**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-Q**

(Mark One)

[X] Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the quarterly period ended December 28, 2001.

OR

[ ] Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
for the transition period from ____________ to ____________.

Commission file number 1-8703

**WESTERN DIGITAL CORPORATION**

(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| Delaware<br>(State or other jurisdiction of<br>incorporation or organization) | 33-0956711<br>(I.R.S. Employer<br>Identification No.) |
| 20511 Lake Forest Drive<br>Lake Forest, California<br>(Address of principal executive offices) | 92630<br>(Zip Code) |

**REGISTRANT'S TELEPHONE NUMBER INCLUDING AREA CODE: (949) 672-7000**
**REGISTRANT'S WEB SITE: http://www.westerndigital.com**

N/A

Former name, former address and former fiscal year if changed since last report.

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

Number of shares outstanding of Common Stock, as of January 25, 2002, is 189,437,385.

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**WESTERN DIGITAL CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**

**(UNAUDITED)**

| | THREE-MONTH PERIOD ENDED | |
|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 |
| Revenues, net | $561,570 | $574,670 |
| Costs and expenses: | | |
| Cost of revenues | 494,029 | 504,112 |
| Research and development | 33,617 | 31,293 |
| Selling, general and administrative | 31,925 | 29,675 |
| Total costs and expenses | 559,571 | 565,080 |
| Operating income | 1,999 | 9,590 |
| Net interest and other income | 839 | 3,105 |
| Income from continuing operations before extraordinary gain (loss) | 2,838 | 12,695 |
| Loss from discontinued operations | (9,827) | — |
| Extraordinary gain (loss) from redemption of debentures | 10,576 | (101) |
| Net income | $ 3,587 | $ 12,594 |
| Basic income per common share: | | |
| Income from continuing operations before extraordinary gain (loss) | $ .02 | $ .07 |
| Loss from discontinued operations | (.06) | — |
| Extraordinary gain (loss) | .06 | (.00) |
| | $ .02 | $ .07 |
| Diluted income per common share: | | |
| Income from continuing operations before extraordinary gain (loss) | $ .02 | $ .07 |
| Loss from discontinued operations | (.06) | — |
| Extraordinary gain (loss) | .06 | (.00) |
| | $ .02 | $ .07 |
| Shares used in computing income per share amounts: | | |
| Basic | 171,175 | 187,691 |
| Diluted | 173,171 | 191,624 |

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

**WESTERN DIGITAL CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**

**(UNAUDITED)**

| | SIX-MONTH PERIOD ENDED | |
|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 |
| Revenues, net | $ 985,936 | $1,015,613 |
| Costs and expenses: | | |
| Cost of revenues | 892,459 | 889,048 |
| Research and development | 65,618 | 62,834 |
| Selling, general and administrative | 61,448 | 58,311 |
| Total costs and expenses | 1,019,525 | 1,010,193 |
| Operating income (loss) | (33,589) | 5,420 |
| Net interest and other income (expense) | (793) | 3,261 |
| Income (loss) from continuing operations before extraordinary gain (loss) and cumulative effect of change in accounting principle | (34,382) | 8,681 |
| Discontinued operations: | | |
| Loss from discontinued operations | (17,872) | — |
| Gain on disposal of discontinued operations | — | 24,532 |
| Extraordinary gain (loss) from redemption of debentures | 21,819 | (101) |
| Cumulative effect of change in accounting principle | (1,504) | — |
| Net income (loss) | $ (31,939) | $ 33,112 |
| Basic income (loss) per common share: | | |
| Income (loss) from continuing operations before extraordinary gain (loss) and cumulative effect of change in accounting principle | $ (.22) | $ .05 |
| Discontinued operations | | |
| Loss from discontinued operations | (.11) | — |
| Gain on disposal of discontinued segments | — | .13 |
| Extraordinary gain (loss) | .14 | (.00) |
| Cumulative effect of change in accounting principle | (.01) | — |
| | $ (.20) | $ .18 |
| Diluted income (loss) per common share: | | |
| Income (loss) from continuing operations before extraordinary gain (loss) and cumulative effect of change in accounting principle | $ (.22) | $ .05 |
| Discontinued operations | | |
| Loss from discontinued operations | (.11) | — |
| Gain on disposal of discontinued segments | — | .12 |
| Extraordinary gain (loss) | .14 | (.00) |
| Cumulative effect of change in accounting principle | (.01) | — |
| | $ (.20) | $ .17 |
| Shares used in computing income (loss) per share amounts: | | |
| Basic | 159,609 | 187,163 |
| Diluted | 159,609 | 189,381 |

