

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 29, 2006

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$.01 Par Value Per Share	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 whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of the close of business on February 2, 2007, 222.0 million shares of common stock, par value \$.01 per share, were outstanding.

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We have a 52- or 53-week fiscal year, which typically ends on the Friday nearest to June 30. However, approximately every six years, we report a 53-week fiscal year to align our fiscal quarters with calendar quarters by adding a week to our fourth fiscal quarter. The quarters ended December 29, 2006 and December 30, 2005, were 13 weeks. Fiscal year 2006 was comprised of 52 weeks and ended on June 30, 2006. Fiscal year 2007 will be comprised of 52 weeks and will end on June 29, 2007. Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms “we”, “us” and “our” refer to Western Digital Corporation and its subsidiaries.

We are a Delaware corporation that operates as the parent company of our hard drive business, Western Digital Technologies, Inc., which was formed in 1970.

Our principal executive offices are located at 20511 Lake Forest Drive, Lake Forest, California 92630. Our telephone number is (949) 672-7000 and our web site is <http://www.westerndigital.com>. The information on our web site is not incorporated in this Quarterly Report on Form 10-Q.

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PART I. FINANCIAL INFORMATION**Item 1. FINANCIAL STATEMENTS**

WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except par values; unaudited)

	Dec. 29, 2006	Jun. 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 676	\$ 551
Short-term investments	154	148
Accounts receivable, net	668	481
Inventories	265	205
Advances to suppliers	76	80
Prepaid expenses and other	27	27
Total current assets	1,866	1,492
Property and equipment, net	637	549
Intangible and other assets	37	32
Total assets	<u>\$ 2,540</u>	<u>\$ 2,073</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 816	\$ 632
Accrued expenses	140	131
Accrued warranty	72	71
Current portion of long-term debt	28	25
Total current liabilities	1,056	859
Long-term debt	21	19
Other liabilities	38	38
Total liabilities	1,115	916
Commitments and contingent liabilities (Note 5)		
Shareholders' equity:		
Preferred stock, \$.01 par value; authorized — 5.0 shares; Outstanding — None	—	—
Common stock, \$.01 par value; authorized — 450.0 shares; Outstanding — 223.3 and 221.7 shares, respectively	2	2
Additional paid-in capital	802	775
Accumulated comprehensive income	—	1
Retained earnings	622	391
Treasury stock — common shares at cost; 0.2 and 0.7 shares, respectively	(1)	(12)
Total shareholders' equity	1,425	1,157
Total liabilities and shareholders' equity	<u>\$ 2,540</u>	<u>\$ 2,073</u>

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

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

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Dec. 29, 2006	Dec. 30, 2005	Dec. 29, 2006	Dec. 30, 2005
Revenue, net	\$ 1,428	\$ 1,117	\$ 2,691	\$ 2,127
Cost of revenue	1,173	889	2,218	1,720
Gross margin	<u>255</u>	<u>228</u>	<u>473</u>	<u>407</u>
Operating expenses:				
Research and development	77	76	152	147
Selling, general and administrative	56	48	100	88
Total operating expenses	<u>133</u>	<u>124</u>	<u>252</u>	<u>235</u>
Operating income	122	104	221	172
Non-operating income:				
Interest income	8	4	15	7
Interest and other expense	2	1	2	2
Total non-operating income	<u>6</u>	<u>3</u>	<u>13</u>	<u>5</u>
Income before income taxes	128	107	234	177
Income tax provision	—	3	3	4
Net income	<u>\$ 128</u>	<u>\$ 104</u>	<u>\$ 231</u>	<u>\$ 173</u>
Income per common share:				
Basic	<u>\$.58</u>	<u>\$.49</u>	<u>\$ 1.06</u>	<u>\$.81</u>
Diluted	<u>\$.57</u>	<u>\$.47</u>	<u>\$ 1.02</u>	<u>\$.78</u>
Weighted average shares outstanding:				
Basic	<u>220</u>	<u>213</u>	<u>219</u>	<u>213</u>
Diluted	<u>226</u>	<u>221</u>	<u>226</u>	<u>221</u>

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

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

	SIX MONTHS ENDED	
	Dec. 29, 2006	Dec. 30, 2005
Cash flows from operating activities		
Net income	\$ 231	\$ 173
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	94	74
Stock-based compensation	21	16
Other non-cash items	—	7
Changes in:		
Accounts receivable	(188)	(25)
Inventories	(60)	(15)
Accounts payable	193	20
Accrued expenses	8	(17)
Advances to suppliers	2	(62)
Prepaid expenses and other	(1)	(5)
Net cash provided by operating activities	<u>300</u>	<u>166</u>
Cash flows from investing activities		
Capital expenditures	(169)	(112)
Purchases of short-term investments	(6)	(54)
Redemption of short-term investments	—	73
Net cash used in investing activities	<u>(175)</u>	<u>(93)</u>
Cash flows from financing activities		
Issuance of common stock under employee plans	16	29
Repurchase of common stock	—	(26)
Repayment of long-term debt	(16)	(11)
Net cash used in financing activities	<u>—</u>	<u>(8)</u>
Net increase in cash and cash equivalents	125	65
Cash and cash equivalents, beginning of period	551	485
Cash and cash equivalents, end of period	<u>\$ 676</u>	<u>\$ 550</u>
Supplemental disclosure of cash flow information:		
Cash paid during the period for income taxes	\$ 5	\$ 3
Cash paid during the period for interest	\$ 1	\$ 1
Supplemental disclosure of non-cash investing and financing activities:		
Equipment acquired under capital lease	\$ 21	\$ 15

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

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

1. Basis of Presentation

The accounting policies followed by Western Digital Corporation (“the Company”) are set forth in Note 1 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K as of and for the year ended June 30, 2006. In the opinion of management, all adjustments necessary to fairly state the unaudited condensed consolidated financial statements have been made. All such adjustments are of a normal, recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K as of and for the year ended June 30, 2006. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

Company management makes estimates and assumptions relating to the reporting of certain assets and liabilities in conformity with U.S. GAAP. These estimates and assumptions are applied using methodologies that are consistent throughout the periods presented. However, actual results can differ from these estimates. The Company makes adjustments to these estimates and assumptions in subsequent reporting periods as more current information becomes available.

Beginning in the second quarter of 2007, the presentation within the condensed consolidated statement of cash flows for capital expenditures has been corrected to reflect capital expenditures on a cash disbursements basis in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 95, “Statement of Cash Flows.” Previously, the Company presented capital expenditures on an incurred (accrual) basis. The comparative amounts in the prior period have been corrected to conform to the current period presentation as follows (in millions):

	SIX MONTHS ENDED Dec. 30, 2005	
	Current Classification	Previous Classification
Changes in accounts payable	\$ 20	\$ 11
Net cash provided by operating activities	166	156
Capital expenditures	(112)	(102)
Net cash used in investing activities	(93)	(84)

2. Supplemental Financial Statement Data*Inventories*

	Dec. 29, 2006	Jun. 30, 2006
	(in millions)	
Inventories:		
Raw materials and component parts	\$ 17	\$ 23
Work in process	90	62
Finished goods	158	120
Total inventories	<u>\$ 265</u>	<u>\$ 205</u>

Warranty

The Company records an accrual for estimated warranty costs when revenue is recognized. Warranty covers costs of repair or replacement of the hard drive over the warranty period, which generally ranges from one to five years. This accrual is based on estimated future returns within the warranty period and costs to repair, using factory test data, historical field returns and current repair costs by product type. Return rate and repair cost estimates are reviewed quarterly and updated to reflect management’s current assessment of the impact of current results on prior expectations. If actual product return trends or costs to repair returned products demonstrate significant differences

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

from expectations, a change in the warranty accrual is made. Changes in the warranty accrual for the three and six months ended December 29, 2006 and December 30, 2005 were as follows (in millions):

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Dec. 29, 2006	Dec. 30, 2005	Dec. 29, 2006	Dec. 30, 2005
Warranty accrual, beginning of period	\$ 91	\$ 96	\$ 89	\$ 92
Charges to operations	17	19	36	41
Utilization	(13)	(10)	(24)	(20)
Changes in estimate related to pre-existing warranties	(7)	(10)	(13)	(18)
Warranty accrual, end of period	<u>\$ 88</u>	<u>\$ 95</u>	<u>\$ 88</u>	<u>\$ 95</u>

Accrued warranty also includes amounts classified in non-current liabilities of \$16 million at December 29, 2006, \$18 million at June 30, 2006, and \$17 million at December 30, 2005.

3. Income per Share

The Company computes basic income per share using the net income and the weighted average number of common shares outstanding during the period. Diluted income per share is computed using the net income and the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include outstanding employee stock options, employee stock purchase plan shares and restricted stock awards.

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

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Dec. 29, 2006	Dec. 30, 2005	Dec. 29, 2006	Dec. 30, 2005
Net income	<u>\$ 128</u>	<u>\$ 104</u>	<u>\$ 231</u>	<u>\$ 173</u>
Weighted average shares outstanding:				
Basic	220	213	219	213
Employee stock options and other	6	8	7	8
Diluted	<u>226</u>	<u>221</u>	<u>226</u>	<u>221</u>
Income per common share:				
Basic	<u>\$.58</u>	<u>\$.49</u>	<u>\$ 1.06</u>	<u>\$.81</u>
Diluted	<u>\$.57</u>	<u>\$.47</u>	<u>\$ 1.02</u>	<u>\$.78</u>
Antidilutive common share equivalents excluded	<u>2</u>	<u>6</u>	<u>2</u>	<u>9</u>

For purposes of computing diluted income per share, common share equivalents with an exercise price that exceeded the average fair market value of common stock for the period are considered antidilutive and have been excluded from the calculation of diluted shares outstanding.

4. Stock-Based Compensation

Stock-Based Compensation Expense

During the three and six months ended December 29, 2006, the Company charged to expense \$5 million and \$9 million, respectively, for stock-based compensation related to options issued under stock option and ESPP plans. At December 29, 2006, total compensation cost related to unvested stock options and ESPP issued to employees but not yet recognized was \$32 million and will be amortized on a straight-line basis over a weighted average vesting period of approximately 2.3 years.

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

Fair Value Disclosures

The fair value of stock options granted during the three and six months ended December 29, 2006 was estimated using a binomial option pricing model. The binomial model requires the input of highly subjective assumptions including the expected stock price volatility, the expected price multiple at which employees are likely to exercise stock options and the expected employee termination rate. The Company uses historical data to estimate the rate at which employee options are exercised, employee terminations, and expected stock price volatility within the binomial model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The fair value of stock options granted during the six months ended December 29, 2006 was estimated using the following weighted average assumptions:

	THREE MONTHS ENDED Dec. 29, 2006	SIX MONTHS ENDED Dec. 29, 2006
Suboptimal exercise factor	1.63	1.63
Range of risk-free interest rates	4.70% to 5.00%	4.60% to 5.00%
Range of expected stock price volatility	0.42 to 0.77	0.42 to 0.77
Weighted average expected volatility	0.61	0.61
Post-vesting termination rate	5.34%	5.33%
Dividend yield	—	—
Fair value	\$ 8.38	\$ 8.31

The fair value of ESPP shares issued are estimated at the date of issue using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes-Merton option pricing model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until options are exercised. Shares granted under the current ESPP provisions are issued on either June 1 or December 1, except for the initial offering period, which began on December 15, 2005. ESPP activity was immaterial to the condensed consolidated financial statements for the three and six months ended December 29, 2006.

Stock Options

The following table summarizes activity under the Company's stock option plans (in millions, except per share amounts):

	Number of Shares	Weighted Average Exercise Price Per Share	Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding at June 30, 2006	12.4	\$ 10.65		
Granted	0.1	17.26		
Exercised	(0.2)	9.47		
Canceled or expired	(0.1)	11.62		
Options outstanding at September 29, 2006	<u>12.2</u>	<u>\$ 10.73</u>	<u>5.9</u>	<u>\$ 102</u>
Granted	1.0	19.52		
Exercised	(0.9)	8.46		
Canceled or expired	(0.3)	18.98		
Options outstanding at December 29, 2006	<u>12.0</u>	<u>\$ 11.50</u>	<u>6.1</u>	<u>\$ 116</u>
Exercisable at December 29, 2006	<u>7.7</u>	<u>\$ 9.86</u>	<u>4.8</u>	<u>\$ 89</u>

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company's common stock for those awards that have an exercise price currently below the quoted price. As of December 29, 2006, the Company had options outstanding to purchase an aggregate of 7 million shares with an exercise price below the quoted price of the Company's stock resulting in an aggregate intrinsic value of \$116 million. During the three and six months ended December 29, 2006, the aggregate intrinsic

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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value of options exercised under the Company's stock option plans was \$11 million and \$13 million, respectively, determined as of the date of exercise. The aggregate intrinsic value of options exercised under the Company's stock option plans during the three and six months ended December 30, 2005, was \$22 million and \$28 million, respectively.

Deferred Stock Compensation

The Company granted approximately 0.5 million shares of restricted stock during the six months ended December 29, 2006. The aggregate market value of these awards was \$10 million. As of December 29, 2006, the aggregate unamortized fair value of all unvested restricted stock awards was \$29 million and will be amortized on a straight-line basis over a weighted average vesting period of approximately 1.4 years. For the three and six months ended December 29, 2006, the Company charged to expense approximately \$7 million and \$11 million, respectively, related to restricted stock awards that were vested during the period. Of the \$7 million expensed during the second quarter of fiscal 2007, \$4 million represented the incremental cost from the modification of stock awards granted prior to fiscal 2007.

5. Legal Proceedings

In the normal course of business, the Company is subject to legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of monetary liability or financial impact with respect to these matters is subject to many uncertainties and is therefore not predictable with assurance, management believes that any monetary liability or financial impact to the Company from these matters or the specified matters below, individually and in the aggregate, beyond that provided at December 29, 2006, would not be material to the Company's financial condition. However, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these legal proceedings, lawsuits and other claims could differ materially from those projected.

