4.20%	5.75%	6.15%	4.20%
Stock price volatility82	.83	1.05	.82	.83	1.05
Dividend yield	—	—	—	—	—	—

The following is a summary of the per share weighted average fair value of stock options granted in the years listed below:

	1999	2000	2001
Options granted under the Stock Option Plans	\$7.74	\$2.44	\$3.86
Shares granted under the ESPP Plan	\$9.92	\$8.77	\$4.65

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company applies APB Opinion No. 25 in accounting for its stock option and ESPP plans and, accordingly, no compensation expense has been recognized for the options in the consolidated financial statements. Had the Company determined compensation expense based on the fair value at the grant date for its options under SFAS 123, the Company's net loss and net loss per share would have been increased to the amounts indicated below:

	Year Ended		
	July 3, 1999	June 30, 2000	June 29, 2001
Pro forma net loss (in thousands)	\$(538,637)	\$(227,799)	\$(128,642)
Pro forma net loss per share:			
Basic and diluted.....	\$ (6.02)	\$ (1.86)	\$ (0.76)

Stock Purchase Rights

In 1989, the Company implemented a plan to protect shareholders' rights in the event of a proposed takeover of the Company. Under the plan, each share of the Company's outstanding common stock carried one Right to Purchase Series A Junior Participating Preferred Stock (the "Right"). The Right enabled the holder, under certain circumstances, to purchase common stock of Western Digital or of an acquiring company at a substantially discounted price ten days after a person or group publicly announces it has acquired or has tendered an offer for 15% or more of the Company's outstanding common stock. On September 10, 1998 the Company's Board of Directors approved the adoption of a new Rights plan to replace the previous plan, which expired in September of 1998. The Rights under the 1998 plan were similar to the rights under the 1989 plan except they were redeemable by the Company at \$.01 per Right and expired in 2008. In connection with the establishment of a holding company structure on April 6, 2001, the Company terminated the Rights under the 1998 plan and adopted a new Rights plan. The 2001 plan is similar to the terminated 1998 plan, except that the exercise price was reduced from \$150.00 to \$50.00 per share, and the expiration date for the 2001 Rights plan was extended to April 2011.

Note 7. Savings and Profit Sharing Plan

Effective July 1, 1991, the Company adopted a Savings and Profit Sharing Plan, the Western Digital Corporation Retirement Savings and Profit Sharing Plan ("the Plan"). The Plan includes an employee 401(k) plan. The Plan covers substantially all domestic employees, subject to certain eligibility requirements. The Company may make annual contributions to the 401(k) plan at the discretion of the Board of Directors. For 1999, 2000 and 2001 the Company made contributions to the 401(k) plan of \$3.3 million, \$2.3 million and \$1.7 million, respectively.

Note 8. Restructurings

1999 Restructuring Actions

In January 1999, the Company initiated a restructuring program which resulted in the combination of its personal storage and enterprise storage divisions into a single hard drive operating unit. Accordingly, design, manufacturing, materials, business and product marketing resources to address both the personal storage and enterprise markets were combined. In connection with the combination, the Company's Tuas, Singapore facility was closed and production of SCSI drives was moved to the Company's facility in Chai-Chee, Singapore. This restructuring program, which was substantially completed by the end of the third quarter of 1999, resulted in a reduction of worldwide employee headcount of 934 employees, approximately 250 of which were direct and indirect labor and the remainder were management, professional and administrative personnel. A \$41.0 million restructuring charge was recorded consisting of \$19.6 million for the write-down of the Tuas building and equipment to its estimated fair value of \$7.8 million, based on a valuation done by an

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

independent party, \$14.3 million for severance and other incremental costs related to the closure of the facility, \$5.7 million for the write-off of duplicate warranty repair and engineering supplies and \$1.4 million for renovation related costs of the Tuas facility. Of the severance and other related charges, approximately \$11.0 million was paid in 1999, and the remainder was paid in 2000. The write-off of duplicate warranty repair and engineering supplies, including base replacement stock for warranty repairs and engineering materials, was necessary due to the reduced requirements of a single combined repair facility. Tuas facility renovation and related costs consisted of costs incurred to ready the facility for sale.

In April 1999, the Company completed the sale of its Santa Clara disk media operations to Komag. The components of the sale are summarized below (in millions):

Proceeds:	
Common stock of Komag, Inc.	\$34.9
Note receivable	30.1
Trade receivable for certain inventory sold	<u>12.1</u>
	<u>77.1</u>
Costs:	
Equipment sold	68.3
Inventory sold	18.1
Prepays and other related assets sold or written off	7.7
Severance and outplacement	<u>3.0</u>
	<u>97.1</u>
Restructuring charge	<u>\$20.0</u>

The Company received, as a component of the total consideration, an unsecured note (the "Note") in the amount of \$30.1 million, which was recorded in other assets. The Note matures in April 2002 and has an annual interest rate of 4.9%, compounded quarterly. The outstanding principal balance and accrued interest is due and payable in full upon maturity. The Note contains a principal and accrued interest reduction provision which is based on the excess, if any, of proceeds received upon sale of Komag stock over a predetermined floor. In conjunction with the sale of Company assets, Komag assumed certain liabilities, mainly leases related to production equipment and facilities. The Company is contingently liable for these leases. If Komag is unable to meet its payment obligations on the remaining leases, totaling approximately \$9.3 million as of June 29, 2001, the Company is liable to make the payments (see Note 2).