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

**WESTERN DIGITAL CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**

**(UNAUDITED)**

| | JUN. 29, 2001 | DEC. 28, 2001 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 167,582 | $ 193,317 |
| Accounts receivable, less allowance for doubtful accounts of $13,298 at June 29, 2001 and $12,127 at December 28, 2001 | 127,767 | 222,822 |
| Inventories | 78,905 | 96,441 |
| Prepaid expenses and other current assets | 11,455 | 6,165 |
| Total current assets | 385,709 | 518,745 |
| Property and equipment at cost, net | 106,166 | 111,467 |
| Other assets, net | 15,777 | 5,437 |
| Total assets | $ 507,652 | $ 635,649 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 224,544 | $ 323,330 |
| Accrued expenses | 82,741 | 82,037 |
| Accrued warranty | 30,943 | 32,548 |
| Net liabilities of discontinued operations | 2,118 | — |
| Total current liabilities | 340,346 | 437,915 |
| Other liabilities | 38,629 | 37,424 |
| Convertible debentures | 112,491 | 102,404 |
| Minority interest | 9,383 | 9,012 |
| Shareholders' equity: | | |
| Preferred stock, $.01 par value; Authorized: 5,000 shares Outstanding: None | — | — |
| Common stock, $.01 par value; Authorized: 450,000 shares Outstanding: 192,800 shares at June 29, 2001 and 194,346 shares at December 28, 2001 | 1,928 | 1,944 |
| Additional paid-in capital | 731,694 | 731,064 |
| Accumulated deficit | (581,720) | (548,608) |
| Accumulated other comprehensive income | 3,112 | 2,179 |
| Treasury stock-common stock at cost: 6,420 shares at June 29, 2001 and 5,409 shares at December 28, 2001 | (148,211) | (137,685) |
| Total shareholders' equity | 6,803 | 48,894 |
| Total liabilities and shareholders' equity | $ 507,652 | $ 635,649 |

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

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**WESTERN DIGITAL CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(IN THOUSANDS)**
**(UNAUDITED)**

| | SIX-MONTH PERIOD ENDED | |
|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 |
| **Cash flows from operating activities:** | | |
| Net income (loss) | $ (31,939) | $ 33,112 |
| Adjustments to reconcile net loss to net cash used for operating activities of continuing operations: | | |
| Gain on sale of discontinued segments | — | (24,532) |
| Loss from discontinued operations | 17,872 | — |
| Extraordinary (gain) loss on debenture redemptions | (21,819) | 101 |
| Depreciation and amortization | 26,689 | 22,609 |
| Non-cash interest expense | 4,329 | 3,072 |
| Other, net | 738 | (1,479) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (13,128) | (95,091) |
| Inventories | 1,109 | (17,536) |
| Prepaid expenses and other assets | 1,406 | 5,664 |
| Accrued warranty | (9,747) | (1,447) |
| Accounts payable and accrued expenses | (29,242) | 91,257 |
| Other, net | (3,684) | (1,505) |
| Net cash provided by (used for) continuing operations | (57,416) | 14,225 |
| **Cash flows from investing activities:** | | |
| Capital expenditures, net | (26,849) | (26,038) |
| Proceeds from sales of marketable equity securities | 14,979 | — |
| Proceeds from recovery of Komag note receivable | — | 9,000 |
| Net cash used for investing activities of continuing operations | (11,870) | (17,038) |
| **Cash flows from financing activities:** | | |
| Proceeds from ESPP shares issued and stock option exercises | 3,522 | 2,636 |
| Common stock issued for cash | 72,674 | — |
| Cash used in debenture redemptions | — | (6,263) |
| Proceeds from minority investment in subsidiary | — | 2,950 |
| Proceeds from subsidiary bridge loan | 5,000 | — |
| Net cash provided by (used for) financing activities of continuing operations | 81,196 | (677) |
| Net cash provided by (used for) discontinued operations | (16,548) | 29,225 |
| Net increase (decrease) in cash and cash equivalents | (4,638) | 25,735 |
| Cash and cash equivalents, beginning of period | 184,021 | 167,582 |
| Cash and cash equivalents, end of period | $179,383 | $193,317 |
| **Supplemental disclosures of cash flow information:** | | |
| Cash paid during the period for income taxes | $ 1,089 | $ 1,015 |
| Cash paid during the period for interest | 84 | — |

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 the Company are set forth in Note 1 of Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K as of and for the year ended June 29, 2001.

In the opinion of management, all adjustments necessary to fairly state the condensed consolidated financial statements have been made. All such adjustments are of a normal recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K as of and for the year ended June 29, 2001.

The Company has a 52 or 53-week fiscal year and each fiscal month ends on the Friday nearest to the last day of the calendar month. All general references to years relate to fiscal years unless otherwise noted.

Certain prior periods' amounts have been reclassified to conform to the current period presentation as a result of the adoption of Staff Accounting Bulletin No. 101 and related interpretations and the discontinuance of the Company's Connex and SANavigator businesses.