Since the Company's announcement on July 27, 2006 that it was conducting a company-initiated, voluntary review of its historical stock option grants, several purported derivative actions were filed nominally on behalf of the Company against certain current and former directors and officers of the Company in the United States District Court for the Central District of California and the Superior Court of the State of California for the County of Orange. These complaints assert claims for violations of Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act, accounting, breach of fiduciary duty and/or aiding and abetting, constructive fraud, waste of corporate assets, unjust enrichment, rescission, breach of contract, violation of the California Corporations Code, abuse of control, gross mismanagement, and constructive trust in connection with the Company's option granting practices. The complaints seek unspecified monetary damages and other relief against the individual defendants and certain governance reforms affecting the Company. The Company is named solely as a nominal defendant in each action. The Company has joined or intends to join the other defendants in filing motions to dismiss each action.

6. New Accounting Standards

In July 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation ("FIN") No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes." FIN No. 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The interpretation applies to all tax positions related to income taxes subject to SFAS No. 109. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN No. 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is currently evaluating the impact the adoption of FIN No. 48 will have on its consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors’ requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances, but provides clarification on acceptable fair valuation methods and applications. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of SFAS No. 157 will have on its consolidated financial statements.

In September 2006, the SEC staff published Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. This statement is effective for fiscal years ending after November 15, 2006. The Company is currently evaluating the impact the adoption of SAB 108 will have on its consolidated financial statements.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This information should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K as of and for the year ended June 30, 2006.

Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters. As used herein, the terms "we", "us" and "our" refer to Western Digital Corporation and its subsidiaries.

Forward-Looking Statements

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

- *growth in demand for hard drives in the desktop, mobile, enterprise and consumer electronics markets and factors contributing to such growth;*
- *our expansion into new hard drive markets, such as consumer electronics, retail, and enterprise, and into emerging geographic markets;*
- *increase in our sales of notebook hard drives and our on-going volume ramp of our Scorpio™ 2.5-inch hard drives;*
- *our planned use of new recording technologies;*
- *expectations regarding traditional seasonal demand trends and price declines for the hard drive industry;*
- *beliefs regarding the sufficiency of our cash, cash equivalents and short-term investments to meet our working capital needs; and*
- *beliefs regarding our operating performance and general industry conditions and their impacts on the realization of our deferred tax assets and the need to reduce all or a portion of our valuation allowance.*

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

Our Company

We design, develop, manufacture and sell hard drives. A hard drive is a device that uses one or more rotating magnetic disks to store and allow fast access to data. Hard drives are key components of computers, data storage subsystems and many consumer electronic devices.

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We sell our products worldwide to original equipment manufacturers (“OEMs”) for use in computer systems, subsystems and consumer electronics (“CE”) devices, and to distributors, resellers and retailers. Our hard drives are used in desktop computers, notebook computers, and enterprise applications such as servers, workstations, network attached storage and storage area networks. Additionally, our hard drives are used in CE applications such as digital video recorders (“DVRs”), satellite and cable set-top boxes, MP3 players, and USB thumb drives. We also sell our hard drives as stand-alone storage products and integrate them into our own WD-branded external storage products for purposes such as personal data backup and portable or expanded storage of digital music, photography, video, and other data.

Hard drives provide non-volatile data storage, which means that the data remains present when power is no longer applied to the device. Our hard drives currently include 3.5-inch, 2.5-inch and 1.0-inch form factor drives. The 3.5-inch form factor drives have capacities ranging from 36 gigabytes (“GB”) to 500 GB, nominal rotation speeds of 7,200 and 10,000 revolutions per minute (“RPM”), and offer interfaces including both Enhanced Integrated Drive Electronics (“EIDE”) and Serial Advanced Technology Attachment (“SATA”). The 2.5-inch form factor drives have capacities ranging from 40 GB to 160 GB, nominal rotation speed of 5,400 RPM, and offer both the EIDE and SATA interfaces. Our 1.0-inch form factor drives, with 4 GB and 6 GB capacities, have a nominal rotation speed of 3,600 RPM and use the CompactFlash® interface.

We assemble hard drives in Malaysia and Thailand. We also design and manufacture a substantial portion of our required magnetic heads, head gimbal assemblies and head stack assemblies in Fremont, California and Bang Pa-In, Thailand. For geographical financial data, see Part II, Item 8, Note 10 in the Notes to Consolidated Financial Statements, included in our Annual Report on Form 10-K as of and for the year ended June 30, 2006.

Market Overview

For calendar year 2006, we believe that the total market for hard drives was more than 435 million units, or over \$29 billion in sales. Over half of these unit shipments were desktop-class drives. As a result, developments in the personal computer (“PC”) market significantly impact total hard drive unit growth. We believe that the demand for hard drives in the PC market has grown in part due to:

- the overall growth of PC sales;
- the increasing needs of businesses and individuals for increased storage capacity on their PCs;
- the continuing development of software applications to manage multimedia content; and
- the increasing use of broadband Internet, including content downloaded from the Internet onto PC hard drives.

We believe several other factors affect the rate of PC unit growth, including maturing PC markets in North America and Western Europe, an increase in first-time buyers of PCs in Asia, Eastern Europe and Latin America, and the lengthening of PC replacement cycles.

We entered the mobile computing segment of the PC market in the first quarter of 2005, commencing volume production of our WD Scorpio™ family of 2.5-inch hard drives for notebook computers. We expect the mobile market, which is primarily notebook computers, to continue to grow faster than the desktop or enterprise markets in the next three years. We believe that the demand for mobile drives has grown from approximately 16% of the overall hard drive market in 2003 to 27% of the overall hard drive market in 2006. As the mobile market evolves to a higher volume market, we believe customers are placing increased emphasis on attributes such as quality, reliability, execution, flexibility, and competitive cost structures on their hard drive suppliers. These are the same attributes that have mattered for many years to customers in the high-volume desktop market. In addition to the mobile computing space, 2.5-inch hard drives are also being utilized in certain enterprise applications and in game consoles.

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The enterprise market for hard drives focuses on customers that make workstations, servers, network attached storage devices, storage area networks, and other computing systems or subsystems. We serve this market with hard drives using the SATA interface, which is similar in performance in some applications to the Small Computer Systems Interface (“SCSI”), but more cost effective than SCSI. We believe that the enterprise market has two distinct sectors: a marketplace for high-performance enterprise hard drives and a marketplace for high capacity enterprise hard drives. We believe that acceptance of SATA in both of these enterprise market sectors is growing. The emergence of a new interface, Serial Attached SCSI (SAS), the storage systems of which interconnects with SATA hard drives, is expected to offer new business opportunities for WD’s high-capacity and high-performance SATA drives. Additionally, we offer high-capacity, high reliability Parallel Advanced Technology Attachment (“PATA”) enterprise products to service video surveillance and similar PATA-based systems. Expansion of our involvement in the enterprise market may require us to make additional investments.

The use of hard drives in CE products has been a major growth area in recent years. Today’s three largest segments of this market are: (1) digital television content in applications such as DVRs; (2) audio content in applications such as consumer handheld devices, such as MP3 players; and (3) hard drives in game consoles. As all of these CE applications become increasingly sophisticated, they are taking on greater and more diverse content from a variety of hard drive intensive hosts. Since 1999, DVRs have been available for use in home entertainment systems and they offer enhanced capabilities such as pausing live television, simplifying the process of recording, cataloging recorded television programs and quickly forwarding or returning to any section of a recorded television program. The market for DVR products favors larger capacity hard drives in the 3.5-inch form factor, and continues to grow in Japan, North America, and Europe. We believe growth in this market will continue to build demand for higher capacity hard drives. Hard drives with 1.8-inch or 1.0-inch form factors primarily address the consumer handheld device and portable external storage markets. The majority of hard drives used in portable media players that play both digital audio and video content are 1.8-inch form factors. Game consoles that include hard drives primarily use the 2.5-inch form factors.

The branded products storage market features external and internal hard drives that are sold directly to end customers through retail store fronts and online stores. Our branded products include the WD My Book™ and WD Passport® Portable external hard drive families, which are WD branded PC/Mac peripheral-style enclosures housing 3.5- and 2.5-inch internal hard drives and using FireWire™, USB 2.0 and Ethernet network connections; and internal hard drives that are packaged as an installation kit with the WD brand. We believe the worldwide demand for external hard drives is growing, spurred by consumers’ expanding use of digital content in the form of photographs, video and music — all of which require large amounts of storage — and by an increasingly mobile workforce requiring secure storage of their files in a portable device.

Second Quarter Overview

The following table sets forth, for the periods indicated, selected summary information from our condensed consolidated statements of income (dollars in millions):

	THREE MONTHS ENDED				SIX MONTHS ENDED			
	Dec. 29, 2006		Dec. 30, 2005		Dec. 29, 2006		Dec. 30, 2005	
Net revenue	\$1,428	100.0%	\$1,117	100.0%	\$2,691	100.0%	\$2,127	100.0%
Gross margin	255	17.9	228	20.4	473	17.6	407	19.1
Total operating expenses	133	9.3	124	11.1	252	9.4	235	11.0
Operating income	122	8.5	104	9.3	221	8.2	172	8.1
Net income	128	9.0	104	9.3	231	8.6	173	8.1

The following is a summary of our financial performance for the second quarter of 2007:

- Our net revenue for the second quarter of 2007 totaled \$1.4 billion, an increase of 28% over the prior year’s second quarter.
- During the December quarter, 42% of our revenue was derived from newer market sources, including notebook computers, CE products, enterprise applications, and WD branded product sales, as compared to 26% in the prior year.
- Unit shipments increased by 35% over the prior year to 24.5 million.
- Operating income for the December quarter was \$122 million, an increase of 17% over the prior year’s second quarter.
- We generated \$184 million in cash flow from operations and we finished the quarter with \$830 million in cash, cash equivalents and short-term investments.

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We expect demand for the March quarter to be down slightly from the seasonally stronger December quarter. Strength in our newer markets should help to counteract some of the seasonal softness. Our gross margin percentage is anticipated to ease from the December quarter given typical seasonal factors in the desktop, consumer electronics and branded products markets, coupled with continued competition in the notebook market.

Results of Operations

Net Revenue

(in millions, except percentages & ASP)

	THREE MONTHS ENDED			SIX MONTHS ENDED		
	Dec. 29, 2006	Dec. 30, 2005	Percentage Change	Dec. 29, 2006	Dec. 30, 2005	Percentage Change
Net revenue	\$1,428	\$1,117	27.8%	\$2,691	\$2,127	26.5%
Unit shipments	24.5	18.1	35.4%	47.2	35.2	34.1%
ASP (per unit)	\$ 58	\$ 62	6.5%	\$ 57	\$ 60	5.0%

Revenues by Geography (%)

Americas	38%	32%	37%	34%
Europe	32	34	30	32
Asia	30	34	33	34

Revenues by Channel (%)

OEM	46%	56%	49%	55%
Distributors	37	39	37	39
Branded products	17	5	14	6

Revenues by Product (%)

Desktop computers	58%	74%	61%	74%
Non-desktop sources	42	26	39	26

For the quarter ended December 29, 2006, net revenue was \$1.4 billion, an increase of 28% over the quarter ended December 30, 2005. Total unit shipments increased to 24.5 million for the second quarter of 2007 as compared to 18.1 million for the second quarter of 2006. For the six months ended December 29, 2006, net revenue was \$2.7 billion, an increase of 27% over the six months ended December 30, 2005. Total unit shipments increased to 47.2 million for the six months ended December 29, 2006, as compared to 35.2 million for the same period during 2006. These unit increases resulted from higher overall demand for hard drives and an increase in our market share, in part due to our continuing diversification into non-desktop PC markets. For example, we shipped 2.7 million mobile drives in the second quarter of 2007 as compared to 1.4 million units in the second quarter of 2006. In addition, we shipped 2.7 million units to the DVR market in the second quarter of 2007 as compared to 1.5 million units in the second quarter of 2006. For the six-month period, we shipped 4.9 million units of 2.5-inch mobile drives compared to 2.5 million the year before, and we shipped 5.2 million units to the DVR market compared to 2.8 million the year before.

Average selling prices ("ASPs") for the second quarter of 2007 were approximately \$4 lower than the prior year due to normal technology industry price declines. These price declines were partially offset by an increase in sales of higher capacity products, due in part to an increase in sales of branded products. For the quarter ended December 29, 2006, branded products represented 17% of revenues as compared to 5% for the year-ago quarter. This increase is attributable to the growing worldwide acceptance of our WD My Book™ and WD Passport® external digital storage appliances. On a combined basis, revenue from non-desktop PC markets comprised 42% of total revenue for the quarter ended December 29, 2006 as compared to 26% for the year-ago quarter.

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Other changes in revenue by geography and by channel generally reflect normal fluctuations in market demand and competitive dynamics. In addition, the percentage of net revenue by channel was impacted by the significant increase in sales of our WD branded products as compared to the prior year.

Gross Margin

(in millions, except percentages)	THREE MONTHS ENDED			SIX MONTHS ENDED		
	Dec. 29, 2006	Dec. 30, 2005	Percentage Change	Dec. 29, 2006	Dec. 30, 2005	Percentage Change
Net revenue	\$1,428	\$1,117	27.8%	\$2,691	\$2,127	26.5%
Gross margin	255	228	11.8	473	407	16.2
Gross margin %	17.9%	20.4%		17.6%	19.1%	

For the three months ended December 29, 2006, gross margin as a percentage of sales declined 250 basis points from the prior-year quarter. For the six-month period, gross margin percentage declined 150 basis points from the prior year. These decreases were due primarily to normal technology industry price declines, partially offset by an increase in sales of higher capacity products, including branded products, ongoing cost reduction efforts and manufacturing efficiencies. Additionally, margins in the prior year were impacted by a more favorable pricing environment.