The transaction with Komag included a three-year volume purchase agreement under which the Company must purchase a significant percentage of its media requirements from Komag. The agreement does not require the Company to purchase a fixed minimum amount of media from Komag. The Company also entered into a License Agreement and Joint Development Agreement. The License Agreement grants Komag a fully paid-up license to utilize certain of the Company's technology in the development of future media products for the Company. The Joint Development Agreement provides the basis for determining the ownership of any media manufacturing related technology developed by Komag and/or the Company in the future. There is no additional consideration related to the sale inherent in these other agreements. Therefore, no portion of the sales proceeds was allocated to them.

The April 1999 sale of the media business resulted in a reduction of employee headcount of 1,106 employees, approximately 650 of which were direct labor, with the rest being technicians, management and other professionals. Of the severance and outplacement charge of \$3.0 million, approximately \$1.9 million was paid in 1999, and the balance was paid in 2000. The sale of the Company's media assets to Komag and the related transition and restructuring program were substantially completed by the end of the fourth quarter of 1999.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Following is a summary of the 1999 restructuring charges, the amounts paid and the ending accrual balances (in thousands) for the years ended July 3, 1999 and June 30, 2000:

	<u>Accruals</u>	<u>Non-Cash Charges</u>	<u>Total Charges</u>
Consolidation of hard drive divisions:			
Write-down of building and equipment to fair value	\$ —	\$19,642	\$19,642
Write-off of duplicate warranty repair and engineering supplies	—	5,748	5,748
Severance and other	14,271	—	14,271
Tuas facility renovation and related costs	<u>1,339</u>	<u>—</u>	<u>1,339</u>
	<u>15,610</u>	<u>25,390</u>	<u>41,000</u>
Sale of media assets to Komag:			
Assets sold or written off, net of proceeds received	—	16,996	16,996
Severance and outplacement	<u>3,004</u>	<u>—</u>	<u>3,004</u>
	<u>3,004</u>	<u>16,996</u>	<u>20,000</u>
	18,614	<u><u>\$42,386</u></u>	<u><u>\$61,000</u></u>
1999 cash payments	<u>(16,668)</u>		
Balance at July 3, 1999	<u>\$ 1,946</u>		
Changes during 2000 to 1999 restructuring actions:			
Cash payments	(170)		
Accrual reversal	<u>(1,776)</u>		
Balance at June 30, 2000	<u><u>\$ —</u></u>		

The accrual balance at July 3, 1999 after remaining cash obligations paid in 2000, was reversed through the restructuring charges line item on the consolidated statement of operations in 2000 (see table below).

2000 Restructuring Actions

During 2000, the Company initiated restructuring actions to improve operational efficiency and reduce operating expenses. Charges related to these restructuring actions were accrued in the periods in which executive management committed to execute such actions. The restructuring actions taken in 2000 included the reorganization of worldwide operational and management responsibilities, transfer of hard drive production from Singapore to the Company's manufacturing facility in Malaysia, removal of property and equipment from service, closure of the Company's Singapore operations and closure of its Rochester, Minnesota design center. These actions resulted in a net reduction of worldwide headcount of approximately 2,000, of which approximately 540 were management, professional and administrative personnel and the remainder were manufacturing employees. These employees were given legally required notification and outplacement services. Restructuring charges recorded in connection with these actions totaled \$85.8 million and consisted of severance and outplacement costs of \$28.7 million, the write-off of manufacturing equipment and information systems assets of \$56.3 million (taken out of service and held for disposal), including a loss recognized on the sale of the Rochester facility of \$1.9 million (sold for cash proceeds of approximately \$29.7 million), and net lease cancellation and other costs associated with the closure of \$11.0 million. Reducing these charges was the favorable settlement of lease commitments in Singapore of \$5.3 million, favorable settlement of 1999 restructuring accruals of \$1.8 million and a gain realized on the sale of the Tuas facility of \$3.1 million. The restructuring effort was substantially completed by June 30, 2000. Of the charges, approximately \$30.5 million was paid in 2000 and the remainder was paid in 2001.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table summarizes the restructuring charges, the amounts paid and the ending accrual balances (in thousands) for the years ended June 30, 2000 and June 29, 2001:

	<u>Accruals</u>	<u>Non-Cash Charges</u>	<u>Total Charges</u>
Consolidation of Asian operations and closure of Rochester design center:			
Fixed asset write-offs	\$ —	\$56,301	\$56,301
Severance and outplacement	28,679	—	28,679
Lease cancellation and other (net of favorable lease settlement of \$5,252)	<u>5,733</u>	<u>—</u>	<u>5,733</u>
	<u>34,412</u>	<u>56,301</u>	<u>90,713</u>
Changes to 1999 restructuring estimates:			
Gain on sale of Tuas building	—	—	(3,100)
Favorable settlement of 1999 restructuring accruals	—	<u>—</u>	<u>(1,776)</u>
		<u>\$56,301</u>	<u>\$85,837</u>
Cash payments during 2000	<u>(30,529)</u>		
Balance at June 30, 2000	<u>\$ 3,883</u>		
Changes during 2001 to 2000 restructuring actions:			
Cash payments	<u>(3,883)</u>		
Balance at June 29, 2001	<u>\$ —</u>		

Note 9. Business Segment, International Operations and Major Customer

Segment Information

The Company adopted Statement of Financial Accounting Standards No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131") in 1999. SFAS 131 establishes standards for reporting financial and descriptive information about an enterprise's operating segments in its annual financial statements and selected segment information in interim financial reports.