2. Supplemental Financial Statement Data (in thousands)

| | JUN. 29, 2001 | DEC. 28, 2001 |
|---|---|---|
| Inventories: | | |
| Finished goods | $48,123 | $79,364 |
| Work in process | 8,888 | 12,929 |
| Raw materials and component parts | 21,894 | 4,148 |
| | $78,905 | $96,441 |

| | THREE-MONTH PERIOD ENDED | | SIX-MONTH PERIOD ENDED | |
|---|---|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 | DEC. 29, 2000 | DEC. 28, 2001 |
| Net Interest and Other Income (Expense): | | | | |
| Interest income | $ 2,109 | $ 983 | $ 3,950 | $ 2,352 |
| Interest and other expense | (1,663) | (2,251) | (4,754) | (4,381) |
| Gains (losses) on investments, net (See note 6) | — | 3,479 | (738) | 3,479 |
| Minority interest in losses of consolidated subsidiaries | 393 | 894 | 749 | 1,811 |
| | $ 839 | $ 3,105 | $ (793) | $ 3,261 |

| | SIX-MONTH PERIOD ENDED | |
|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 |
| Supplemental disclosure of non-cash investing and financing activities: | | |
| Common stock issued for redemption of convertible debentures | $ 92,456 | $6,592 |
| Redemption of convertible debentures for Company common stock, net of capitalized issuance costs | $114,275 | $6,377 |

3. Income (loss) per Share

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

| | THREE-MONTH PERIOD ENDED | | SIX-MONTH PERIOD ENDED | |
|---|---|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 | DEC. 29, 2000 | DEC. 28, 2001 |
| Numerator for basic and diluted income (loss) per share: | | | | |
| Net income (loss) | $ 3,587 | $ 12,594 | $ (31,939) | $ 33,112 |
| Denominator: | | | | |
| Basic weighted average common shares outstanding | 171,175 | 187,691 | 159,609 | 187,163 |
| Incremental common shares attributable to exercise of outstanding options, warrants, stock awards and ESPP contributions | 1,996 | 3,933 | — | 2,218 |
| Diluted shares | 173,171 | 191,624 | 159,609 | 189,381 |
| Basic income (loss) per share | $ .02 | $ .07 | $ (.20) | $ .18 |
| Diluted income (loss) per share | $ .02 | $ .07 | $ (.20) | $ .17 |

The computation of diluted income per share for the three months ended December 29, 2000 and December 28, 2001 excludes 22.9 and 25.4 million shares, respectively, relating to the possible exercise of outstanding stock options. The computation of diluted income (loss) per share for the six months ended December 29, 2000 and December 28, 2001 excludes 24.4 and 27.0 million shares, respectively, relating to the possible exercise of outstanding stock options. The computation of diluted income per share for the three months ended December 29, 2000 and December 28, 2001 excludes 4.1 and 3.5 million shares, respectively, issuable upon conversion of the convertible debentures. The computation of diluted income (loss) per share for the six months ended December 29, 2000 and December 28, 2001 excludes 5.3 and 3.7 million shares, respectively, issuable upon conversion of the convertible debentures. These items were not included in the computation of diluted income (loss) per share as their effect would have been anti-dilutive.

4. Common Stock Transactions

During the six months ended December 29, 2000, the Company issued approximately 686,000 shares of its common stock in connection with ESPP purchases and 343,000 shares of its common stock in connection with common stock option exercises, for aggregate cash proceeds of $3.5 million. During the six months ended December 28, 2001, the Company issued approximately 514,000 shares of its common stock in connection with ESPP purchases and 348,000 shares of its common stock in connection with common stock option exercises, for aggregate cash proceeds of $2.6 million.

Under preexisting shelf registrations (the “equity facility”), the Company issued shares of common stock to institutional investors for cash. Shares sold under the equity facility were at the market price of the Company’s common stock less a discount ranging from 2.75% to 4.25%. During the six months ended December 29, 2000, the Company issued 14.5 million shares of common stock under the equity facility for net cash proceeds of $72.7 million. As of December 28, 2001, the Company had $167.7 million remaining under the equity facility. Subsequent to December 28, 2001, the Company withdrew the shelf registrations.

During the six months ended December 29, 2000, the Company issued 15.4 million shares of common stock to redeem a portion of its 5.25% zero coupon convertible subordinated debentures due February 18, 2018 (the “Debentures”) with a book value of $116.6 million, and an aggregate principal amount at maturity of $286.9 million. During the six months ended December 28, 2001, the Company issued 1.5 million shares of common stock and $6.3 million in cash to redeem a portion of its Debentures with a book value of $13.0 million, and an aggregate principal amount at maturity of $30.0 million. These redemptions were private, individually negotiated transactions with certain institutional investors. The redemptions resulted in an extraordinary gain of $21.8 million during the six months ended December 29, 2000 and an extraordinary loss of $0.1 million during the six months ended December 28, 2001. As of December 28, 2001, the book value of the remaining outstanding Debentures was $102.4 million and the aggregate principal amount at maturity was $235.9 million.