Gross margin includes favorable adjustments to our warranty accrual of \$7 million for the quarter ended December 29, 2006 and \$10 million for the quarter ended December 30, 2005. Gross margin for the six-month periods ended December 29, 2006 and December 30, 2005 include favorable adjustments to our warranty accrual of \$13 million and \$18 million, respectively. These favorable adjustments relate to lower customer returns and ongoing improvements in repair costs and recovery yields.

Operating Expenses

(in millions, except percentages)	THREE MONTHS ENDED			SIX MONTHS ENDED		
	Dec. 29, 2006	Dec. 30, 2005	Percentage Change	Dec. 29, 2006	Dec. 30, 2005	Percentage Change
R&D expense	\$ 77	\$ 76	1.3%	\$152	\$147	3.4%
SG&A expense	56	48	16.6	100	88	13.6
Total operating expenses	133	124	7.3	252	235	7.2

Research and development ("R&D") expense was \$77 million for the three months ended December 29, 2006 compared to \$76 million for the three months ended December 30, 2005. For the six months ended December 29, 2006, R&D expense was \$152 million, an increase of \$5 million over the six months ended December 30, 2005. These increases were primarily related to expenditures for advanced head technologies.

Selling, general and administrative ("SG&A") expense was \$56 million for the three months ended December 29, 2006, an increase of \$8 million from the prior year's comparable period. SG&A expense for the current-year period included a \$13 million bad debt expense for potentially uncollectible receivables related to a customer whose financial condition significantly deteriorated during the quarter. SG&A expense for the prior-year period included a \$7 million software abandonment charge. For the six months ended December 29, 2006, SG&A expense was \$100 million, an increase of \$12 million from the prior year's comparable period. In addition to the aforementioned factors, this increase reflects approximately \$6 million of expenses associated with the independent stock option investigation, which concluded during the second quarter of 2007.

Interest Income

Interest income was \$8 million for the December quarter, an increase of \$4 million over the prior year. For the six months ended December 29, 2006, interest income increased to \$15 million compared to \$7 million in the prior year. These increases resulted from higher average daily invested cash balances for the period and an increase in the rates of return on our investments given an increase in interest rates compared to the prior year.

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Income Tax Provision

Our income tax provision for the three months ended December 29, 2006 was \$0.3 million, or approximately 0.3% of income before taxes. For the six months ended December 29, 2006, the income tax provision was \$3 million, or 1.3% of income before taxes. Differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia and Thailand that expire at various times ranging from 2008 to 2022 and the partial utilization of net operating loss carryforwards. We currently anticipate the fiscal 2007 effective tax rate to be approximately 3%. However, our quarterly effective tax rate may fluctuate given changes in the valuation of deferred tax assets as we update our estimates of future taxable income. Each period we evaluate the need for a valuation allowance for our deferred tax assets and we adjust the valuation allowance to record net deferred tax assets only to the extent that we conclude it is more likely than not that these deferred tax assets will be realized. The realization of our deferred tax assets is primarily dependent on our ability to generate sufficient earnings in certain jurisdictions, primarily in the U.S., in future periods through the end of the second quarter of fiscal 2009. A two-year period is used due to the difficulty in accurately projecting income for longer periods of time given the cyclical nature of our industry. This assumption may change in the future based on fluctuating industry or company conditions. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters when we update our estimates of future income or re-evaluate the two-year assumption. The impact of such updates were not material to the tax provision for the three months ended December 29, 2006.

Liquidity and Capital Resources

Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing return through the full investment of available funds. A portion of our funds is invested in auction rate securities, which are short-term investments in bonds with original maturities greater than 90 days. We ended the second quarter of 2007 with total cash, cash equivalents and short-term investments of \$830 million, an increase of \$131 million from June 30, 2006. The following table summarizes our statements of cash flows for the six months ended December 29, 2006 and December 30, 2005 (in millions):

	SIX MONTHS ENDED	
	Dec. 29, 2006	Dec. 30, 2005
Net cash flow provided by (used in):		
Operating activities	\$ 300	\$ 166
Investing activities	(175)	(93)
Financing activities	—	(8)
Net increase in cash and cash equivalents	<u>\$ 125</u>	<u>\$ 65</u>

Operating Activities

Net cash provided by operating activities during the six months ended December 29, 2006 was \$300 million as compared to \$166 million during the six months ended December 30, 2005. Cash flow from operations consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash used to fund working capital changes was \$46 million for the six months ended December 29, 2006 as compared to net cash used to fund working capital changes of \$104 million for the prior year. This decrease in net cash used to fund working capital was primarily due to repayments of advances previously made to our suppliers.

Our working capital requirements primarily depend on the effective management of our cash conversion cycle, which measures how quickly we can convert our products into cash through sales. The cash conversion cycles for the six months ended December 29, 2006 and December 30, 2005 were as follows:

	SIX MONTHS ENDED	
	Dec. 29, 2006	Dec. 30, 2005
Days sales outstanding	44	38
Days in inventory	19	18
Days payables outstanding	(64)	(65)
Cash conversion cycle	<u>(1)</u>	<u>(9)</u>

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Our days sales outstanding (“DSOs”) for the six months ended December 29, 2006 increased by six days from the prior-year comparative period. This increase was due primarily to discontinuance of an early pay program offering incentives for accelerated receivable collections with one of our larger customers.

From time to time, we modify the timing of payments to our vendors. We make modifications primarily to manage our vendor relationships and to manage our cash flows, including our cash balances. Generally, we make the payment modifications through negotiations with or by granting to or receiving from our vendors payment term accommodations.

Investing Activities

Net cash used in investing activities for the six months ended December 29, 2006 was approximately \$175 million as compared to \$93 million for the six months ended December 30, 2005. Investment activities in the current six-month period included capital expenditures of \$169 compared to \$112 million for the prior-year period. The increase in capital expenditures consists primarily of investments in advanced head technologies, new product platforms and capacity for our broadening and growing product portfolio.

For fiscal 2007, capital expenditures are currently expected to be approximately \$400 million. Depreciation and amortization expense for fiscal 2007 is estimated to be approximately \$200 million.

Financing Activities

Net cash from financing activities for the six months ended December 29, 2006 was \$0.4 million as compared to net cash used in financing activities of \$8 million in the prior year. Net cash from financing activities for the six months ended December 29, 2006 consisted of \$16 million utilized for debt repayment offset by \$16 million received upon exercise of outstanding employee stock options. Net cash used in financing activities for the six months ended December 30, 2005 consisted primarily of \$11 million for debt repayments and \$26 million used to repurchase our common stock, offset by \$29 million received from issuance of stock under employee stock option and purchase plans.

Off-Balance Sheet Arrangements

Other than facility and equipment lease commitments incurred in the normal course of business and certain indemnification provisions (see “Capital Commitments” below), we do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in our unaudited condensed consolidated financial statements. Additionally, we do not have an interest in, or relationships with, any special-purpose entities.

Capital Commitments

Line of Credit — We have a \$125 million credit facility (“Senior Credit Facility”) consisting of a revolving credit line (subject to outstanding letters of credit and a borrowing base calculation) and a term loan of \$19 million as of December 29, 2006. Both the revolving credit facility and the term loan mature on September 20, 2009, and are secured by our accounts receivable, inventory, 65% of our stock in our foreign subsidiaries and other assets. For the three months ended December 29, 2006, we had no borrowings on the revolving credit line and the average variable rate on our term loan was 7.4%. The term loan requires quarterly principal payments of approximately \$3 million. Principal payments made on the term loan increase the amount of revolving credit available. At December 29, 2006, \$105 million was available for borrowing under the revolving credit line and we had \$1 million in outstanding letters of credit. As of December 29, 2006, we were in compliance with all covenants related to the Senior Credit Facility.

Purchase Orders — In the normal course of business, we enter into purchase orders with suppliers for the purchase of hard drive components used to manufacture our products. These purchase orders generally cover forecasted component supplies needed for production during the next quarter, are recorded as a liability upon receipt of the components, and generally may be changed or canceled at any time prior to shipment of the components. In some cases, we may be obligated to pay for certain costs related to changes to, or cancellation of, a purchase order, such as costs incurred for raw materials or work in process.

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We have entered into long-term purchase agreements with various component suppliers, which contain minimum quantity requirements. However, the dollar amount of the purchases may depend on the specific products ordered, achievement of pre-defined quantity or quality specifications or future price negotiations. In conjunction with these agreements, we have advanced approximately \$90 million, net of repayments, related to future purchase commitments, of which \$14 million has been classified as a long-term asset at December 29, 2006.

See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—"Capital Commitments" in our Annual Report on Form 10-K as of and for the year ended June 30, 2006, for further discussion of our purchase orders and purchase agreements and the associated dollar amounts.

We enter into, from time to time, other long-term purchase agreements for components with certain vendors. Generally, future purchases under these agreements are not fixed and determinable as they depend on our overall unit volume requirements and are contingent upon the prices, technology and quality of the supplier's products remaining competitive. See Part II, Item 1A in this Quarterly Report on form 10-Q for a discussion of these commitments.

Forward Exchange Contracts — We purchase short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. See Part I, Item 3, under the heading "Disclosure About Foreign Currency Risk," for our current forward exchange contract commitments.

Indemnifications — In the ordinary course of business, we may provide indemnifications of varying scope and terms to customers, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of our breach of such agreements, services to be provided by us, or from intellectual property infringement claims made by third parties. In addition, we have entered into indemnification agreements with our directors and certain of our officers that will require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. We maintain director and officer insurance, which may cover certain liabilities arising from our obligation to indemnify our directors and officers in certain circumstances.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Such indemnification agreements may not be subject to maximum loss clauses. Historically, we have not incurred material costs as a result of obligations under these agreements.

Stock Repurchase Program — Our Board of Directors has authorized us to repurchase \$250 million of our common stock in open market transactions. The term of the program is a five-year period from November 17, 2005 to November 17, 2010. We expect stock repurchases to be funded principally by operating cash flows. We did not repurchase any shares of common stock under our repurchase program during the second quarter of 2007. Subsequent to the end of our second quarter, we purchased 1.0 million shares for approximately \$19 million (including commissions). Since the inception of our stock repurchase program through February 2, 2007, we have repurchased 11.2 million shares for a total cost of \$134 million (including commissions). We may continue to repurchase our stock as we deem appropriate and market conditions allow.

We believe our current cash, cash equivalents and short-term investments will be sufficient to meet our working capital needs through the foreseeable future. Additionally, there can be no assurance that our Senior Credit Facility will continue to remain available. Also, our ability to sustain our working capital position is dependent upon a number of factors that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q. We currently anticipate that we will continue to utilize our liquidity and cash flows to improve the efficiency and capability of our existing hard drive and head manufacturing operations.

Critical Accounting Policies

We have prepared the accompanying unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. The preparation of the financial statements requires the use of judgment and estimates that affect the reported amounts of revenues, expenses, assets, liabilities and equity. We have adopted accounting policies and practices that are generally accepted in the industry in which we operate. We believe the following are our most critical accounting policies that affect significant areas and involve judgment and estimates made by us. If these estimates differ significantly from actual results, the impact to the consolidated financial statements may be material.

Revenue and Accounts Receivable

In accordance with standard industry practice, we have agreements with resellers that provide limited price protection for inventories held by resellers at the time of published list price reductions and other incentive programs. In accordance with current accounting standards, we recognize revenue upon delivery to OEMs and resellers and record a reduction to revenue for estimated price protection and other programs in effect until the resellers sell such inventory to their customers. We base these adjustments on anticipated price decreases during the reseller holding period, estimated amounts to be reimbursed to qualifying customers, as well as historical pricing information. If end-market demand for hard drives declines significantly, we may have to increase sell-through incentive payments to resellers, resulting in an increase in our allowances, which could adversely impact operating results.

We record an allowance for doubtful accounts by analyzing specific customer accounts and assessing the risk of loss based on insolvency, disputes or other collection issues. In addition, we routinely analyze the different receivable aging categories and establish reserves based on a combination of past due receivables and expected future losses based primarily on our historical levels of bad debt losses. If the financial condition of a significant customer deteriorates resulting in its inability to pay its accounts when due, or if our overall loss history changes significantly, an adjustment in our allowance for doubtful accounts would be required, which could affect operating results.

We establish provisions against revenue and cost of revenue for estimated sales returns in the same period that the related revenue is recognized. We base these provisions on existing product return notifications. If actual sales returns exceed expectations, an increase in the sales return accrual would be required, which could negatively affect operating results.

Warranty

We record an accrual for estimated warranty costs when revenue is recognized. Warranty covers costs of repair or replacement of the hard drive over the warranty period, which generally ranges from one to five years. We have comprehensive processes with which to estimate accruals for warranty, which include specific detail on hard drive reliability, such as factory test data, historical field return rates, and costs to repair by product type. If actual product return trends or costs to repair returned products demonstrate significant differences from expectations, a change in the warranty provision is made. If these estimates differ significantly from actual results, the impact to the consolidated financial statements may be material. For a summary of historical changes in estimates related to pre-existing warranty provisions, refer to Part I, Item 1, Note 2 of the Notes to Condensed Consolidated Financial Statements, included in this Quarterly Report on Form 10-Q.

Inventory

We value inventories at the lower of cost (first-in, first-out basis) or net realizable value. We record inventory write-downs for the valuation of inventory at the lower of cost or net realizable value by analyzing market conditions and estimates of future sales prices as compared to inventory costs and inventory balances.

We evaluate inventory balances for excess quantities and obsolescence on a regular basis by analyzing backlog, estimated demand, inventory on hand, sales levels and other information, and reduce inventory balances to net realizable value for excess and obsolete inventory based on this analysis. Unanticipated changes in technology or customer demand could result in a decrease in demand for one or more of our products, which may require an increase in inventory balance adjustments that could negatively affect operating results.