The Company formed new business ventures in 1999, 2000 and 2001. The Company's new business ventures have included Connex, Inc. ("Connex"), SANavigator, Inc. ("SANavigator"), SageTree, Inc. ("SageTree"), Keen Personal Media, Inc. ("Keen PM"), and Cameo Technologies, Inc. ("Cameo"). Connex was formed in 1999 to design and market network attached storage products. SANavigator was formed as a subsidiary of Connex in 2001 to develop and market storage area network ("SAN") management software. SageTree was formed in 2000 to design and market packaged analytical software and related services for supply chain and product lifecycle applications. Keen PM was formed in 2000 to develop and sell interactive personal video recorder and set-top box software, services and hardware for broadband television content management and commerce. Cameo was formed in 2000 to develop technologies and services for delivering broadcast-quality video content to PC users. Subsequent to June 29, 2001, substantially all of the assets of Connex and SANavigator were sold and, accordingly, their operations were discontinued (See Note 10). The Company's chief operating decision maker uses the segment information for WDT and the Company's combined new business ventures to assess performance and to determine resource allocation. The continuing separate new business venture amounts do not meet the disclosure requirements of SFAS 131 and they have been combined and presented in an "all other" category, separate from the WDT segment results.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

General and corporate expenses of the Company are included in the WDT segment. Losses from discontinued operations of \$25.4 million in 2000 and \$32.7 million in 2001 have been excluded from the table below.

	<u>WDT</u>	<u>All Other</u> (in thousands)	<u>Total</u>
Year ended June 30, 2000			
Revenues	<u>\$1,956,671</u>	<u>\$ 528</u>	<u>\$1,957,199</u>
Restructuring charges	<u>\$ 85,837</u>	<u>\$ —</u>	<u>\$ 85,837</u>
Operating loss	<u>\$ (340,348)</u>	<u>\$(13,528)</u>	<u>\$ (353,876)</u>
Net loss	<u>\$ (149,115)</u>	<u>\$(13,488)</u>	<u>\$ (162,603)</u>
Total assets	<u>\$ 593,412</u>	<u>\$ 19,540</u>	<u>\$ 612,952</u>
Depreciation and amortization	<u>\$ 77,538</u>	<u>\$ 745</u>	<u>\$ 78,283</u>
Additions to property and equipment	<u>\$ 22,562</u>	<u>\$ 95</u>	<u>\$ 22,657</u>
Year ended June 29, 2001			
Revenues	<u>\$1,952,868</u>	<u>\$ 524</u>	<u>\$1,953,392</u>
Operating loss	<u>\$ (3,580)</u>	<u>\$(30,317)</u>	<u>\$ (33,897)</u>
Net loss	<u>\$ (35,837)</u>	<u>\$(30,359)</u>	<u>\$ (66,196)</u>
Total assets	<u>\$ 495,555</u>	<u>\$ 12,097</u>	<u>\$ 507,652</u>
Depreciation and amortization	<u>\$ 47,883</u>	<u>\$ 4,022</u>	<u>\$ 51,905</u>
Additions to property and equipment	<u>\$ 49,261</u>	<u>\$ 1,486</u>	<u>\$ 50,747</u>

International Operations

The Company's operations outside the United States include a manufacturing facility in Malaysia as well as sales offices throughout Europe and Asia. During 1999 and the first half of 2000, the Company also had manufacturing facilities in Singapore. The following table summarizes operations by geographic areas for the past three years. United States revenues to unaffiliated customers include export sales to various countries in Europe and Asia of \$482.5, \$546.5, and \$443.3 million in 1999, 2000 and 2001, respectively.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Transfers between geographic areas are accounted for at prices comparable to normal sales through outside distributors. General and corporate expenses of \$83 million, \$62 million and \$51 million in 1999, 2000, and 2001 respectively, have been excluded in determining operating income (loss) by geographic region.

	<u>United States</u>	<u>Europe</u>	<u>Asia</u>	<u>Eliminations</u>	<u>Total</u>
	(in millions)				
Year ended July 3, 1999					
Sales to unaffiliated customers	\$2,001	\$751	\$ 15	\$ —	\$2,767
Transfers between geographic areas	746	1	2,607	(3,354)	—
Revenues, net	<u>\$2,747</u>	<u>\$752</u>	<u>\$2,622</u>	<u>\$(3,354)</u>	<u>\$2,767</u>
Operating income (loss)	<u>\$(275)</u>	<u>\$ 7</u>	<u>\$(114)</u>	<u>\$ 8</u>	<u>\$(374)</u>
Identifiable assets	<u>\$ 113</u>	<u>\$ 97</u>	<u>\$ 390</u>	<u>\$ (15)</u>	<u>\$ 585</u>
Year ended June 30, 2000					
Sales to unaffiliated customers	\$1,462	\$485	\$ 10	\$ —	\$1,957
Transfers between geographic areas	479	3	1,858	(2,340)	—
Revenues, net	<u>\$1,941</u>	<u>\$488</u>	<u>\$1,868</u>	<u>\$(2,340)</u>	<u>\$1,957</u>
Operating income (loss)	<u>\$(296)</u>	<u>\$104</u>	<u>\$(58)</u>	<u>\$ (42)</u>	<u>\$(292)</u>
Identifiable assets	<u>\$ 474</u>	<u>\$154</u>	<u>\$ 16</u>	<u>\$ (31)</u>	<u>\$ 613</u>
Year ended June 29, 2001					
Sales to unaffiliated customers	\$1,554	\$397	\$ 2	\$ —	\$1,953
Transfers between geographic areas	385	5	1,769	(2,159)	—
Revenues, net	<u>\$1,939</u>	<u>\$402</u>	<u>\$1,771</u>	<u>\$(2,159)</u>	<u>\$1,953</u>
Operating income (loss)	<u>\$ 4</u>	<u>\$(98)</u>	<u>\$ 111</u>	<u>\$ 0</u>	<u>\$ 17</u>
Identifiable assets	<u>\$ 326</u>	<u>\$ 38</u>	<u>\$ 180</u>	<u>\$ (36)</u>	<u>\$ 508</u>

Major Customer

During 1999 and 2000 sales to one customer accounted for 21% of the Company's revenues. During 2001 sales to one customer accounted for 17% of the Company's revenues and another accounted for 12% of the Company's revenues.