5. Credit Facility

The Company has a three-year Senior Credit Facility for its hard drive business, Western Digital Technologies, Inc. (“WDT”), which provides up to $125 million in revolving credit (subject to a borrowing base calculation), matures on September 20, 2003 and is secured by WDT’s accounts receivable, inventory, 65% of the stock in its foreign subsidiaries and other assets. At the option of WDT, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. The Senior Credit Facility requires WDT to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. As of December 28, 2001, there were no borrowings under the facility.

6. Investments

As of December 28, 2001, the Company owned approximately 1.2 million shares of Vixel Corporation (“Vixel”) common stock. The Company has identified these shares as “available for sale” under the provisions of SFAS 115, and accordingly, the shares were marked to market value. At December 28, 2001, accumulated other comprehensive income consisted of an unrealized gain of $2.2 million from these shares. The aggregate book value of the shares was $2.2 million as of December 28, 2001, and the investment was classified as current.

During the three months ended December 28, 2001, the Company recorded a $9.0 million cash recovery from its Komag note receivable that was written off during the fourth quarter of 2001. Also during the quarter, the Company recorded a $5.5 million non-cash loss on the write-down of certain cost-method investments that were determined to be impaired. The net amount of the recovery and write-downs is classified in the accompanying statement of operations in “Net interest and other income”.

7. Other Comprehensive Income (Loss)

Other comprehensive income (loss) refers to revenue, expenses, gains and losses that are recorded as an element of shareholders’ equity but are excluded from net income (loss). The Company’s other comprehensive income is comprised of unrealized gains and losses on marketable securities categorized as “available for sale” under SFAS 115. The components of total comprehensive income (loss) for the three and six months ended December 29, 2000 and December 28, 2001 were as follows (in millions):

| | THREE-MONTH PERIOD ENDED | | SIX-MONTH PERIOD ENDED | |
|---|---|---|---|---|
| | DEC. 29, 2000 | DEC. 28, 2001 | DEC. 29, 2000 | DEC. 28, 2001 |
| Net income (loss) | $ 3.6 | $12.6 | $(31.9) | $33.1 |
| Other comprehensive income (loss): | | | | |
| Unrealized gain (loss) on available for sale investments, net | (18.9) | 0.6 | (11.4) | (0.9) |
| Total comprehensive income (loss) | $(15.3) | $13.2 | $(43.3) | $32.2 |

8. Business Segments

The Company’s primary segment is its hard drive business, WDT. In addition, the Company formed new business ventures in 1999, 2000 and 2001. The Company’s new business ventures have included Connex, Inc. (“Connex”), SANavigator, Inc. (“SANavigator”), SageTree, Inc. (“SageTree”), Keen Personal Media, Inc. (“Keen PM”), and Cameo Technologies, Inc. (“Cameo”). Connex was formed in 1999 to design and market network attached storage products. SANavigator was formed as a subsidiary of Connex in 2001 to develop and market storage area network (“SAN”) management software. SageTree was formed in 2000 to design and market packaged analytical software and related services for supply chain and product lifecycle applications. Keen PM was formed in 2000 to develop and sell interactive personal video recorder and set-top box software, services and hardware for broadband television content management and commerce. Cameo was formed in 2000 to develop technologies and services for delivering broadcast-quality video content to PC users. During the three months ended September 28, 2001, substantially all of the assets of Connex and SANavigator were sold and, accordingly, their operations were discontinued (See Note 9).

The Company’s chief operating decision maker uses the segment information for WDT and the Company’s combined new business ventures to assess performance and to determine resource allocation. The new business venture amounts have been combined and presented in an “all other” category, separate from the WDT segment results. General and corporate expenses of the Company are included in the WDT segment. The loss from discontinued operations of $9.8 million and $17.9 million during the three and six months ended December 29, 2000, respectively, and the gain from the disposal of discontinued segments of $24.5 million during the six months ended December 28, 2001 have been excluded from the tables below.

Segment information (in thousands):

| | THREE-MONTH PERIOD ENDED DEC. 29, 2000 | | | THREE-MONTH PERIOD ENDED DEC. 28, 2001 | | |
|---|---|---|---|---|---|---|
| | WDT | ALL OTHER | TOTAL | WDT | ALL OTHER | TOTAL |
| Revenues | $561,511 | $ 59 | $561,570 | $ 574,313 | $ 357 | $ 574,670 |
| Operating income (loss) | 11,985 | (9,986) | 1,999 | 15,345 | (5,755) | 9,590 |
| Total assets | 571,818 | 17,497 | 589,315 | 629,285 | 6,364 | 635,649 |
| Depreciation and amortization | 11,999 | 976 | 12,975 | 10,827 | 522 | 11,349 |
| Additions to property and equipment | 16,265 | 40 | 16,305 | 14,025 | — | 14,025 |

| | SIX-MONTH PERIOD ENDED DEC. 29, 2000 | | | SIX-MONTH PERIOD ENDED DEC. 28, 2001 | | |
|---|---|---|---|---|---|---|
| | WDT | ALL OTHER | TOTAL | WDT | ALL OTHER | TOTAL |
| Revenues | $985,673 | $ 263 | $985,936 | $1,014,719 | $ 894 | $1,015,613 |
| Operating income (loss) | (15,544) | (18,045) | (33,589) | 19,367 | (13,947) | 5,420 |
| Total assets | 571,818 | 17,497 | 589,315 | 629,285 | 6,364 | 635,649 |
| Depreciation and amortization | 24,723 | 1,966 | 26,689 | 21,602 | 1,007 | 22,609 |
| Additions to property and equipment | 25,805 | 1,044 | 26,849 | 26,038 | — | 26,038 |