Litigation and Other Contingencies

We apply Statement of Financial Accounting Standards (“SFAS”) No. 5, “Accounting for Contingencies,” to determine when and how much to accrue for and disclose related to legal and other contingencies. Accordingly, we disclose contingencies deemed to be reasonably possible and accrue loss contingencies when, in consultation with our legal advisors, we conclude that a loss is probable and reasonably estimable (Refer to Part I, Item 1, Note 5 of the Notes to Condensed Consolidated Financial Statements, included in this Quarterly Report on Form 10-Q). The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management’s estimates.

Income Taxes

We account for income taxes under the asset and liability method, which provides that deferred tax assets and liabilities be recognized for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities and expected benefits of utilizing net operating loss (“NOL”) and tax credit carryforwards. We record a valuation allowance where it is more likely than not that the deferred tax assets will not be realized. Each period we evaluate the need for a valuation allowance for our deferred tax assets and we adjust the valuation allowance so that we record net deferred tax assets only to the extent that we conclude it is more likely than not that these deferred tax assets will be realized. The realization of our deferred tax assets is primarily dependent on our ability to generate sufficient earnings in certain jurisdictions in future periods through the end of the second quarter of fiscal 2009. A two-year period is used due to the difficulty in accurately projecting income for longer periods of time given the cyclical nature of our industry. This assumption may change in the future based on fluctuating industry or company conditions. The amount of deferred tax assets considered realizable may increase or decrease in subsequent quarters when we update our estimates of future income or re-evaluate the two-year assumption.

We record estimated liabilities for tax uncertainties. To the extent a tax position does not meet a probable level of certainty, a liability is established based on the best estimate of the amount that will not be sustained. However, the actual liability in any such contingency may be materially different from our estimates, which could result in the need to record additional tax liabilities or potentially adjust previously recorded tax liabilities.

Stock-Based Compensation

We account for all stock-based compensation in accordance with the fair value recognition provisions of SFAS No. 123-R, “Share-Based Payment”. Under these provisions, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. The fair values of all stock options granted are estimated using a binomial model, and the fair values of all ESPP shares are estimated using the Black-Scholes-Merton option pricing model. Both the binomial and the Black-Scholes-Merton models require the input of highly subjective assumptions. Under SFAS No. 123-R, we are required to use judgment in estimating the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ significantly from the original estimate, stock-based compensation expense and our results of operations could be materially impacted.

New Accounting Standards

In July 2006, the FASB issued FASB Interpretation No. 48 (“FIN No. 48”), “Accounting for Uncertainty in Income Taxes, an interpretation of Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes.” FIN No. 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The interpretation applies to all tax positions related to income taxes subject to SFAS No. 109. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN No. 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. We are currently evaluating the impact the adoption of FIN No. 48 will have on our consolidated financial statements.

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In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors’ requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances, but provides clarification on acceptable fair valuation methods and applications. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We are currently evaluating the impact the adoption of SFAS No. 157 will have on our consolidated financial statements.

In September 2006, the SEC staff published Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”). SAB 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. This statement is effective for fiscal years ending after November 15, 2006. We are currently evaluating the impact the adoption of SAB 108 will have on our consolidated financial statements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**Disclosure About Foreign Currency Risk**

Although the majority of our transactions are in U.S. Dollars, some transactions are based in various foreign currencies. We purchase short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on our results of operations. The contract maturity dates do not exceed six months. We do not purchase short-term forward exchange contracts for trading purposes. Currently, we focus on hedging our foreign currency risk related to the Thai Baht, the Euro and the British Pound Sterling. Thai Baht contracts are designated as cash flow hedges. All other contracts are designated as fair value hedges. See Part II, Item 8, Note 1 in the Notes to Consolidated Financial Statements, included in our Annual Report on Form 10-K as of and for the year ended June 30, 2006.

As of December 29, 2006, we had the following purchased foreign currency forward exchange contracts outstanding (in millions, except weighted average contract rate):

	December 29, 2006		
	Contract Amount	Weighted Average Contract Rate *	Unrealized Gain
Foreign currency forward contracts:			
Thai Baht	\$83.8	36.05	\$0.1
Euro	2.2	0.76	—
British Pound Sterling	1.5	0.51	—

* Expressed in units of foreign currency per U.S. dollar.

During the six-month periods ended December 29, 2006 and December 30, 2005, total net realized transaction and forward exchange contract currency gains and losses were not material to the condensed consolidated financial statements.

Disclosure About Other Market Risks*Variable Interest Rate Risk*

At our option, 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. If LIBOR or the base rate increases, our interest payments would also increase. At December 29, 2006, we had a \$19 million term loan outstanding under the Senior Credit Facility. A one percent increase in the variable rate of interest on the Senior Credit Facility would increase interest expense by approximately \$0.1 million annually.

Item 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective. There were no changes in our internal control over financial reporting during the quarter ended December 29, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

For a description of our legal proceedings, see Note 5 of our Unaudited Condensed Consolidated Financial Statements, which is incorporated by reference in response to this item.

Item 1A. RISK FACTORS

We have updated the risk factors discussed in Item 1A of our Annual Report on Form 10-K as of and for the year ended June 30, 2006. We do not believe any of the updates constitute material changes from the risk factors previously disclosed in our Annual Report on Form 10-K as of and for the year ended June 30, 2006.

Declines in average selling prices (“ASPs”) in the hard drive industry adversely affect our operating results.

The hard drive industry historically has experienced declining ASPs. Our ASPs tend to decline when competitors lower prices as a result of decreased costs or to absorb excess capacity, liquidate excess inventories, restructure or attempt to gain market share. Our ASPs also decline when there is a shift in the mix of product sales, and sales of lower priced products increase relative to those of higher priced products. If ASPs in the hard drive industry continue to decline, then our ASPs will also likely decline, which would adversely affect our operating results.

If we fail to anticipate or timely respond to changes in the markets for hard drives, our operating results could be adversely affected.

Over the past few years the consumer market for computers has shifted significantly towards lower priced systems. If we are not able to continue to offer a competitively priced hard drive for the low-cost PC market, our share of that market will likely fall, which could harm our operating results.

The market for hard drives is also fragmenting into a variety of devices and products. Many industry analysts expect, as do we, that as content increasingly converts to digital technology from the older, analog technology, the technology of computers and consumer electronics will continue to converge, and hard drives will be found in many CE products other than computers. In addition, we expect that the consumer market for multi-media applications, including audio-video products, incorporating high capacity, and handheld consumer storage will continue to grow. However, because this market remains relatively new, accurate forecasts for future growth remain challenging.

Moreover, some devices, such as personal video recorders and digital video recorders, or some new PC operating systems which allow greater consumer choice in levels of functionality, therefore allowing for greater market differentiation, may require attributes not currently offered in our products, resulting in a need to expend capital to develop new interfaces, form factors, technical specifications or hard drive features, increasing our overall operational expense without corresponding incremental revenue at this stage. If we are not successful in continuing to deploy our hard drive technology and expertise to develop new products for the emerging CE market, or if we are required to incur significant costs in developing such products, it may harm our operating results.

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 systems manufactured by our customers and on storage upgrades to existing systems. The demand for 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 has experienced periods of excess capacity which can lead to liquidation of excess inventories and intense price competition. If intense price competition occurs, we may be forced to lower prices sooner and more than expected, which could result in lower revenue and gross margins.

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Our failure to accurately forecast market and customer demand for our products could adversely affect our business and financial results.

The hard drive industry faces difficulties in accurately forecasting market and customer demand for its products. The variety and volume of products we manufacture is based in part on these forecasts. If our forecasts exceed actual market demand, or if market demand decreases significantly from our forecasts, then we could experience periods of product oversupply and price decreases, which could impact our financial performance. If our forecasts do not meet actual market demand, or if market demand increases significantly beyond our forecasts, then we may not be able to satisfy customer product needs, which could result in a loss of market share if our competitors are able to meet customer demands.

We also use forecasts in making decisions regarding investment of our resources. For example, as the hard drive industry transitions from the Parallel Advanced Technology Attachment (“PATA”) interface to the SATA interface, we may invest more resources in the development of products using the SATA interface. If our forecasts regarding the replacement of the PATA interface with the SATA interface are inaccurate, we may not have products available to meet our customers’ needs.

In addition, although we receive forecasts from our customers, they are not obligated to purchase the forecasted amounts. In particular, sales volumes in the distribution channel are volatile and harder to predict than sales to our OEM customers. We consider these forecasts in determining our component needs and our inventory requirements. If we fail to accurately forecast our customers’ product demands, we may have inadequate or excess inventory of our products or components, which could adversely affect our operating results.

Increases in areal density may outpace customers’ demand for storage capacity, which may lower the prices our customers are willing to pay for new products.

Historically, the industry has experienced periods of variable areal density growth rates. When the rate of areal density growth increases, the rate of increase may exceed the increase in our customers’ demand for aggregate storage capacity. Furthermore, our customers’ demand for storage capacity may not continue to grow at current industry estimates as a result of developments in the regulation and enforcement of digital rights management or otherwise. These factors could lead to our customers’ storage capacity needs being satisfied with lower capacity hard drives at lower prices, thereby decreasing our revenue. As a result, even with increasing aggregate demand for storage capacity, our ASPs could decline, which could adversely affect our results of operations.

A low cost structure is critical to our operating results and increased costs may adversely affect our operating margins and shortages of commodity materials, or use by other industries of materials used in the hard drive industry, may increase our cost structure.

A low cost structure for our products, including critical components, labor and overhead, is critical to the success of our business and our operating results depend on our ability to maintain competitive cost structures on new and established products. If our competitors are able to achieve a lower cost structure for manufacturing hard drives, and we are unable to match their cost structure, we could be at a competitive disadvantage to those competitors.

There are costs for certain commodity materials, an increase in which increases our costs of manufacturing and transporting hard drives and key components. For example, shortages of materials such as steel, aluminum and precious metals increase our costs and may result in lower operating margins if we are unable to find ways to mitigate these increased costs. The variability in the cost of oil also affects our costs and may result in lower operating margins if we are unable to pass increased costs through to our customers.

Additionally, there are certain limited supply materials, like the metals neodymium and ruthenium, which are used in the manufacturing of hard drive components. If other high volume industry demands for any of these materials increase, our costs will increase which could have an adverse affect on our operating margins.

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Changes in product life cycles could adversely affect our financial results.

Product life cycles lengthened over the four years beginning in calendar year 2002 due in large part to a decrease in the rate of hard drive areal density growth. However, with the use of perpendicular recording in hard drives beginning in calendar year 2006, especially in sub-3.5-inch form factors, we anticipate that the life cycle of these products may shorten. If product life cycles lengthen, we may need to develop new technologies or programs to reduce our costs on any particular product to maintain competitive pricing for that product. This may result in an increase in our overall expenses and a decrease in our gross margins, both of which could adversely affect our operating results. If product life cycles shorten, it may be more difficult to recover the cost of product development before the product becomes obsolete. Our failure to recover the cost of product development in the future could adversely affect our operating results.

If we fail to make the technical innovations necessary to continue to increase areal density, we may fail to remain competitive.

New products in the hard drive market typically require higher areal densities than previous product generations, posing formidable technical and manufacturing challenges. Higher areal densities require existing head and media technology to be improved or new technology developed to accommodate more data on a single disk. In addition, our introduction of new products during a technology transition increases the likelihood of unexpected quality concerns. Our failure to bring high quality new products to market on time and at acceptable costs may put us at a competitive disadvantage to companies that achieve these results.

A fundamental change in recording technology could result in significant increases in our operating expenses and could put us at a competitive disadvantage.

Currently the majority of the hard drive industry uses giant magnetoresistive head technology, which allows significantly higher storage capacities than the previously utilized thin-film head technology. However, the industry is developing and now implementing new recording technologies that may enable greater recording densities than currently available using magnetoresistive head technology, including perpendicular, current perpendicular-to-plane, and tunneling junction technology, each of which represent a significant change in fundamental recording technology. The industry is experiencing a fundamental shift in recording technology, this shift in technology is difficult to implement and historically, when the industry experiences a fundamental change in technology, any manufacturer that fails to successfully and timely adjust their designs and processes to accommodate the new technology, fails to remain competitive. There are some technologies, such as heat assisted magnetic recording, that, if they can be implemented by a competitor on a commercially viable basis, will represent a revolutionary recording technology that could put us at a competitive disadvantage.

As a result, we could incur substantial costs in developing new technologies, such as, heads, media, and tools to remain competitive. If we fail to successfully implement these new technologies, or if we are significantly slower than our competitors at implementing new technologies, we may not be able to offer products with capacities that our customers desire. Furthermore, as we attempt to develop and implement new technologies, we may become more dependent on suppliers to ensure our access to components that accommodate the new technology. For example, new recording technology requires changes in the manufacturing process of media, which may cause longer production times and reduce the overall availability of media in the industry. Additionally, the new technology requires a greater degree of integration between heads and media which may lengthen our time of development of hard drives using this technology. These results would increase our operating costs, which may negatively impact our operating results.

The difficulty of introducing hard drives with higher levels of areal density and the challenges of reducing other costs may impact our ability to achieve historical levels of cost reduction.

Storage capacity of the hard drive, as manufactured by us, is determined by the number of disks and each disk's areal density. Areal density is a measure of the amount of magnetic bits that can be stored on the recording surface of the disk. Generally, the higher the areal density, the more information can be stored on a single platter. Historically, we have been able to achieve a large percentage of cost reduction through increases in areal density. Increases in areal density mean that the average drive we sell has fewer heads and disks for the same capacity and,

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therefore, may result in a lower component cost. However, because increases in areal density have become more difficult in the hard drive industry, such increases may require increases in component costs. In addition, other opportunities to reduce costs may not continue at historical rates. Our inability to achieve cost reductions could adversely affect our operating results.

If we fail to maintain effective relationships with our major component suppliers, our supply of critical components may be at risk and our profitability could suffer.