Note 10. Discontinued Operations

The Company acquired Connex, a San Jose-based startup company formed to develop storage systems and solutions, on February 1, 1999 for approximately \$12.0 million. The purchase price included 575,662 shares of Western Digital common stock valued at \$7.9 million, forgiveness of amounts advanced to Connex prior to the acquisition totaling \$2.0 million and the assumption of certain liabilities of approximately \$2.1 million. The acquisition was accounted for as a purchase. At the time of the acquisition, Connex was a development stage operation with no commercial products yet available for sale. Connex had, at the time of acquisition, several in-process research and development projects which were approximately 40% complete. The Company allocated \$12.0 million of the purchase price as a one-time charge for in-process research and development in 1999. Connex continued the development efforts and began shipping network attached storage products during the third quarter of 2000.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

SANavigator operated as a division of Connex from its inception in November 1999 until March 22, 2001, at which time it was incorporated as a wholly owned subsidiary of Connex. SANavigator was formed to develop and market storage area network (SAN) management software and released its first product in October 2000.

On July 1, 2001, the Company decided to discontinue Connex and SANavigator. Connex and SANavigator are separate major lines of business and legal entities with separate facilities, operations, management teams, and classes of end-user customers from the Company's hard drive business. As such, the disposals have been accounted for as discontinued operations and, accordingly, the consolidated financial statements for all periods presented have been reclassified. On August 8, 2001 substantially all of the operating assets of Connex were sold to Quantum Corporation for cash proceeds of \$11.0 million, and on September 21, 2001 substantially all of the operating assets of SANavigator were sold to McData Corporation for cash proceeds of \$29.8 million. Approximately \$4.1 million of the combined cash proceeds will be escrowed for one year pending expiration of customary indemnification periods. The transactions are expected to generate gains, which will be recognized during the first quarter of 2002, when realized. At June 29, 2001 and June 30, 2000 the net liabilities of discontinued operations consisted principally of individually immaterial amounts of inventories, fixed assets, accounts payable and accrued compensation. Combined operating results for Connex and SANavigator in 1999, 2000 and 2001 were as follows:

	Year Ended		
	July 3, 1999(1)	June 30, 2000	June 29, 2001
Revenues	\$ —	\$ 381	\$ 557
Operating losses	\$(20,200)	\$(25,413)	\$(32,667)

(1) 1999 operating losses include in-process research and development charges of \$12.0 million.

Note 11. Quarterly Results of Operations (unaudited)

	First(1), (5)	Second(2), (5)	Third(3), (5)	Fourth(4), (5)
	(in thousands, except per share amounts)			
2000				
Revenues, net	\$ 406,957	\$560,174	\$516,502	\$473,566
Gross profit (loss)	(65,003)	20,555	12,032	42,021
Operating loss	(185,919)	(83,316)	(78,069)	(6,572)
Income (loss) from continuing operations	(191,248)	(86,344)	(64,580)	12,670
Loss from discontinued operations	(5,689)	(5,130)	(6,089)	(8,505)
Net income (loss)	(106,315)	(15,197)	(70,669)	4,165
Basic and diluted earnings (loss) per share	<u>\$ (1.11)</u>	<u>\$ (.13)</u>	<u>\$ (.53)</u>	<u>\$.03</u>
2001				
Revenues, net	\$ 424,366	\$561,570	\$511,723	\$455,733
Gross profit	25,936	67,541	63,295	50,966
Operating income (loss)	(35,588)	1,999	985	(1,293)
Income (loss) from continuing operations	(37,220)	2,838	1,037	(53,747)
Loss from discontinued operations	(8,045)	(9,827)	(7,156)	(7,639)
Net income (loss)	(35,526)	3,587	(5,748)	(61,176)
Basic and diluted earnings (loss) per share	<u>\$ (0.24)</u>	<u>\$ 0.02</u>	<u>\$ (0.03)</u>	<u>\$ (0.34)</u>

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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- (1) During the first quarter of 2000, the Company announced a recall of its 6.8GB per platter series of WD Caviar® desktop hard drives because of a reliability problem resulting from a faulty power driver chip manufactured by a third-party supplier. Approximately 1.2 million units were manufactured with the faulty chip. Replacement of the chips involved rework of the printed circuit board assembly. Revenues of approximately \$100 million, which related to products shipped during the first quarter and that were recalled, were reversed in the first quarter of 2000. In addition, the Caviar product line was shut down for approximately two weeks, eliminating approximately \$70 million of forecasted revenue during the quarter. Cost of revenues for the first quarter of 2000 included charges totaling \$37.7 million for estimated costs to recall and repair the affected drives, consisting of \$23.1 million for repair and retrieval, \$4.5 million for freight and other, and \$10.1 million for write-downs of related inventory.

During the first quarter of 2000 the Company recorded a restructuring charge of \$32.3 million related to the consolidation of the Asian operations, consisting of \$14.1 million for the write-off of fixed assets no longer utilized as a result of the restructuring, \$13.0 million for severance and outplacement as a result of headcount reductions from the restructuring, and lease cancellations and other costs of \$5.2 million.