9. Discontinued Operations

In July 2001, the Company decided to discontinue its Connex and SANavigator businesses. Connex and SANavigator were separate major lines of business and legal entities with separate facilities, operations, management teams, and classes of end-user customers from the Company's hard drive business. As such, the disposals have been accounted for as discontinued operations and, accordingly, the consolidated financial statements for the periods presented have been reclassified. On August 8, 2001, substantially all of the operating assets of Connex were sold to Quantum Corporation for cash proceeds of $11.0 million, and on September 21, 2001 substantially all of the operating assets of SANavigator were sold to McData Corporation for cash proceeds of $29.8 million. Approximately $4.1 million of the combined cash proceeds are held in escrow for one year pending expiration of customary indemnification periods and included in cash and cash equivalents on the accompanying balance sheet. As a result of these transactions, during the three months ended September 28, 2001, the Company recognized a gain of $24.5 million, net of costs incurred from the measurement date of July 1, 2001 through the end of the period to shutdown the businesses. At June 29, 2001, the net liabilities of discontinued operations consisted principally of individually immaterial amounts of inventories, fixed assets, accounts payable and accrued compensation. Revenues for the three and six months ended December 29, 2000 were $0.1 million and $0.3 million, respectively, for Connex and SANavigator combined.

10. Legal Proceedings

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

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

In 1994 Papst Licensing ("Papst") brought suit against the Company in federal court in California alleging infringement by the Company of five of its patents relating to disk drive motors that the Company purchased from motor vendors. Later that year

Papst dismissed its case without prejudice, but it has notified the Company that it intends to reinstate the suit if the Company does not enter into a license agreement with Papst. Papst has also put the Company on notice with respect to several additional patents. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

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

On May 22, 2001, Cambrian Consultants, Inc. (“Cambrian”) filed a complaint against the Company in the United States District Court, Central District of California. The suit alleges infringement by the Company of a Cambrian patent. On July 20, 2001, the Company filed an answer denying the allegations contained in Cambrian’s complaint and a counter claim asserting that Cambrian’s patent was invalid. The Court ordered an accelerated discovery schedule and scheduled the case for trial on March 26, 2002. On January 4, 2002, the Company entered into a settlement agreement with Cambrian, settling all claims in the litigation, and on January 7, 2002 the Court entered a dismissal of the action. The settlement was not material to the Company’s consolidated financial position, results of operations or liquidity.

On July 5, 2001, the Company (and its Malaysian subsidiary) filed suit against Cirrus Logic, Inc. (“Cirrus”) in California Superior Court for the County of Orange for breach of contract and other claims resulting from Cirrus’ role as a strategic supplier of read channel chips for the Company’s hard drives. The Company also stopped making payments to Cirrus for past deliveries of chips and terminated all outstanding purchase orders from Cirrus for such chips. The Company’s complaint alleges that Cirrus’ unlawful conduct caused damages in excess of any amounts that may be owing on outstanding invoices or arising out of any alleged breach of the outstanding purchase orders. On August 20, 2001, Cirrus filed an answer and cross-complaint. Cirrus denied the allegations contained in the Company’s complaint and asserted counterclaims against the Company for, among other things, the amount of the outstanding invoices and the Company’s alleged breach of the outstanding purchase orders. The disputed payable, which is included in the Company’s balance sheet in accounts payable, is approximately $27 million. Cirrus claims that the canceled purchase orders, which are not reflected in the Company’s financial statements, total approximately $26 million. On October 9, 2001, the Court granted Cirrus’ Motion for Judgment on the Pleadings, with leave to amend, and on November 8, 2001, the Company filed its First Amended Complaint. Cirrus demurred to the First Amended Complaint, and on December 18, 2001, the Court denied Cirrus’ demurrer. On November 2, 2001, Cirrus filed Applications for Right to Attach Orders and for Writs of Attachment against the Company and its Malaysian subsidiary in the amount of $25.2 million as security for the approximately $27 million allegedly owed for read-channel chips purchased from Cirrus that is disputed by the Company. On December 20, 2001, the Court granted Cirrus’ Applications but required Cirrus to post undertakings in the amount of $0.5 million on each Writ before issuance. Neither the Right to Attach Orders nor the Writs of Attachment have been filed by Cirrus or issued by the Court as the Company and its Malaysian subsidiary are in discussions with Cirrus concerning a negotiated posting of security in satisfaction of Cirrus’ Writs. If the parties are unable to reach agreement, the Company and its Malaysian subsidiary will comply with the Court’s final order. The parties have begun discovery and expect that such discovery will continue for the next several months. Based on its initial investigation and the limited discovery done to date, the Company does not believe that the ultimate resolution of this matter will have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity.