Under our business model, we do not manufacture many of the component parts used in our hard drives, however, for some of our product families, we do make most of our own heads. 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 major component suppliers. We must also effectively integrate different products from a variety of suppliers, each of which employs variations on technology, which can impact, for example, feasible combinations of heads and media components. In August 2003, we settled litigation with a supplier who previously was the sole source of read channel devices for our hard drives. As a result of the disputes that gave rise to the litigation, our profitability was at risk until another supplier’s read channel devices could be designed into our products. Similar disputes with other strategic component suppliers could adversely affect our operating results.

Dependence on a limited number of qualified suppliers of components and manufacturing equipment could lead to delays, lost revenue or increased costs.

Certain components are available from a limited number of suppliers. Because we depend on a limited number of suppliers for certain hard drive components and manufacturing equipment, each of the following could significantly harm our operating results:

- an increase in the cost of such components or equipment;
- an extended shortage of required components or equipment;
- consolidation of key suppliers;
- failure of a key supplier’s business process; or
- the failure of key suppliers to remain in business, to remain an independent merchant supplier, to adjust to market conditions, or to meet our quality, yield or production requirements.

Our future operating results may also depend substantially on our suppliers’ ability to timely qualify their components in our programs, and their ability to supply us with these components in sufficient volumes to meet our production requirements. A number of the components that we use are available from only a single or limited number of qualified outside suppliers, and may be used across multiple product lines. In addition, some of the components (or component types) used in our products are used in other devices, such as mobile telephones and digital cameras. If there is a significant simultaneous upswing in demand for such a component (or component type) from several high volume industries, resulting in a supply reduction, or a component is otherwise in short supply, or if a supplier fails to qualify or has a quality issue with a component, we may experience delays or increased costs in obtaining that component. For example, in the last year the hard drive industry faced a tightness in the availability of materials used in the manufacture of magnetic components, such as heads, media and magnets. If we are unable to obtain sufficient quantities of materials used in the manufacture of magnetic components, or other necessary components, we may experience production delays which could cause us loss of revenue. If a component becomes unavailable, we could suffer significant loss of revenue.

In addition, certain equipment we use in our manufacturing or testing processes is available only from a limited number of suppliers. Some of this equipment uses materials that at times could be in short supply. If these materials are not available, or are not available in the quantities we require for our manufacturing and testing processes, our ability to manufacture our products could be impacted, and we could suffer significant loss of revenue.

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Contractual commitments with component suppliers may result in us paying increased charges and cash advances for such components.

To reduce the risk of component shortages, we attempt to provide significant lead times when buying these components. As a result, we may be subject to cancellation charges if we cancel orders, which may occur when we make technology transitions or when our component needs change. In addition, we have entered into contractual commitments with component suppliers, such as suppliers of media, and may enter into contractual commitments with other component suppliers, in an effort to increase and stabilize the supply of those components, and enable us to purchase such components at favorable prices. Some of these commitments require or may require us to buy a substantial number of components from the supplier or make significant cash advances to the supplier, however these commitments may not result in a satisfactory increase or stabilization of the supply of such components.

Our high-volume hard drive manufacturing facilities, and the manufacturing facilities of many of our suppliers, are in Malaysia and Thailand, which subjects us to the risk of damage or loss of any of these facilities and localized risks to personnel in these locations.

Our high-volume hard drive manufacturing facilities, as well as the manufacturing facilities of a substantial portion of our suppliers, are in Malaysia and Thailand. A fire, flood, earthquake or other disaster, condition or event such as a power outage, political instability or civil unrest that adversely affects any of these facilities or our ability to manufacture could limit the total volume of hard drives we are able to manufacture and result in a loss of sales and revenue and harm our operating results. Similarly, a localized health risk affecting our personnel in Malaysia and Thailand, such as a new pandemic influenza in Asia Pacific, could impair the total volume of hard drives that we are able to manufacture.

Our head manufacturing operations include a single wafer fabrication facility in Fremont, California and a single head gimbal/head stack assembly facility in Bang Pa-In, Thailand, which subjects us to substantial risk of damage or loss if operations at either of these facilities are disrupted.

As we have previously discussed in public statements, our business plan presently contemplates that we plan to design and manufacture approximately 70% of the heads required for the hard drives we manufacture. We fabricate wafers in our Fremont, California facility, and the wafers are then sent to our Thailand facility for slider fabrication/wafer slicing, HGA assembly and testing, and HSA assembly and testing. A fire, flood, earthquake or other disaster, condition or event such as a power outage that adversely affects our facilities in Fremont, California or Bang Pa-In, Thailand would significantly affect our supply of heads and limit our ability to manufacture hard drives which would result in a substantial loss of sales and revenue and a substantial harm to our operating results.

Our head manufacturing operations may result in additional costs and risks to our business.

Our vertical integration of head manufacturing resulted in a fundamental change in our operating structure, as we now manufacture heads for use in many of the hard drives we manufacture. Consequently, we make more capital investments than we would if we were not vertically integrated and carry a higher percentage of fixed costs than assumed in our prior financial business model. If the overall level of production decreases for any reason, and we are unable to reduce our fixed costs to match sales, our head manufacturing assets may face under-utilization that may impact our results of operations. We are therefore subject to additional risks related to overall asset utilization, including the need to operate at high levels of utilization to drive competitive costs, and the need for assured supply of components, especially hard drive media, that is optimized to work with our heads.

In addition, we may incur additional risks, including:

- insufficient head sources if we are unable to manufacture a sufficient supply of heads to satisfy our needs;
- third party head suppliers may not continue to do business with us or may not do business with us on the same terms and conditions we have previously enjoyed;
- claims that our manufacturing of heads may infringe certain intellectual property rights of other companies; and
- difficulties locating suitable manufacturing equipment for our head manufacturing processes and replacement parts for such equipment.

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If we do not adequately address the challenges related to our head manufacturing operations, our ongoing operations could be disrupted, resulting in a decrease in our revenue or profit margins and negatively impacting our operating results.

Our operating results will be adversely affected if we fail to optimize the overall quality, time-to-market and time-to-volume of new and established products.

To achieve consistent success with our customers who manufacture computers, systems and CE products, we must balance several key attributes such as time-to-market, time-to-volume, quality, cost, service, price and a broad product portfolio. If we fail to:

- maintain overall quality of products on new and established programs;
- produce sufficient quantities of products at the capacities our customers demand while managing the integration of new and established technologies;
- develop and qualify new products that have changes in overall specifications or features that our customers may require for their business needs;
- obtain commitments from our customers to qualify new products, redesigns of current products, or new components in our existing products;
- qualify these products with key customers on a timely basis by meeting all of our customers' needs for performance, quality and features;
- maintain an adequate supply of components required to manufacture our products;
- maintain the manufacturing capability to quickly change our product mix between different capacities, form factors and spin speeds in response to changes in customers' product demands; or
- consistently meet stated quality requirements on delivered products,

our operating results will be adversely affected.

If we are unable to timely and cost-effectively develop heads with leading technology and overall quality, our ability to sell our products may be significantly diminished, which could materially and adversely affect our business and financial results.

Under our business plan, we are developing and manufacturing a substantial portion of the heads used in some of the product families of hard drives we manufacture. Consequently, we are more dependent upon our own development and execution efforts and less able to take advantage of head technologies developed by other head manufacturers. Technology transition for head designs is critical to increasing our volume production of heads. There can be no assurance, however, that we will be successful in timely and cost-effectively developing and manufacturing heads for products using future technologies. We also may not effectively transition our head design and head technology to achieve acceptable manufacturing yields using the technologies necessary to satisfy our customers' product needs, or we may encounter quality problems with the heads we manufacture. In addition, we may not have access to external sources of supply without incurring substantial costs. For example, we recently began using perpendicular recording heads in certain of our products. We face various challenges in ramping the manufacturing volume of these products and if we do not adequately address these challenges, or if we encounter quality problems with the heads we manufacture for these products, our continued shipment of these products may be delayed, impairing our ability to realize revenue from these products.

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If we fail to qualify our products with our customers, they may not purchase any units of a particular product line, which would have a significant adverse impact on our sales.

We 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, failures or delays 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 OEMs, which continue to consolidate their share of the desktop, mobile and CE markets. If product life cycles continue to be extended due to a decrease in the rate of areal density growth, we may have a significantly longer period to wait before we have an opportunity to qualify a new product with a customer, which could harm our competitive position. These risks are increased because we expect cost improvements and competitive pressures to result in declining gross margins on our current generation products.

We are subject to risks related to product defects, which could result in product recalls and could subject us to warranty claims in excess of our warranty provisions or which are greater than anticipated due to the unenforceability of liability limitations.

We warrant the majority of our products for periods of one to five years. We test our hard drives in our manufacturing facilities through a variety of means. However, there can be no assurance that our testing will reveal latent defects in our products, which may not become apparent until after the products have been sold into the market. Accordingly, there is a risk that product defects will occur, which could require a product recall. Product recalls can be expensive to implement and, if a product recall occurs during the product's warranty period, we may be required to replace the defective product. In addition, a product recall may damage our relationship with our customers, and we may lose market share with our customers, including our OEM customers.

Our standard warranties contain limits on damages and exclusions of liability for consequential damages and for misuse, improper installation, alteration, accident or mishandling while in the possession of someone other than us. We record an accrual for estimated warranty costs at the time revenue is recognized. We may incur additional operating expenses if our warranty provision does not reflect the actual cost of resolving issues related to defects in our products. If these additional expenses are significant, it could adversely affect our business, financial condition and results of operations.

Current or future competitors may gain a technology advantage or develop an advantageous cost structure that we cannot match.

It may be possible for our current or future competitors to gain an advantage in product technology, manufacturing technology, or process technology, which may allow them to offer products or services that have a significant advantage over the products and services that we offer. Advantages could be in capacity, performance, reliability, serviceability, or other attributes.

Higher capacity storage needs have typically been better served by magnetic hard drives than flash memory as hard drive manufacturers can offer better value at high capacities, while lower capacity needs have been successfully served by solid state storage such as flash memory technology. 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 we fail to be cost competitive against flash memory, we could be at a competitive disadvantage to competitors using semiconductor technology. For example, flash memory recently achieved improvements in their cost structure and we believe reduced their pricing, thus more effectively competing with our 1.0-inch hard drive product. If we are unable to lower the cost structure of future generations of sub-2.5-inch form factor hard drive products through technology advances such as increased storage capacity, this product category could be at a competitive disadvantage to flash technology.

Further industry consolidation could provide competitive advantages to our competitors.

The hard drive industry has experienced consolidation over the past several years. Consolidation by our competitors may enhance their capacity, abilities and resources and lower their cost structure, causing us to be at a competitive disadvantage. Additionally, continued industry consolidation may lead to uncertainty in areas such as component availability, which could negatively impact our cost structure.

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Sales in the distribution channel are important to our business, and if we fail to maintain brand preference with our distributors or if distribution markets for hard drives weaken, our operating results could suffer.

Our distribution customers typically sell to small computer manufacturers, dealers, systems integrators and other resellers. We face significant competition in this channel as a result of limited product qualification programs and a significant focus on price and availability of product. If we fail to remain competitive in terms of our technology, quality, service and support, our distribution customers may favor our competitors, and our operating results could suffer. We also face significant risk in the distribution market for hard drives. If the distribution market weakens as a result of a slowing PC growth rate, technology transitions or a significant change in consumer buying preference from white box to branded PCs, or we experience significant price declines due to oversupply in the distribution channel, then our operating results would be adversely affected.

The hard drive industry is highly competitive and can be characterized by significant 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 attempting to 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. We also face competition from other companies that produce alternative storage technologies like flash memory. These factors, taken together, may result in significant shifts in market share among the industry's major participants. In addition, product recalls can lead to a loss of market share, which could adversely affect our operating results.

Some of our competitors with diversified business units outside the hard drive industry periodically sell disk drives at prices that we cannot profitably match.

Some of our competitors earn a significant portion of their revenue from business units outside the hard drive industry. Because they do not depend solely on sales of hard drives to achieve profitability, they periodically sell hard drives at lower prices and operate their hard drive business unit at a loss while still remaining profitable overall. In addition, if these competitors can increase sales of non-hard drive products to the same customers, they may benefit from selling their hard drives at low prices. Our results of operations may be adversely affected if we can not successfully compete with the pricing by these companies.

If we do not successfully expand into new hard drive markets and transition the features of our products, our business may suffer.

To remain a significant supplier of hard drives, we will need to offer a broad range of hard drive products to our customers. We currently offer a variety of 3.5-inch hard drives for the desktop, enterprise, CE and external storage markets, and we also offer 2.5-inch form factor hard drives for the mobile, CE and external storage markets. However, demand for hard drives may shift to products in smaller other form factors, which our competitors may already offer. We entered into the sub-2.5-inch hard drive market with a 1.0-inch hard drive product, however the demand for the 1.0-inch form factor drive has been significantly less than our initial estimates of this market, thus impairing our ability to realize revenue and profit from this product.

In addition, to handle higher data transfer rates, the PC and enterprise markets are transitioning from parallel interfaces, such as PATA and SCSI, to serial interfaces, such as SATA and SAS, respectively. We must effectively manage the transition of the features of our products to serial interfaces in order to remain competitive and cost effective. For example, in the PC market, we currently offer PATA and SATA products and must timely and efficiently manage both our manufacture of PATA products through their end of life and our ramp of SATA products and features. If we fail to successfully manage the transition from parallel interfaces to serial interfaces, our business may suffer.

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While we continue to develop new products and look to expand into other hard drive markets, the success of our new product introductions is dependent on a number of factors, including difficulties faced in manufacturing ramp, market acceptance, effective management of inventory levels in line with anticipated product demand, and the risk that our new products may have quality problems or other defects in the early stages of introduction that were not anticipated in the design of those products. Further, we need to identify how any of the hard drive markets that we are expanding into may have different characteristics from the desktop market, such as, demand volume growth rates, demand seasonality, product generations development rates, customer concentrations, and cost and performance requirements, and we must properly address these differences. If we fail to successfully develop and manufacture new products and expand into new hard drive markets, customers may decrease the amount of our products that they purchase, and we may lose business to our competitors who offer these products.