During the first quarter of 2000 the Company also recognized an extraordinary gain of \$90.6 million for the redemption of debentures.

The first quarter of 2001 includes an extraordinary gain of \$11.2 million the Company recognized for the redemption of debentures.

- (2) During the second quarter of 2000, the Company continued with its restructuring actions and recorded a restructuring charge of \$25.5 million related to further consolidation of the Asian operations, consisting of \$14.7 million for the write-off of fixed assets, \$5.8 million for lease cancellation and other costs, and \$5.0 million for severance and outplacement costs.

Also during the second quarter of 2000 the Company recognized an extraordinary gain of \$76.3 million relating to the redemption of debentures.

The second quarter of 2001 includes an extraordinary gain of \$10.6 million the Company recognized for the redemption of debentures.

- (3) The third quarter of 2000 includes a \$28.0 million net restructuring charge and a special charge to cost of revenues of \$34.8 million, directly resulting from the Company's exit from SCSI hard drive production.

The third quarter of 2000 also includes a \$14.8 million gain on the disposition of certain investment securities.

- (4) The fourth quarter of 2000 includes benefits for adjustments to tax and other accrual accounts of \$19.5 million and \$11.0 million, respectively.

During the fourth quarter of 2001, the Company recorded nonoperating charges of \$52.4 million to adjust the carrying value of equity investments in and notes receivable from Komag and accruals of Komag contingent guarantees.

- (5) As a result of the adoption of Staff Accounting Bulletin 101 ("SAB 101"), "Revenue Recognition in Financial Statements", the Company changed its revenue recognition policy effective July 1, 2000 to recognize revenue on certain product shipments upon delivery rather than shipment and recorded a cumulative effect of change in accounting principle of \$1.5 million in the first quarter of 2001. In accordance with the requirements of SAB 101, as a result of its adoption during the fourth quarter of 2001, previously reported quarterly information for 2001 has been restated.

The quarterly results presented have been reclassified to present the operations of Connex and SANavigator as discontinued.

WESTERN DIGITAL CORPORATION
SCHEDULE II — CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS
Three years ended June 29, 2001
(in thousands)

	<u>Allowance for Doubtful Accounts</u>	<u>Accrued Warranty(1)</u>
Balance at June 27, 1998	\$15,926	\$ 47,135
Charges to operations	2,632	153,000
Deductions	<u>(21)</u>	<u>(121,948)</u>
Balance at July 3, 1999	18,537	78,187
Charges to operations	945	77,719
Deductions	<u>(6,221)</u>	<u>(85,341)</u>
Balance at June 30, 2000	13,261	70,565
Charges to operations	1,218	39,736
Deductions	<u>(1,181)</u>	<u>(57,831)</u>
Balance at June 29, 2001	<u>\$13,298</u>	<u>\$ 52,470</u>

(1) Accrued warranty includes amounts classified in non-current liabilities of \$25.0 million at July 3, 1999, \$30.2 million at June 30, 2000 and \$21.5 million at June 29, 2001.

Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

None.

PART III

Item 10. *Directors and Executive Officers of the Registrant*

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2001 Annual Meeting of Shareholders under the captions "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2001.

Item 11. *Executive Compensation*

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2001 Annual Meeting of Shareholders under the captions "Directors' Compensation," "Executive Compensation," "Report of the Compensation Committee," "Compensation Committee Interlocks and Insider Participation," "Stock Performance Graph" and "Separation and Change of Control Arrangements" which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2001.

Item 12. *Security Ownership of Certain Beneficial Owners and Management*

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2001 Annual Meeting of Shareholders under the caption "Security Ownership by Principal Shareholders and Management," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2001.

Item 13. *Certain Relationships and Related Transactions*

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2001 Annual Meeting of Shareholders under the caption "Security Ownership by Principal Shareholders and Management," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2001.

PART IV

Item 14. *Exhibits, Financial Statement Schedules, and Reports on Form 8-K*

(a) Documents filed as a part of this Report:

(1) Index to Financial Statements

The financial statements included in Part II, Item 8 of this document are filed as part of this Report.

(2) Financial Statement Schedules

The financial statement schedule included in Part II, Item 8 of this document is filed as part of this Report.

All other schedules are omitted as the required information is inapplicable or the information is presented in the consolidated financial statements or related notes.

Separate financial statements of the Company have been omitted as the Company is primarily an operating company and its subsidiaries are wholly or majority owned and do not have minority equity interests and/or indebtedness to any person other than the Company in amounts which together exceed 5% of the total consolidated assets as shown by the most recent year-end consolidated balance sheet.