In November 2001, Dynacore Holding Corporation (“Dynacore”) filed suit against the Company and several other defendants in the United States District Court for the Southern District of New York. The suit alleges that the Company’s 1394 external hard drives fall within the scope of the subject matter of Dynacore’s patent covering communication between nodes within a network, wherein nodes have both enhanced and common capabilities. During January 2002, the Company filed an answer denying Dynacore’s complaint and alleged counterclaims. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

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

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

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

**Forward-Looking Statements**

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

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

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

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

**Overview**

Western Digital is a longtime leader and one of the pioneers of the data storage industry. Through significant reorganization of its hard drive business in 1999 and 2000 the Company has become one of the most cost-effective producers of hard drives in the industry. During that time, the Company also established a framework to apply its data storage core competencies to emerging markets and expand beyond the traditional market for hard drives through new business ventures and market areas, while maintaining its core business.

The hard drive industry, the Company's core and primary business, is intensely competitive and has experienced a great deal of growth, entry and exit of competitors, and technological change over recent years. This industry is characterized by short product life cycles, dependence upon highly skilled engineering and other personnel, significant expenditures for product development and recurring periods of oversupply.

The Company continuously evaluates opportunities to apply its data storage core competencies to emerging markets and to expand beyond traditional markets for hard drives through new business ventures meeting certain predefined criteria. The Company's new business ventures have included Connex, Inc. ("Connex"), SANavigator, Inc. ("SANavigator"), SageTree, Inc. ("SageTree"), Keen Personal Media, Inc. ("Keen PM") and Cameo Technologies, Inc. ("Cameo"). During the three months ended September 28, 2001, the Company discontinued the operations of both Connex and SANavigator, selling substantially all the assets of the two companies. The Company's other new businesses have not yet generated significant revenue and the Company continues to evaluate their progress.

The following discussion of the Company's results of operations includes the results of its continuing new ventures (see also footnote 8 to the condensed consolidated financial statements). The operating losses of the new ventures consist principally of research and development and selling, general and administrative costs. These operating losses have decreased from $10.0 million for the three months ended December 29, 2000 to $5.8 million for the three months ended December 28, 2001 due to expense reduction efforts. The operating losses of the new ventures have decreased from $18.0 million for the six months ended December 29, 2000 to $13.9 million for the six months ended December 28, 2001, also due to expense reduction efforts.

**Results of Operations**

*Summary Comparison*

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

| | THREE- MONTH PERIOD ENDED | | SIX- MONTH PERIOD ENDED | |
|---|---|---|---|---|
| | DEC 29, 2000 | DEC 28, 2001 | DEC 29, 2000 | DEC 28, 2001 |
| Revenues, net | 100.0% | 100.0% | 100.0% | 100.0% |
| Costs and expenses: | | | | |
| Cost of revenues | 88.0 | 87.7 | 90.5 | 87.5 |
| Research and development | 6.0 | 5.4 | 6.7 | 6.2 |
| Selling, general and administrative | 5.6 | 5.2 | 6.2 | 5.8 |
| Total costs and expenses | 99.6 | 98.3 | 103.4 | 99.5 |
| Operating income (loss) | 0.4 | 1.7 | (3.4) | 0.5 |
| Net interest and other income (expense) | 0.1 | 0.5 | (0.1) | 0.3 |
| Income (loss) from continuing operations | 0.5% | 2.2% | (3.5)% | 0.8% |

The Company's income from continuing operations of $12.7 million for the three months ended December 28, 2001 increased by $9.9 million from the three months ended December 29, 2000 and $16.7 million from the immediately preceding quarter. The increase in income from continuing operations as compared to the corresponding period of the prior year was due to a $3.4 million increase in operating income in the hard drive business, a $4.2 million decrease in operating losses from new business ventures and a $2.3 million increase in interest and other income. The increase as compared to the immediately preceding quarter was due to an $11.4 million increase in operating income in the hard drive business, a $2.4 million decrease in operating losses from new business ventures and a $2.9 million increase in interest and other income. The Company's income from continuing operations of $8.7 million for the six months ended December 28, 2001 increased by $43.1 million, or 125%, from the six months ended December 29, 2000. The increase was due to a $34.9 million increase in operating income in the hard drive business, a $4.1 million decrease in operating losses from new business ventures and a $4.1 million increase in interest and other income.