Expanding into new hard drive markets exposes our business to different seasonal demand cycles, which in turn could adversely affect our operating results.

The CE markets that we are attempting to expand into have different seasonal pricing and volume demand cycles as compared to the PC market. By expanding into these markets, we become exposed to seasonal fluctuations that are different than, and in addition to, those of the PC market. For example, because the primary customer for products such as consumer handheld devices and game consoles are individual consumers, these markets experience a dramatic increase in demand during the winter holiday season. If we do not properly adjust our supply to new demand cycles such as this, we risk having excess inventory during periods of low demand and insufficient inventory during periods of high demand, therefore adversely affecting our operating results.

If we do not successfully continue to expand into the mobile market, or if we do not accurately predict the growth and demands of the mobile market, our business may suffer.

We began shipping 2.5-inch form factor hard drives for the mobile market during calendar year 2004. If we are unable to successfully continue to expand into the mobile market, we would have a competitive disadvantage to companies that are successful in this regard, and our business and financial results could suffer. To increase the sale of our products in the mobile market, we must adapt to the differences between the desktop and mobile markets, such as different requirements, features and competitors. In addition, if we continue to incur significant costs in manufacturing and selling the 2.5-inch hard drives, and if we are unable to recover those costs from sales of the products, then we may not be able to compete successfully in this market and our operating results may suffer.

Furthermore, if we do not accurately predict the future growth and demands of the mobile market, our business may suffer. For example, if the volume demand of the PC market shifts from desktop computers to mobile computers at a faster rate than we anticipate, we would be at a more significant competitive disadvantage to companies who have been more successful in the mobile market.

Selling to the retail market is an important part of our business, and if we fail to maintain and grow our market share or gain market acceptance of our branded products, our operating results could suffer.

We sell our branded products directly to a select group of major retailers, for example, computer superstores and CE stores, and authorize sales through distributors to other retailers and online resellers. Our current retail customer base is primarily in the United States, Canada and Europe. We are facing increased competition from other companies for shelf space at major retailers, which could result in lower revenues. If we fail to successfully maintain a customer preference for Western Digital brand products or fail to successfully expand into multiple channels, our operating results may be adversely affected. In certain markets, we are trying to grow market share, and in the process may face strong competition, which could result in lower gross margins. We will continue to introduce new products in the retail market that incorporate our disk drives. There can be no assurance that these products gain market acceptance, and if they do not, our operating results could suffer.

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

A majority of our revenue comes from about a dozen customers. For example, during 2006, one customer, Dell, accounted for more than 12% of our revenue, and sales to our top 10 customers, including Dell, accounted for 47% of revenue. These customers have a variety of suppliers to choose from and therefore can make substantial demands

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on us, including demands on product pricing and on contractual terms, which often results in the allocation of risk to us as the supplier. 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 may be able to cancel an order or 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, 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, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship then our operating results would likely be harmed. In addition, if customer pressures require us to reduce our pricing such that our gross margins are diminished, we could decide not to sell our products to a particular customer, which could result in a decrease in our revenue.

We may be unable to retain our key personnel and skilled employees.

Our success depends upon the continued contributions of our key personnel and skilled employees, many of whom would be extremely difficult to replace. Worldwide competition for skilled employees in the hard drive industry is intense. Volatility or lack of positive performance in our stock price may adversely affect our ability to retain key personnel or skilled employees who have received equity compensation. If we are unable to retain our existing key personnel or skilled employees, or hire and integrate new key personnel or skilled employees, or if we fail to implement a succession plan to prepare qualified individuals to join us upon the departure of a member of our key personnel, our operating results would likely be harmed.

Manufacturing and marketing our products abroad subjects us to numerous risks.

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

- obtaining requisite United States of America and foreign governmental permits and approvals;
- currency exchange rate fluctuations or restrictions;
- political instability and civil unrest;
- limited transportation availability, delays, and extended time required for shipping, which risks may be compounded in periods of price declines;
- higher freight rates;
- labor problems;
- trade restrictions or higher tariffs;
- exchange, currency and tax controls and reallocations;
- increasing labor and overhead costs; and
- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

While neither the 2006 Thai coup d'état nor recent terrorist bombings in Bangkok had any appreciable impact on our manufacturing operations, these events illustrate the risks associated with our foreign manufacturing operations and foreign marketing efforts and the importance to our business of stability in the countries in which we operate.

Terrorist attacks may adversely affect our business and operating results.

The continued threat of terrorist activity and other acts of war or hostility have created uncertainty in the financial and insurance markets and have significantly increased the political, economic and social instability in some of the geographic areas in which we operate. Additionally, it is uncertain what impact the reactions to such acts by various governmental agencies and security regulators worldwide will have on shipping costs. Acts of

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terrorism, either domestically or abroad, could create further uncertainties and instability. To the extent this results in disruption or delays of our manufacturing capabilities or shipments of our products, our business, operating results and financial condition could be adversely affected.

Sudden disruptions to the availability of air freight could have an impact on our operations.

We ship our products to our various customers via air freight. The sudden unavailability of air cargo operations used to ship our products would impair our ability to deliver our products in a timely and efficiently manner, which could adversely impact our operating results.

We face litigation risks relating to our historical stock option grants that could have a material adverse effect on the operation of our business.

Several purported derivative actions were filed nominally on our behalf against certain of our current and former directors and officers in connection with our historical stock option granting practices. See Part I, Item 3, "Legal Proceedings" for a more detailed description of these proceedings. We are and may in the future be subject to other litigation or government investigations arising in connection with such option practices. These proceedings may be time-consuming, expensive and disruptive to normal business operations, and the outcome of any such proceeding is difficult to predict. The defense of such lawsuits or investigations could result in significant expense and the diversion of our management's time and attention from the operation of our business, which could impede our ability to achieve our business objectives. Some or all of the amount we may be required to pay to defend or to satisfy a judgment or settlement of any or all of these proceedings may not be covered by insurance.

Under indemnification agreements we have entered into with our current and former officers and directors, we are required to indemnify them, and advance expenses to them, in connection with their participation in proceedings arising out of their service to us. These payments may be material.

The nature of our business and 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. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may result in adverse rulings or decisions. We may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on our business, financial condition or results of operations.

We evaluate notices of alleged patent infringement and notices of patents from patent holders that we receive from time to time. If claims or actions are asserted against us, we may be required to obtain a license or cross-license, modify our existing technology or design a new non-infringing technology. Such licenses or design modifications can be extremely costly. In addition, we may decide to settle a claim or action against us, which settlement could be 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 contractual provisions 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.

Environmental regulation costs could harm our operating results.

We may be subject to various state, federal and international laws and regulations governing the environment, including those restricting the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling and disposal of certain products. Such laws and regulations have been passed in several jurisdictions in which we operate, including various European Union member countries. For example, the European Union has enacted the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) and the Waste Electrical and Electronic Equipment (WEEE) directives. RoHS prohibits the use of certain substances, including lead, in certain products, including hard drives, put on the market after July 1, 2006. The WEEE directive obligates parties that place electrical and electronic equipment onto the market in the EU to put a clearly identifiable mark on the equipment, register with and report to EU member countries regarding distribution of the equipment, and provide a mechanism to take-back and properly dispose of the equipment. There is still some uncertainty in certain EU countries as to which party involved in the manufacture, distribution and sale of electronic equipment will be ultimately responsible for registration, reporting and disposal. Similar legislation may be enacted in other locations where we manufacture or sell our products, such as Asia. We will need to ensure that we comply with such laws and regulations as they are enacted, and that our component suppliers also timely comply with such laws and regulations. If we fail to timely comply with the legislation, our customers may refuse to purchase our products, which would have a materially adverse effect on our business, financial condition and results of operations.

In connection with our compliance with such environmental laws and regulations, we could incur substantial costs and be subject to disruptions to our operations and logistics. In addition, if we were found to be in violation of these laws, we could be subject to governmental fines and liability to our customers. If we have to make significant capital expenditures to comply with environmental laws, or if we are subject to significant expenses in connection with a violation of these laws, our financial condition or operating results could suffer.

Fluctuations in currency exchange rates as a result of our international operations may negatively affect our operating results.

Because we manufacture our products abroad, our operating costs are subject to fluctuations in foreign currency exchange rates. Further fluctuations in the exchange rate of the Thai Baht and of the Malaysian Ringgit may negatively impact our operating results.

The Thai Baht is a free floating currency while the Malaysian Ringgit exchange rate policy is one of a managed float. We have attempted to manage the impact of foreign currency exchange rate changes by, among other things, entering into short-term, forward contracts. However, these contracts do not cover our full exposure and can be canceled by the issuer if currency controls are put in place. Currently, we hedge the Thai Baht, Euro and British Pound Sterling with forward contracts.

If the U.S. dollar exhibits sustained weakness against most foreign currencies, the U.S. dollar equivalents of unhedged manufacturing costs could increase because a significant portion of our production costs are foreign-currency denominated. Conversely, there would not be an offsetting impact to revenues since revenues are substantially U.S. dollar denominated.

Increases in our customers' credit risk could result in credit losses and an increase in our operating costs.

Some of our OEM customers have adopted a subcontractor model that requires us to contract directly with companies that provide manufacturing services to our OEM customers. Because these subcontractors are generally not as well capitalized as our direct OEM customers, this subcontractor model exposes us to increased credit risks. Our agreements with our OEM customers may not permit us to increase our product prices to alleviate this increased credit risk. Additionally, as we attempt to expand our OEM and distribution channel sales into emerging economies such as Brazil, Russia, India and China, the customers in these regions may have a relatively short operating history, making it more difficult for us to accurately assess the associated credit risks. Any credit losses we may suffer as a result of these increased risks, or as a result of credit losses from any significant customer, would increase our operating costs, which may negatively impact our operating results.

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

We often ship a high percentage of our total quarterly sales in the third month of the quarter, which makes it difficult for us to forecast our financial results before the end of the quarter. 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 availability of components that we obtain from a single or a limited number of suppliers;
- competition and consolidation in the data storage industry;
- seasonal and other fluctuations in demand for PCs often due to technological advances; and
- availability and rates of transportation.

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

We have made and continue to make a number of estimates and assumptions relating to our consolidated financial reporting. The highly technical nature of our products and the rapidly changing market conditions with which we deal means that actual results may differ significantly from our estimates and assumptions. These changes have impacted our financial results in the past and may continue to do so in the future. Key estimates and assumptions for us include:

- accruals for warranty costs related to product defects;
- price protection adjustments and other sales promotions and allowances on products sold to retailers, resellers and distributors;
- inventory adjustments for write-down of inventories to lower of cost or market value (net realizable value);
- reserves for doubtful accounts;
- accruals for product returns;
- accruals for litigation and other contingencies; and
- reserves for deferred tax assets.

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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 or industry consolidation;
- developments with respect to patents or proprietary rights;
- conditions and trends in the hard drive, computer, data and content management, storage and communication industries; and
- changes in financial estimates by securities analysts relating specifically to us or the hard drive industry in general.

In addition, general economic conditions may cause the stock market to experience extreme price and volume fluctuations from time to time that particularly affect the stock prices of many high technology companies. These fluctuations often appear to be 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 should any new lawsuits be filed, such 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 the risks described herein, in the future we may be unable to maintain adequate financial resources for capital expenditures, expansion or acquisition activity, working capital and research and development. We have a credit facility which matures on September 20, 2009. 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 acceptable terms. An equity financing could also be dilutive to our existing stockholders.

If our internal controls are found to be ineffective, our financial results or our stock price may be adversely affected.

Our most recent evaluation resulted in our conclusion that as of December 29, 2006, in compliance with Section 302 of the Sarbanes-Oxley Act of 2002, our disclosure controls and procedures were effective. We believe that we currently have adequate internal control procedures in place for future periods; however, if our internal controls are found to be ineffective, our financial results or our stock price may be adversely affected.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(c) The following table provides information about repurchases by us of our common stock during the quarter ended December 29, 2006:

	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share(1)</u>	<u>Total Number of Shares Purchased As Part of Publicly Announced Program</u>	<u>Maximum Value of Shares that May Yet be Purchased Under the Program(2)</u>
Sept. 30, 2006 — Oct. 27, 2006	2,359(3)	\$ 18.09	—	\$ 135,922,313
Oct. 28, 2006 — Nov. 24, 2006	54,541(3)	\$ 21.41	—	\$ 135,922,313
Nov. 25, 2006 — Dec. 29, 2006	1,787(3)	\$ 20.52	—	\$ 135,922,313
Total	<u>58,687</u>	<u>\$ 21.25</u>	<u>—</u>	<u>\$ 135,922,313</u>

(1) Average price paid per share excludes commission.

(2) As announced on November 21, 2005, our Board of Directors has authorized us to repurchase \$250 million of our common stock in open market transactions. The term of the program is a five-year period from November 17, 2005 to November 17, 2010.

(3) Represents shares delivered by our employees to us to satisfy tax-withholding obligations upon the vesting of restricted stock.

Our Senior Credit Facility prohibits us from paying cash dividends on our common stock.

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Item 6. EXHIBITS

<u>Exhibit No.</u>	<u>Description</u>
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Incorporated by reference to the Company's Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on February 8, 2006)
3.3	Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of May 10, 2006 (Incorporated by reference to the Company's Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on May 16, 2006)
10.16.2	Letter Agreement, dated November 15, 2006, between Western Digital Corporation and Hossein M. Moghadam†*
10.18.6	Letter Agreement, dated November 15, 2006, between Western Digital Corporation and John F. Coyne†*
10.22	Western Digital Corporation Executive Severance Plan, effective February 16, 2006†*
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002†
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002†

† Exhibit filed with this Report.