(3) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
2.1	Agreement and Plan of Merger to Form Holding Company, dated April 6, 2001, by and among the Company, Western Digital Technologies, Inc. (f/k/a Western Digital Corporation) and Western Digital Merger Sub, Inc.(25)
3.1	Amended and Restated Certificate of Incorporation of the Company, filed with the office of the Secretary of State of the State of Delaware on April 6, 2001 (25)
3.2	Amended and Restated By-laws of the Company, adopted as of April 6, 2001 (25)
4.1	Rights Agreement between the Company and American Stock Transfer and Trust Company, as Rights Agent, dated April 6, 2001, which includes as Exhibit A thereto the Form of Rights Certificate to be distributed to holders of Rights after the Distribution Date (as that term is defined in the Rights Agreement) (25)
4.2	Form of Common Stock Certificate(1)
4.3	Certificate of Designations of Series A Junior Participating Preferred Stock of the Company(25)
4.4	Indenture, dated as of February 18, 1998, between the Company and State Street Bank and Trust Company of California, N.A.(12)
4.4.1	Supplemental Indenture, dated as of April 6, 2001, between the Company and State Street Bank and Trust Company, N.A.(25)
4.7	The Company's Zero Coupon Convertible Subordinated Debenture due 2018 and the Global Form of the Company's Zero Coupon Convertible Subordinated Debenture due 2018 (which is identical to the Company's Zero Coupon Convertible Subordinated Debenture due 2018, except for certain provisions as marked) (12)
10.1.4	Western Digital Corporation Amended and Restated Employee Stock Option Plan, as amended on November 5, 1998(15)*
10.1.5	First Amendment to the Western Digital Corporation Employee Stock Option Plan, dated April 6, 2001*†
10.3	Western Digital Corporation 1993 Employee Stock Purchase Plan, as amended on November 18, 1999(22)*
10.3.1	First Amendment to the Western Digital Corporation 1993 Employee Stock Purchase Plan, dated April 6, 2001†*
10.10.1	Western Digital Corporation Deferred Compensation Plan, as amended and restated effective January 1, 1998(11)*
10.10.2	First Amendment to the Western Digital Corporation Deferred Compensation Plan, dated April 6, 2001*†
10.11	The Western Digital Corporation Executive Bonus Plan(4)*
10.11.1	Amendment No. 1 to the Western Digital Corporation Executive Bonus Plan(13)*
10.12	The Extended Severance Plan of the Registrant(4)*
10.12.1	Amendment No. 1 to the Company's Extended Severance Plan(7)*
10.12.2	Western Digital Corporation Change of Control Severance Plan(26)*
10.13	Manufacturing Building Lease between Wan Tien Realty Pte Ltd and Western Digital (Singapore) Pte Ltd dated as of November 9, 1993(3)
10.16.1	Western Digital Long-Term Retention Plan, as amended July 10, 1997(10)*
10.16.2	Western Digital Corporation Executive Retention Plan(14)*
10.17	Sublease between Wan Tien Realty Pte Ltd and Western Digital (Singapore) Pte Ltd dated as of September 1, 1991(2)

<u>Exhibit Number</u>	<u>Description</u>
10.18	Sublease between Wan Tien Realty Pte Ltd and Western Digital (Singapore) Pte Ltd dated as of October 12, 1992(2)
10.19	Retention Agreement effective September 21, 1998 between the Company and Teresa A. Hopp(20)*
10.21	The Company's Non-Employee Directors Stock-For-Fees Plan, Amended and Restated as of January 27, 2000†*
10.21.1	First Amendment to the Company's Non-Employee Directors Stock-For-Fees Plan, dated as of April 6, 2001†*
10.23	Lease by and between Serrano Jack, L.L.C., and Western Digital Corporation, dated May 30, 2000(23)
10.30	The Company's Savings and Profit Sharing Plan(5)*
10.31	First Amendment to the Company's Savings and Profit Sharing Plan(5)*
10.32	Second Amendment to the Company's Savings and Profit Sharing Plan(6)*
10.32.1	Third Amendment to the Company's Retirement Savings and Profit Sharing Plan(8)*
10.32.2	Fourth Amendment to the Company's Retirement Savings and Profit Sharing Plan(9)*
10.32.3	Fifth Amendment to the Company's Retirement Savings and Profit Sharing Plan(13)*
10.32.4	Sixth Amendment to the Company's Retirement Savings and Profit Sharing Plan(20)*
10.32.5	Seventh Amendment to the Company's Retirement Savings and Profit Sharing Plan(20)*
10.32.6	Eighth Amendment of the Company's Savings and Profit Sharing Plan, dated April 6, 2001†*
10.33	The Company's Amended and Restated Stock Option Plan for Non-Employee Directors, amended as of May 25, 2000†*
10.33.1	First Amendment to the Company's Amended and Restated Stock Option Plan for Non-Employee Directors, dated April 6, 2001†*
10.34	Western Digital Corporation Broad-Based Stock Incentive Plan(20)*
10.34.1	First Amendment to the Western Digital Corporation Broad-Based Stock Incentive Plan, dated April 6, 2001†*
10.37	Separation and Consulting Agreement dated October 1, 1999, by and between the Company and Charles A. Haggerty(18)*
10.39	Agreement dated July 6, 1999, by and between the Company and David W. Schafer(18)*
10.40	OEM Component Supply and Technology License Agreement, dated June 7, 1998, between Western Digital Corporation and IBM Corporation(13)(16)
10.41	OEM Sales and Purchase Agreement, dated June 7, 1998, between Western Digital Corporation and IBM Corporation(13)(16)
10.42	Asset Purchase Agreement, dated April 8, 1999, by and between Western Digital Corporation and Komag, Incorporated(17)(21)
10.43	Volume Purchase Agreement, dated April 8, 1999, by and between Western Digital Corporation and Komag, Incorporated(17)(21)
10.44	Agreement dated October 7, 1999, by and between the Company and Russell R. Stern(19)*
10.45	Western Digital Corporation 1999 Employee Severance Plan for U.S. Employees(19)*
10.45.1	First Amendment to the Western Digital Corporation 1999 Employee Severance Plan for U.S. Employees, dated April 6, 2001†*
10.46	Amended and Restated Purchase Agreement dated February 23, 2000, by and between Western Digital Corporation and Mayo Foundation(20)