Consolidated revenues were $574.7 million for the three months ended December 28, 2001, an increase of 2%, or $13.1 million, from the three months ended December 29, 2000 and an increase of 30%, or $133.7 million, from the immediately preceding quarter. The increase in consolidated revenues as compared to the corresponding period of the prior year resulted from a 25% increase in unit shipments, partially offset by an 18% decrease in average selling prices (ASP's). The increase in consolidated revenues as compared to the immediately preceding quarter resulted from a 43% increase in unit shipments, partially offset by a 9% decrease in ASP's. Consolidated revenues were $1,015.6 million for the six months ended December 28, 2001, an increase of 3%, or $29.7 million, from the six months ended December 29, 2000. The increase in consolidated revenues resulted from a 16% increase in unit shipments, partially offset by an 11% decrease in ASP's. Revenues from new business ventures were not material for all periods presented.

Gross profit for the three months ended December 28, 2001 totaled $70.6 million, or 12.3% of revenue. This compares to a gross profit of $67.5 million, or 12.0% of revenue, for the three months ended December 29, 2000 and gross profit of $56.0 million, or 12.7% of revenue, for the immediately preceding quarter. Gross profit for the six months ended December 28, 2001 totaled $126.6 million, or 12.5% of revenue. This compares to a gross profit of $93.5 million, or 9.5% of revenue, for the six months ended December 29, 2000. The increase in the gross profit over the corresponding three and six-month periods of the prior year was primarily the result of cost reduction efforts and higher volume in the hard drive business, partially offset by lower ASP's. The decrease in gross margin percentage over the immediately preceding quarter was primarily the result of a change in the mix of products shipped.

Research and development ("R&D") expense for the three months ended December 28, 2001 was $31.3 million, a decrease of $2.3 million from the three months ended December 29, 2000 and a decrease of $0.2 million from the immediately preceding quarter. The decrease in R&D expense from the corresponding period of the prior year was primarily due to expense reduction efforts in the new business ventures. The decrease in R&D expense from the immediately preceding quarter was primarily due to expense reduction efforts in the new business ventures, partially offset by an increase in expense in the hard drive business directly related to the increase in volume and revenues. R&D expense for the six months ended December 28, 2001 was $62.8 million, a decrease of $2.8 million from the corresponding period of the prior year. The decrease was primarily due to expense reduction efforts, partially offset by an increase in expense directly related the increase in volume and revenues.

Selling, general and administrative ("SG&A") expense for the three months ended December 28, 2001 was $29.7 million, a decrease of $2.3 million from the three months ended December 29, 2000 and an increase of $1.0 million from the immediately preceding quarter. SG&A expense for the six months ended December 28, 2001 was $58.3 million, a decrease of $3.1 million from the corresponding period of the prior year. The decrease in SG&A expense from the corresponding three and six-month periods of the prior year was primarily due to expense reduction efforts in the hard drive business and the new business ventures. The increase in SG&A expense from the immediately preceding quarter was primarily due to an increase in expense in the hard drive business directly related to the increase in volume and revenues, partially offset by expense reduction efforts in the new business ventures.

Net interest and other income (expense) for the three months ended December 28, 2001 was $3.1 million, compared to $0.8 million for the three months ended December 29, 2000 and $0.2 million for the immediately preceding quarter. The increase in income from the corresponding period of the prior year and the immediately preceding quarter was primarily the result of net investment gains of $3.5 million, consisting of a $9.0 million cash recovery from its Komag note receivable and a $5.5 million write-down of certain cost-method investments which were determined to be impaired, offset by a decrease in net interest income due to lower interest rates. Net interest and other income (expense) for the six months ended December 28, 2001 was $3.3 million, compared to ($0.8) million for the six months ended December 29, 2000. The increase in income was primarily the result of an increase in net investment gains and minority interests in losses of consolidated subsidiaries, partially offset by lower net interest income.

During the three months ended September 28, 2001, the Company decided to discontinue the operations of Connex and SANavigator and sold substantially all of the assets of these two businesses for a net gain of $24.5 million. Accordingly, the operating results of Connex and SANavigator for the periods reported and the net gain recognized on the sale of the businesses during the six months ended December 28, 2001 have been segregated from continuing operations and reported separately on the statements of operations as discontinued operations.

During the six months ended December 28, 2001, the Company issued 1.5 million shares of common stock and $6.3 million in cash in exchange for $30.0 million in face value of the Debentures (with a book value of $13.0 million). During the corresponding period of the prior year, the Company issued 15.4 million shares of common stock in exchange for $286.9 million in face value of the Debentures (with a book value of $116.6 million). These redemptions were private, individually negotiated transactions with certain institutional investors. As a result of the redemptions, the Company recognized an extraordinary loss of $0.1 million for the three and six months ended December 28, 2001 and extraordinary gains of $10.6 million and $21.8 million for the three and six months ended December 29, 2000, respectively.