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

WESTERN DIGITAL CORPORATION
Registrant

/s/ Stephen D. Milligan

Stephen D. Milligan
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ Joseph R. Carrillo

Joseph R. Carrillo
Vice President and Corporate Controller
(Principal Accounting Officer)

Date: February 6, 2007

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[WESTERN DIGITAL LOGO]

Western Digital Corporation
20511 Lake Forest Drive
Lake Forest, California 92630

Tel: 949.672.7821

RAYMOND M. BUKATY
Senior Vice President, Administration
General Counsel & Secretary

November 15, 2006

Hossein M. Moghadam
c/o Western Digital Corporation
20511 Lake Forest Drive
Lake Forest, California 92630

RE: AMENDMENT OF RESTRICTED STOCK AWARD AGREEMENT

Dear Hossein:

Reference is made to that certain Notice of Grant of Restricted Stock and Restricted Stock Agreement between you and Western Digital Corporation, a Delaware corporation (the "COMPANY"), with an award date of November 17, 2005 (the "AGREEMENT"). Capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed to them in the Agreement.

The purpose of this letter agreement is to amend the vesting schedule set forth on the cover page of your Agreement so that the installment of shares of Restricted Stock currently scheduled to vest on November 17, 2006 shall instead be scheduled to vest on the earlier to occur of (i) the first business day after the day on which the mandatory trading restriction applicable to the Company's directors and executive officers pursuant to Regulation BTR under the Securities Exchange Act of 1934, as amended, ends, or (ii) December 29, 2006.

This letter agreement does not modify any other terms of the Agreement except as expressly set forth above.

If this letter accurately sets forth our agreement with respect to the foregoing matters, please sign the enclosed copy of this letter and return it to me.

Sincerely,

/s/ Raymond M. Bukaty

Raymond M. Bukaty
Senior Vice President, Administration,
General Counsel and Secretary

Acknowledged and Agreed:

By: /s/ Hossein M. Moghadam

Hossein M. Moghadam

[WESTERN DIGITAL LOGO]

Western Digital Corporation
20511 Lake Forest Drive
Lake Forest, California 92630

Tel: 949.672.7821

RAYMOND M. BUKATY
Senior Vice President, Administration
General Counsel & Secretary

November 15, 2006

John F. Coyne
c/o Western Digital Corporation
20511 Lake Forest Drive
Lake Forest, California 92630

RE: AMENDMENT OF RESTRICTED STOCK AWARD AGREEMENT

Dear John:

Reference is made to that certain Notice of Grant of Restricted Stock and Restricted Stock Agreement between you and Western Digital Corporation, a Delaware corporation (the "COMPANY"), with an award date of November 17, 2005 (the "AGREEMENT"). Capitalized terms used herein and not otherwise defined herein shall have the meanings ascribed to them in the Agreement.

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This letter agreement does not modify any other terms of the Agreement except as expressly set forth above.

If this letter accurately sets forth our agreement with respect to the foregoing matters, please sign the enclosed copy of this letter and return it to me.

Sincerely,

/s/ Raymond M. Bukaty

Raymond M. Bukaty
Senior Vice President, Administration,
General Counsel and Secretary

Acknowledged and Agreed:

By: /s/ John F. Coyne

John F. Coyne

WESTERN DIGITAL CORPORATION
EXECUTIVE SEVERANCE PLAN

1. PURPOSE

The purpose of the Plan is to provide severance benefits to certain Executives whose employment with the Company or a Subsidiary terminates under certain circumstances as described more fully herein.

2. EFFECTIVE DATE

All of the policies and practices of the Company and its Subsidiaries regarding severance benefits or similar payments upon employment termination with respect to Executives in the United States, other than written employment, separation or equity award agreements with the Company or a Subsidiary that provide severance benefits or the Company's Amended and Restated Change of Control Severance Plan, are hereby superseded by the Plan, which shall be known as the Western Digital Corporation Executive Severance Plan, effective as of the Effective Date.

3. DEFINITIONS

3.1 "Administrator" means the Committee or any delegate of such committee acting within the authority delegated to it pursuant to Section 9.1.

3.2 "Base Pay" means the employee's wages earned on a monthly basis, determined as of the employment termination date, excluding bonuses and commissions.

3.3 "Cause" means the occurrence or existence of any of the following with respect to an Executive:

(a) the Executive's conviction by, or entry of a plea of guilty or nolo contendere in, a court of competent jurisdiction for any crime involving moral turpitude or any felony punishable by imprisonment in the jurisdiction involved;

(b) whether prior or subsequent to the Effective Date, the Executive's willful engaging in dishonest or fraudulent actions or omissions;

(c) failure or refusal to perform his or her duties as reasonably required by the Company and/or a Subsidiary that employs the Executive;

(d) negligence, insubordination, violation by the Executive of any duty (of loyalty or otherwise) owed to the Company and/or a Subsidiary, or any other misconduct on the part of the Executive;

(e) repeated non-prescription use of any controlled substance, or the repeated use of alcohol or any other non-controlled substance which in the Administrator's (or its

delegate's or delegates') reasonable determination interferes with the Executive's service as an officer or employee of the Company and/or a Subsidiary;

(f) sexual harassment by the Executive that has been reasonably substantiated and investigated;

(g) involvement in activities representing conflicts of interest with the Company and/or a Subsidiary;

(h) improper disclosure of confidential information;

(i) conduct endangering, or likely to endanger, the health or safety of another employee;

(j) falsifying or misrepresenting information on the records of the Company and/or a Subsidiary;

(k) the Executive's physical destruction or theft of substantial property or assets of the Company and/or a Subsidiary;

(l) breach of any policy of, or agreement with, the Company and/or a Subsidiary applicable to the Executive or to which the Executive is otherwise bound.

Review of any determination that a termination is for Cause shall be by the Administrator, in its sole and exclusive judgment and discretion, in accordance with the provisions of Section 8 herein.

3.4 "Code" means the United States Internal Revenue Code of 1986, as amended.

3.5 "Committee" means the Compensation Committee of the Board of Directors of the Company.

3.6 "Company" means Western Digital Corporation, a Delaware corporation.

3.7 "Effective Date" means February 16, 2006.

3.8 "Eligible Employee" means any person classified by the Company or a Subsidiary, in its sole discretion, as a non-temporary, full-time or part-time, salaried or hourly employee (specifically excluding any individual who is not classified by the Company or a Subsidiary as a common law employee, such as an independent contractor or an individual working through a third-party provider, such as Kelly Services, without regard to the characterization or recharacterization of such individual's status by any court or governmental agency), who is paid from the United States payroll of the Company or a Subsidiary; provided, however, that in no event shall any employee who as of the Effective Date is a party to a written employment agreement with the Company or a Subsidiary (other than an agreement providing for at-will employment by the Company or a Subsidiary and for no specified term) be an Eligible Employee.

3.9 "ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

3.10 "Executive" means an Eligible Employee who has been designated by the Board or the Committee as a Tier I Executive, Tier II Executive or Tier III Executive for purposes of participation in the Plan.

3.11 "Participant" means an Executive who is entitled, based on the provisions hereof, to severance benefits under Section 6.

3.12 "Plan" means this Western Digital Corporation Executive Severance Plan, as set forth in this instrument as it may be amended from time to time.

3.13 "Service Date" means the first date of employment or adjusted date of employment if rehired with the Company or a Subsidiary.

3.14 "Subsidiary" means any corporation or other entity a majority of whose outstanding voting stock or voting power is beneficially owned directly or indirectly by the Company.

4. TERM

The Plan shall commence on the Effective Date and shall continue in effect through December 31, 2008; provided, however, that on December 31, 2006 and each anniversary of such date thereafter, the term of the Plan shall extend automatically for one additional year, unless the Committee (or the Board) causes the Company to deliver written notice prior to the end of such term (or extended term, as applicable) to each Executive then covered by the Plan that the term of the Plan will not be extended (or further extended, as the case may be), and if such notice is timely given the Plan shall terminate at the end of the term then in progress.

5. PARTICIPATION

Upon approval of the Plan, the Committee shall designate the Executives initially covered by the Plan. The Committee may, from time to time, designate additional Eligible Employees as Executives for purposes of participation in the Plan; provided that the Committee shall limit the group of all persons eligible to participate in the Plan to a "select group of management or highly compensated employees" within the meaning of 29 C.F.R. 2520-104-23 or any similar successor provision. The Committee may, in its sole discretion, remove an Executive from participation in the Plan and from time to time approve modifications to the Tier to which one or more Executives have been designated.

6. SEVERANCE BENEFITS

6.1 Severance Benefits to Executives. An Executive whose employment with the Company or a Subsidiary is terminated by the Company or such Subsidiary, as applicable, without Cause and who meets the departure conditions described in Section 7 shall become a Participant under the Plan and entitled to the benefits set forth in this Section 6. The severance

benefits provided under Sections 6.2, 6.3, 6.5 and 6.6 of the Plan shall be the obligations of, and shall be provided to the Executive by, the entity (the Company or a Subsidiary, as applicable) that employs the Executive immediately prior to the Executive's termination of employment. For avoidance of doubt, in no event shall an Executive become entitled to or receive any payment hereunder if the Executive's employment with the Company or a Subsidiary is terminated voluntarily by the Executive (for any reason), by the Company or a Subsidiary, as applicable, for Cause, or on account of the Executive's death or disability (as defined in Section 22(e)(3) of the Code). Notwithstanding anything else contained herein to the contrary, an Executive shall not be deemed to have terminated employment if his or her employment by the Company or a Subsidiary terminates but he or she continues as an employee of the Company or another Subsidiary.

6.2 Salary Continuation Payments. A Participant shall receive a severance payment equal to the Participant's monthly rate of Base Pay multiplied by the number of months set forth below:

- (a) Tier I Executive: 24 months
- (b) Tier II Executive: 18 months
- (c) Tier III Executive: 12 months

The severance payment shall be paid in one lump-sum cash payment within thirty (30) days of the Participant's compliance with all provisions of Section 7.

6.3 Bonus. A Participant shall receive a payment equal to a pro-rata portion of the Participant's bonus opportunity under the Company's (or a Subsidiary's) bonus program in which the Participant participates for the bonus cycle in which the Participant's date of termination occurs (with such pro-rata portion based on the number of days in the applicable bonus cycle during which the Participant was employed (not to exceed six (6) months) and assuming 100% of the performance target(s) subject to the bonus award are met regardless of actual funding by the Company or a Subsidiary). The payment shall be paid in one lump-sum cash payment within thirty (30) days of the Participant's compliance with all provisions of Section 7.

6.4 Equity Awards. Notwithstanding anything in the applicable stock incentive plan and/or award agreement to the contrary, upon a Participant's termination of employment, the Participant's then outstanding stock options and restricted stock or stock unit awards that are subject to time-based vesting will vest and become exercisable or payable, as applicable, as if the Participant had remained employed with the Company or a Subsidiary for an additional six (6) months. For avoidance of doubt, the foregoing is not intended to apply to any equity awards held by the Participant that are subject to performance-based vesting or to supersede any more favorable provision in any stock incentive plan and/or award agreement regarding accelerated vesting in the event of the Participant's termination of employment. Notwithstanding anything to the contrary herein, the post-termination exercisability of the Participant's then outstanding stock options shall continue to be governed by the stock incentive plan and stock option agreement applicable to such options.

6.5 Outplacement Services. A Participant shall be eligible for outplacement services, provided by a vendor chosen by the Company or applicable Subsidiary and at the Company's or applicable Subsidiary's expense, after the Participant's termination of employment for up to the number of months set forth below:

- (a) Tier I Executive: 12 months
- (b) Tier II Executives: 12 months
- (c) Tier III Executive: 12 months

6.6 Continued Health Care Coverage. If the Participant elects COBRA continuation coverage within the applicable election period, the Company or applicable Subsidiary shall make the applicable COBRA premium payments following the expiration of the Participant's company-provided medical, dental, and/or vision coverage existing as of the Participant's termination date for the number of months set forth below:

- (a) Tier I Executive: 18 months
- (b) Tier II Executives: 12 months
- (c) Tier III Executive: 12 months

Notwithstanding anything in the Plan to the contrary, there shall be no obligation to make such COBRA premium payments on behalf of any Participant if the Participant otherwise becomes eligible for equivalent coverage under another employer's plan.

7. CONDITIONS TO SEVERANCE BENEFITS

7.1 Release. Notwithstanding anything to the contrary contained herein, the Company's or applicable Subsidiary's obligation to pay benefits to a Participant under Section 6 is subject to the condition precedent that the Participant execute a valid and effective release of any and all claims in a form and manner acceptable to the Company, and such release is received by the Company no earlier than, and no later than fourteen (14) days (or such other period as required by law) after, the Participant's termination date and is not revoked by the Participant (pursuant to any revocation rights afforded by applicable law) or otherwise rendered unenforceable by the Participant. Notwithstanding anything else contained herein to the contrary, the Company or applicable Subsidiary will have no obligation to pay any benefit to the Participant under the Plan unless and until that Participant's release (in such form) has been fully executed by the Participant (and the Participant's spouse, to the extent required by the Company), has been received by the Company, and has become effective and irrevocable by the Participant.

7.2 Departure and Entitlement Procedure. As a condition to becoming a Participant and receiving the severance benefits described in Section 6, the Executive must return and deliver to the Administrator or his or her designee all Company and Subsidiary property within seven (7) days of the Executive's termination date. In addition, except as otherwise provided by

the Company, if an Executive resigns prior to his/her scheduled termination date, then he/she shall not be entitled to any severance payments or any other severance benefits provided herein.