<u>Exhibit Number</u>	<u>Description</u>
10.47	Credit Agreement, dated as of September 20, 2000, among Western Digital Technologies, Inc. and the other credit parties identified therein, General Electric Capital Corporation and Bank of America, N.A.(24)
10.47.1	First Amendment to Credit Agreement among Western Digital Technologies, Inc., the lenders identified therein and General Electric Capital Corporation and Bank of America, N.A., dated as of March 8, 2001†
10.47.2	Second Amendment to Credit Agreement among Western Digital Technologies, Inc., the lenders identified therein and General Electric Capital Corporation and Bank of America, N.A., dated as of March 23, 2001†
10.47.3	Third Amendment to Credit Agreement among Western Digital Technologies, Inc., the lenders identified therein and General Electric Capital Corporation and Bank of America, N.A., dated as of April 7, 2001†
10.48	Continuing Guaranty between the Company and General Electric Capital Corporation, dated as of April 7, 2001†
10.49	Agreement between the Company and Teresa Hopp, dated July 5, 2001†*
10.50	Connex, Inc. 1999 Stock Incentive Plan†*
10.51	Cameo Technologies, Inc. 2000 Stock Incentive Plan†*
10.52	Keen Personal Media, Inc. 2000 Stock Incentive Plan†*
10.53	SageTree, Inc. 2000 Stock Incentive Plan†*
21	Subsidiaries of the Company†
23	Consent of Independent Auditors†

† New exhibit filed with this Report.

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

- (1) Incorporated by reference to the Company's Registration Statement on Form 8-B, filed April 13, 1987.
- (2) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 28, 1992.
- (3) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on January 25, 1994.
- (4) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 23, 1994.
- (5) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 29, 1995.
- (6) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 18, 1996.
- (7) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 12, 1996.
- (8) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on February 10, 1997.
- (9) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on May 9, 1997.
- (10) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 12, 1997.

- (11) Incorporated by reference to the Company's Registration Statement on Form S-8 (No. 333-41423) as filed with the Securities and Exchange Commission on December 3, 1997.
- (12) Incorporated by reference to the Company's Registration Statement on Form S-3 (No. 333-52463) as filed with the Securities and Exchange Commission on May 12, 1998.
- (13) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 1, 1998.
- (14) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 10, 1998.
- (15) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on February 8, 1999.
- (16) Subject to confidentiality order dated October 2, 1998.
- (17) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on October 1, 1999.
- (18) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 16, 1999.
- (19) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on February 14, 2000.
- (20) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on May 15, 2000.
- (21) Subject to confidentiality order dated June 27, 2000.
- (22) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (No. 333-95499) as filed with the Securities and Exchange Commission on January 27, 2000.
- (23) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 28, 2000.
- (24) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 13, 2000.
- (25) Incorporated by reference to the Company's Current Report on Form 8-K as filed with the Securities and Exchange Commission on April 6, 2001.
- (26) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on May 14, 2001.

(b) Reports on Form 8-K:

On April 6, 2001, the Company filed a current report on Form 8-K to announce its holding company organizational structure.

On April 9, 2001, the Company filed a current report on Form 8-K to file a press release announcing its expectations of third quarter results to exceed earlier guidance.

On April 30, 2001, the Company filed a current report on Form 8-K to file its press release dated April 26, 2001, announcing its third quarter results.

On June 14, 2001, the Company filed a current report on Form 8-K to announce the sale of shares of its common stock in a private sale to an existing large institutional investor.

SIGNATURES

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

WESTERN DIGITAL CORPORATION

By: /s/ MATTHEW E. MASSENGILL
Matthew E. Massengill
President and Chief Executive Officer

Dated: September 27, 2001

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on September 27, 2001.

<u>Signature</u>	<u>Title</u>
<u> /s/ THOMAS E. PARDUN </u> Thomas E. Pardun	Chairman of the Board
<u> /s/ MATTHEW E. MASSENGILL </u> Matthew E. Massengill	President and Chief Executive Officer (Principal Executive Officer and Principal Financial Officer)
<u> /s/ JOSEPH R. CARRILLO </u> Joseph R. Carrillo	Vice President and Corporate Controller (Principal Accounting Officer)
<u> /s/ PETER D. BEHRENDT </u> Peter D. Behrendt	Director
<u> /s/ I. M. BOOTH </u> I. M. Booth	Director
<u> /s/ KATHLEEN A. COTE </u> Kathleen A. Cote	Director
<u> /s/ HENRY T. DENERO </u> Henry T. DeNero	Director
<u> /s/ ROGER H. MOORE </u> Roger H. Moore	Director

**WESTERN DIGITAL CORPORATION
SUBSIDIARIES OF THE COMPANY**

<u>Name</u>	<u>State or other Jurisdiction of Incorporation</u>
Western Digital Technologies, Inc.	Delaware
Western Digital Ventures, Inc.	Delaware
Pacifica Insurance Corporation	Hawaii
Western Digital Canada Corporation	Ontario, Canada
Western Digital (Deutschland) GmbH	Germany
Western Digital (France) SARL	France
Western Digital Hong Kong Limited	Hong Kong
Western Digital Ireland, Ltd.	Cayman Islands
Western Digital (I.S.) Limited	Ireland
Western Digital Japan Ltd.	Japan
Western Digital (Malaysia) Sdn. Bhd.	Malaysia
Western Digital Netherlands B.V.	The Netherlands
Connex, Inc.	Delaware
SANavigator, Inc.	Delaware
SageTree, Inc.	Delaware
Cameo Technologies, Inc. (FKA wdc.net.inc.)	Delaware
TereoTek, Inc.	Delaware
Keen Personal Media, Inc.	Delaware
Keen Personal Technologies, Inc.	Delaware
Western Digital (S.E.Asia) Pte Ltd	Singapore
Western Digital (Singapore) Pte Ltd	Singapore
Western Digital Taiwan Co., Ltd.	Taiwan, R.O.C.
Western Digital (Tuas - Singapore) Pte Ltd	Singapore
Western Digital (U.K.) Limited	England

Except for Connex, Inc. (“Connex”), SageTree, Inc. (“SageTree”), Keen Personal Media, Inc. (“Keen”) and SANavigator, Inc. (“SANavigator”), all of the above-named subsidiaries are 100% owned, directly or indirectly, by Western Digital Corporation. Connex, SageTree, Keen and SANavigator are each majority owned by Western Digital Corporation.