7.3 Offsets. Except as expressly provided below, a Participant shall not be required to mitigate the amount of any payments provided for by the Plan by seeking employment or otherwise, nor shall the amount of any cash payments or benefits provided under the Plan be reduced by any compensation or benefits earned by the Participant after his or her termination of employment with the Company or applicable Subsidiary. All severance payments under the Plan shall be subject to legal deductions, and the Company and/or applicable Subsidiary reserves the right to offset the benefits payable under the Plan by any advanced monies the Participant owes the Company or a Subsidiary. The benefits and amounts payable under the Plan shall be reduced (but not below zero) by any severance pay or benefits to which a Participant is or becomes entitled under any other severance pay plan, policy, agreement or arrangement. In addition, in no event shall a Participant become entitled to a duplication of benefits under the Plan and any other severance plan or program of the Company or a Subsidiary. Without limiting the generality of the foregoing, in no event shall a Participant receive benefits under the Plan in connection with his or her termination of employment if such Participant is entitled to benefits under the Company's Amended and Restated Change of Control Severance Plan in connection with such termination of employment. Notwithstanding any provision of the Plan to the contrary, to the extent that any Participant is entitled to any period of paid notice under Federal or state law including, but not limited to, the Worker Adjustment Retraining Notification Act, 29 U.S.C. Sections 2101 et seq., the benefits and amounts payable under the Plan shall be reduced (but not below zero) by the Base Pay received by the Participant during the period of such paid notice.

7.4 Limitation On Employee Rights. The Plan shall not give any employee the right to be retained in the service of the Company or to interfere with or restrict the right of the Company or applicable Subsidiary to discharge any employee at any time, with or without Cause.

8. RESOLUTION OF DISPUTES

8.1 Claim. If a Participant or any other individual (herein referred to as a "Claimant") believes that benefits under the Plan are being wrongfully denied, that the Plan is not being operated properly, that fiduciaries of the Plan have breached their duties, or that the Claimant's legal rights are being violated with respect to the Plan, the Claimant must file a formal claim with the Administrator. Any such claim for benefits must be filed in writing within 90 days of the date upon which the Participant first knew or should have known the facts upon which the claim is based.

8.2 Claim Decision. If any claim for benefits under the Plan is denied, in whole or in part, the Claimant shall be so notified by the Administrator within thirty (30) calendar days of the date such person's claim is delivered to the Administrator. At the same time, the Administrator shall notify the Claimant of his or her right to a review by the Administrator and shall set forth, in a manner calculated to be understood by the Claimant, specific reasons for such decision, specific references to pertinent Plan provisions on which the decision is based, a

description of any additional material or information necessary for the Claimant to perfect his or her request for review, an explanation of why such material or information is necessary, and an explanation of the Plan's review procedure.

8.3 Request for Review. Any Claimant or duly authorized representative may appeal from such decision by submitting to the Administrator within sixty (60) calendar days after the date of such notice of its decision a written statement:

(a) requesting a review of the claim for benefits by the Administrator;

(b) setting forth all of the grounds upon which the request for review is based and any facts in support thereof; and

(c) setting forth any issues or comments which the Claimant deems relevant to the claim.

The Administrator shall act upon such appeal within sixty (60) calendar days after the latter of receipt of the Claimant's request for review by it or receipt of all additional materials reasonably requested by it from such Claimant.

8.4 Review of Decision. The Administrator shall make a full and fair review of an appeal and all written materials submitted by the Claimant in connection therewith and may require the Claimant to submit, within ten (10) calendar days of written notice by the Administrator, such additional facts, documents or other evidence as the Administrator, in its sole discretion, deems necessary or advisable in making such a review. On the basis of its review, the Administrator shall make an independent determination of the Claimant's eligibility for an allowance and the amount of such allowance, if any, under this Plan. The decision of the Administrator on any appeal shall be final and conclusive upon all persons if supported by substantial evidence in the record.

8.5 Denial on Review. If on review of a decision, the Administrator denies a claim in whole or in part, it shall give written notice of its decision to the Claimant setting forth, in a manner calculated to be understood by the Claimant, the specific reasons for such denial and specific references to the pertinent Plan provisions on which its decision was based. If a Claimant believes that the Administrator's determination on appeal is incorrect, the Claimant or duly authorized representative may invoke the arbitration procedures described in Section 8.6 or file suit related to such determination; provided that any legal action must be taken by the Claimant within ninety (90) days after the date upon which the Administrator's written decision on review was sent to the Claimant.

8.6 Arbitration. A Claimant who has followed the procedures in Sections 8.1 through 8.5, but who has not obtained full relief on his or her claim for benefits, may, within ninety (90) days following his or her receipt of the Administrator's written decision on review pursuant to Section 8.5, apply in writing to the Administrator for expedited and binding arbitration of his or her claim in Orange County, California, before a sole arbitrator selected from Judicial Arbitration and Mediation Services, Inc., Orange County, California, or its successor ("JAMS"), or if JAMS is no longer able to supply the arbitrator, such arbitrator shall be selected from the

American Arbitration Association, and shall be conducted in accordance with the provisions of California Code of Civil Procedure Sections 1280 et seq. as the exclusive forum for the resolution of such dispute. Pursuant to California Code of Civil Procedure Section 1281.8, provisional injunctive relief may, but need not, be sought by the Company, a Subsidiary or an Executive in a court of law while arbitration proceedings are pending, and any provisional injunctive relief granted by such court shall remain effective until the matter is finally determined by the Arbitrator. Final resolution of any dispute through arbitration may include any remedy or relief which the Arbitrator deems just and equitable, including any and all remedies provided by applicable state or federal statutes. At the conclusion of the arbitration, the Arbitrator shall issue a written decision that sets forth the essential findings and conclusions upon which the Arbitrator's award or decision is based. Any award or relief granted by the Arbitrator hereunder shall be final and binding on the parties hereto and may be enforced by any court of competent jurisdiction. Any rights to trial by jury in any action, proceeding or counterclaim brought by any of the Company, a Subsidiary or an Executive in connection with any matter whatsoever arising out of or in any way connected with the Plan are hereby waived. The Company or applicable Subsidiary shall be responsible for payment of the forum costs of any arbitration hereunder, including the Arbitrator's fee. In any proceeding to enforce the terms of the Plan, the prevailing party shall be entitled to its or his reasonable attorneys' fees and costs (other than forum costs associated with the arbitration) incurred by it or him in connection with resolution of the dispute in addition to any other relief granted.

8.7 Legal Fees and Expenses. If any dispute arises between the parties with respect to the interpretation or performance of the Plan, the prevailing party in any arbitration or proceeding shall be entitled to recover from the other party its attorneys' fees, arbitration or court costs and other expenses incurred in connection with any such proceeding. Amounts, if any, paid to the Executive under this Section 8.7 shall be in addition to all other amounts due to the Executive pursuant to the Plan.

9. ADMINISTRATION

9.1 Administrator. Except as provided herein, the Plan shall be administered and operated by the Administrator. The Administrator is empowered to construe and interpret the provisions of the Plan and to decide all questions of eligibility for benefits under the Plan and shall make such determinations in its sole and absolute discretion. The Administrator may at any time delegate to any other named person or body, or reassume therefrom, any of its responsibilities or administrative duties with respect to the Plan.

9.2 Experts; Rules. The Administrator may contract with one or more persons to render advice with regard to any responsibility it has under the Plan. Subject to the limitations of the Plan, the Administrator shall from time to time establish such rules for the administration of the Plan as it may deem desirable.

9.3 Indemnity. The Company shall, to the extent permitted by law, by the purchase of insurance or otherwise, indemnify and hold harmless the Administrator and each other fiduciary with respect to the Plan for liabilities or expenses they and each of them incur in carrying out their respective duties under the Plan, other than for any liabilities or expenses arising out of such fiduciary's gross negligence or willful misconduct.

10. AMENDMENT

The Committee (or the Board) reserves the right to amend, suspend and/or terminate the Plan at any time in its sole discretion. No amendment, suspension or termination shall diminish benefits to which a Participant is currently entitled under the Plan. Any modification or other amendment of the Plan shall be in writing, signed by either the Company's Chief Executive Officer or Vice President, Human Resources.

11. GENERAL

11.1 Assignment by Participants. None of the benefits, payments, proceeds or claims of any Executive or Participant shall be subject to any claim of any creditor and, in particular, the same shall not be subject to attachment or garnishment or other legal process by any creditor, nor shall any such Executive have any right to alienate, anticipate, commute, pledge, encumber or assign any of the benefits or payments or proceeds that he or she may expect to receive, contingently or otherwise, under the Plan. Notwithstanding the foregoing, benefits that are in pay status may be subject to a court order of garnishment or wage assignment, or similar order, or a tax levy. The Plan shall inure to the benefit of and be enforceable by each Participant's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees, and legatees. If a Participant dies while any amount would still be payable to him or her hereunder had he or she continued to live, all such amounts, unless otherwise provided herein, shall be paid to the Participant's beneficiary in accordance with the terms of the Plan.

11.2 Binding Effect. The Company or applicable Subsidiary will require any successor (whether by purchase of assets, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Company or applicable Subsidiary to expressly assume and agree to perform all of the obligations of the Company or applicable Subsidiary under the Plan (including the obligation to cause any subsequent successor to also assume the obligations of the Plan) unless such assumption occurs by operation of law. For avoidance of doubt, in the event that a successor of a Subsidiary (whether by purchase of assets, merger, consolidation or otherwise) assumes the Subsidiary's obligations under the Plan, the Company will have no obligations under the Plan with respect to the Executives employed by such Subsidiary.

11.3 No Waiver. No waiver of any term, provision or condition of the Plan, whether by conduct or otherwise, in any one or more instances shall be deemed or be construed as a further or continuing waiver of any such term, provision or condition or as a waiver of any other term, provision or condition of the Plan.

11.4 Expenses; Unsecured General Creditor. The benefits and costs of the Plan shall be paid by the Company and/or a Subsidiary out of its general assets. The status of a claim against the Company or a Subsidiary with respect to the benefits provided hereunder shall be same as the status of a claim against the Company or applicable Subsidiary by any general or unsecured creditor.

11.5 ERISA. The Plan is an unfunded compensation arrangement for a select group of management or highly compensated employees of the Company or a Subsidiary and any exemptions under ERISA applicable to such an arrangement shall be applicable to the Plan.

11.6 Section 409A. The Plan shall be construed and interpreted so as to avoid the imputation of any tax liability (penalty or otherwise) pursuant to Section 409A of the Code. The Company may suspend the payment of any benefit pursuant to the Plan to any "specified employee" (within the meaning of Section 409A of the Code) to a date no earlier than the date that is six months after the employee's separation of service to the extent, if any, the Administrator determines that such suspension is reasonably necessary to satisfy Code Section 409A(a)(2)(B)(i) (in which case the benefits that would have otherwise been paid during such six month period shall be paid, without interest, as soon as practical following the end of such six month period).

11.7 WARN Act. Benefits payable under the Plan are intended to satisfy, where applicable, any Company obligations under the Federal Worker Adjustment and Retraining Notification Act and any similar obligations that the Company or its Subsidiaries may have under any successor or other severance pay statute.

11.8 Construction. The masculine pronoun shall include the feminine pronoun and the feminine pronoun shall include the masculine pronoun and the singular pronoun shall include the plural pronoun and the plural pronoun shall include the singular pronoun, unless the context clearly indicates otherwise.

11.9 Governing Law. The Plan shall be construed according to the laws of the State of California, except to the extent such laws are preempted by federal law.

11.10 Severability. If any provision of the Plan is held to be illegal, invalid or unenforceable under any present or future law, and if the rights or obligations of any party hereto under the Plan will not be materially and adversely affected hereby, (i) such provision will be fully severable, (ii) the Plan will be construed and enforced as if such illegal, invalid or unenforceable provision had never comprised a part hereof, (iii) the remaining provisions of the Plan will remain in full force and effect and will not be affected by the illegal, invalid or unenforceable provision or by its severance herefrom and (iv) in lieu of such illegal, invalid or unenforceable provision, there will be added automatically as a part of the Plan a legal, valid and enforceable provision as similar in terms to such illegal, invalid or unenforceable provision as may be possible.

11.11 Notices. Any notice required or permitted by the Plan shall be in writing, delivered by hand, or sent by registered or certified mail, return receipt requested, or by recognized courier service (regularly providing proof of delivery), addressed as follows:

(a) if to the Company or, where applicable, the Administrator:

Western Digital Corporation
20511 Lake Forest Drive
Lake Forest, California 92630

Attention: Vice President, Human Resources

With a copy to:

Western Digital Corporation
20511 Lake Forest Drive
Lake Forest, California 92630
Attention: General Counsel

(b) if to the Executive or Participant, at the address set forth on the records of the Company or applicable Subsidiary, as the case may be, or to such other address or addresses most recently communicated to the Company or applicable Subsidiary by the Executive or Participant.

Each such notice shall be effective (i) if given by mail, three days after being deposited in the mails or (ii) if given personally or by other means when actually delivered at such address.

IN WITNESS WHEREOF, this instrument, evidencing the terms of the Western Digital Corporation Executive Severance Plan, is executed as of February 16, 2006.

WESTERN DIGITAL CORPORATION

By: /s/ Jackie DeMaria

Jackie DeMaria
Vice President, Human Resources

Certification of Principal Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, John F. Coyne, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Western Digital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 6, 2007

/s/ John F. Coyne

John F. Coyne
Chief Executive Officer

Certification of Principal Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Stephen D. Milligan, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Western Digital Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 6, 2007

/s/ Stephen D. Milligan
Stephen D. Milligan
Senior Vice President and Chief Financial Officer

The following certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350 and in accordance with SEC Release No. 33-8238. This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that Western Digital Corporation specifically incorporates it by reference.

Certification of Chief Executive Officer

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Western Digital Corporation, a Delaware corporation (the "Company"), hereby certifies that, to his knowledge:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the period ended December 29, 2006, (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 6, 2007

/s/ John F. Coyne

John F. Coyne
Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

The following certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350 and in accordance with SEC Release No. 33-8238. This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall it be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that Western Digital Corporation specifically incorporates it by reference.

Certification of Chief Financial Officer

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Western Digital Corporation, a Delaware corporation (the "Company"), hereby certifies that, to his knowledge:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the period ended December 29, 2006, (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 6, 2007

/s/ Stephen D. Milligan
Stephen D. Milligan
Senior Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.