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CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
Western Digital Corporation:

We consent to the incorporation by reference in the registration statements (Nos. 2-76179, 2-97365, 33-9853, 33-24585, 33-33365, 33-56128, 33-57953, 33-15771, 33-60166, 33-60168, 33-51725, 333-20359, 333-31487, 333-41423, 333-42991, 333-70413, 333-95499, 333-36332 and 333-56738) on Form S-8 of Western Digital Corporation and in the registration statements (Nos. 333-70785, 333-36350 and 333-49250) on Form S-3 of Western Digital Corporation of our report dated July 25, 2001, except as to Notes 4 and 10, which are as of September 21, 2001, related to the consolidated balance sheets of Western Digital Corporation and subsidiaries as of June 30, 2000 and June 29, 2001 and the related consolidated statements of operations, shareholders' equity (deficiency) and cash flows for each of the years in the three-year period ended June 29, 2001, and the related financial statement schedule, which report appears in the June 29, 2001 annual report on Form 10-K of Western Digital Corporation.

KPMG LLP

Orange County, California
September 27, 2001

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CORPORATE INFORMATION

Board of Directors

Thomas E. Pardun, Chairman
Chairman and Chief Executive Officer
Edge2net
International communication company
focusing on Asian markets

Matthew E. Massengill
President and Chief Executive Officer
Western Digital Corporation

Peter D. Behrendt
Former Chairman and
Chief Executive Officer
Exabyte Corporation
Computer tape storage products

I. M. Booth
Former Chairman, President and
Chief Executive Officer
Polaroid Corporation
Photographic equipment

Kathleen A. Cote
Chief Executive Officer
Worldport Communications, Inc.
Internet managed services provider

Henry T. DeNero
Former Chairman, President and
Chief Executive Officer
Homespace, Inc.
Internet real estate and home services

Roger H. Moore
President and Chief Executive Officer
Illuminet Holdings, Inc.
Advanced intelligent network services

Corporate Officers

Matthew E. Massengill
President and
Chief Executive Officer

Arif Shakeel
Executive Vice President and
Chief Operating Officer

Teresa A. Hopp
Senior Vice President and
Chief Financial Officer

Michael A. Cornelius
Vice President
Law & Administration
and Secretary

David C. Fetah
Vice President
Human Resources

Charles W. Frank, Jr.
Vice President
Chief Technical Officer

Steven M. Slavin
Vice President
Taxes and Treasurer

Research and Development Centers

Lake Forest, California
San Jose, California

Manufacturing Facility
Malaysia

Domestic Sales Offices

Lake Forest, California
San Jose, California
Boca Raton, Florida
Burlington, Massachusetts
Princeton, New Jersey
North Sioux City, South Dakota
Austin, Texas
Carrollton, Texas
Houston, Texas

International Sales Offices

Western Digital Canada Corporation
Mississauga, Ontario, Canada

Western Digital Deutschland GmbH
Munich, Germany

Western Digital (France) Sarl
Orsay, France

Western Digital Hong Kong Limited
Kowloon, Hong Kong

Western Digital Japan Ltd.
Tokyo, Japan

Western Digital (S.E. Asia) Pte Ltd.
Singapore

Western Digital Taiwan Co., Ltd.
Taipei, Taiwan R.O.C.

Western Digital (U.K.) Limited
Leatherhead, Surrey, England
Glasgow, Scotland
Prague, Czech Republic
Dubai, UAE

Transfer Agent and Registrar

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
Telephone: 800.937.5449

Certified Public Accountants

KPMG LLP

Certain Forward-Looking Statements

This Annual Report contains forward-looking statements, including statements relating to growth in the desktop PC market for hard drives, growth in non-traditional markets for hard drives and in the consumer electronics and EIDE enterprise storage segments within those markets, expectations of continued business from OEMs, and the Company's profit outlook and financial prospects. The forward-looking statements are based on current management expectations, and actual results may differ materially as a result of several factors, including: the pace of development of new or emerging markets; successful product development by the Company and its new ventures; market acceptance of their products; pricing trends and other competitive factors; development or acquisition of the intellectual property necessary for the Company's new ventures to expand their products and services; business conditions and growth in the PC market; and other factors listed in the Company's Form 10-K for the fiscal year ended 2001 and in its other recent SEC filings. The Company undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date hereof.

Stock Exchange Listing

Western Digital common stock is listed on the New York Stock Exchange and trades under the symbol WDC.

Worldwide Web Site

For current information on Western Digital Corporation, visit our worldwide Web site at www.westerndigital.com

Western Digital and the Western Digital logo are registered trademarks, and WD Caviar, WD Protégé and WD Performer are trademarks of Western Digital Technologies, Inc. Cameo and CameoCAST are trademarks of Cameo Technologies, Inc. Keen Personal Media and TV4me are trademarks of Keen Personal Media, Inc. SageTree is a trademark of SageTree, Inc. Cameo Technologies, Inc., Keen Personal Media, Inc. and SageTree Inc. are subsidiaries of Western Digital Corporation. Other trademarks may be mentioned herein that belong to other companies.

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