**Liquidity and Capital Resources**

At December 28, 2001, the Company had cash and cash equivalents of $193.3 million as compared to $167.6 million at June 29, 2001. Net cash provided by continuing operations was $14.2 million during the six months ended December 28, 2001, as compared to net cash used for continuing operations of $57.4 million during the six months ended December 29, 2000. This $71.6 million improvement in cash provided by continuing operations consists of a $37.0 million improvement in the Company's operating results, net of non-cash items, and a $34.6 million decrease in cash used to fund working capital requirements. The improvement in operating results is due to significantly better performance by the Company's hard drive business as a result of higher sales volume and improved cost management. The decrease in cash used to fund working capital requirements is primarily due to a decrease in cash used to settle restructuring and other special charge accruals resulting from transactions during 2000. In addition, the Company's cash conversion cycle, which represents the sum of the number of days sales outstanding ("DSO") and days inventory outstanding ("DIO") less days payable outstanding ("DPO"), was reduced by 2 days for the six months ended December 28, 2001 compared to the corresponding period of the prior year.

Other uses of cash during the six months ended December 28, 2001 included net capital expenditures of $26.0 million, primarily to upgrade the Company's desktop hard drive production capabilities and for normal replacement of existing assets, and $6.3 million for debenture redemptions. Other sources of cash during the period included $9.0 million received from the sale of remaining Komag assets, $3.0 million received by the Company's subsidiaries from minority investors and $2.6 million received in connection with stock option exercises and Employee Stock Purchase Plan purchases.

During the six months ended December 29, 2000, other uses of cash included net capital expenditures of $26.8 million. Other sources of cash during that period included proceeds of $15.0 million received upon the sale of marketable equity securities, $72.7 million received upon issuance of 14.5 million shares of the Company's stock under the Company's equity facility, $5.0 million received from a third-party bridge loan to one of the Company's subsidiaries and $3.5 million received in connection with stock option exercises and Employee Stock Purchase Plan purchases.

The Company has a three-year Senior Credit Facility for its hard drive business, Western Digital Technologies, Inc. ("WDT"), which provides up to $125 million in revolving credit (subject to a borrowing base calculation), matures on September 20, 2003 and is secured by WDT's accounts receivable, inventory, 65% of the stock in its foreign subsidiaries and other assets. At the option of WDT, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. The Senior Credit Facility requires WDT to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. As of the date hereof, there were no borrowings under the facility. The Company is in discussions with Cirrus Logic, Inc. ("Cirrus") concerning a negotiated posting of $25 million security for accounts payable to Cirrus, which are included in the Company's balance sheet, that the Company is disputing in its litigation against Cirrus (See Part II, Item 1 — Legal Proceedings). If the Company decides to issue a letter of credit in favor of Cirrus to secure this payable, the availability under the Senior Credit Facility would be reduced by a corresponding amount.

During the six months ended December 29, 2000, the Company issued 14.5 million shares of common stock under preexisting shelf registrations for net cash proceeds of $72.7 million. During the six months ended December 28, 2001, no common stock was issued under the shelf registrations. Subsequent to December 28, 2001, the Company withdrew these shelf registrations as management determined they would not be utilized in the foreseeable future.

At December 28, 2001, the Company had cash and cash equivalents of $193.3 million, working capital of $80.8 million and shareholders' equity of $48.9 million. In addition, the Company has a Senior Credit Facility providing up to $125 million in revolving credit. Furthermore, the Company has achieved significant reductions in manufacturing labor and overhead and operating expenses resulting from the sale in late 1999 of the Company's media operations, the closure in 2000 of the Company's two Singapore based manufacturing facilities and its Rochester design center, the disposal of its Connex and SANavigator businesses, and an overall reduction in worldwide headcount.

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

**New Accounting Pronouncements**

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

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

During October 2001 the FASB issued Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets” (“SFAS 144”). SFAS 144 is effective for fiscal years beginning after December 15, 2001. The Company does not expect the adoption of SFAS 144 to have a material impact on its consolidated financial position, results of operations or liquidity.

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

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

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

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

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

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

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

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

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

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

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

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

*Our average selling prices are declining.*

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

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

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

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

Demand for our hard drives depends on the demand for computer systems manufactured by our customers and on storage upgrades to existing systems. The demand for computer systems has been volatile in the past and often has had an exaggerated effect on the demand for hard drives in any given period. As a result, the hard drive market tends to experience periods of excess capacity, which typically lead to intense price competition. During calendar year 2001, the industry experienced weak PC demand in the U.S. and other markets, and forecasts for calendar year 2002 are cautious. If intense price competition occurs as a result of weak demand, we may be forced to lower prices sooner and more than expected, which could result in lower revenues.

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

Over the past few years the consumer market for desktop computers has shifted significantly towards lower priced systems, especially those systems priced below $1,000. Although we were late to market with a value line hard drive to serve the low-cost PC market, we are now offering such value line products at prices that we view as competitive. However, if we are not able to continue to offer a competitively priced value line hard drive for the low-cost PC market, our share of that market will likely fall, which could harm our operating results.

The PC market is fragmenting into a variety of computing devices and products. Some of these products, such as Internet appliances, may not contain a hard drive. On the other hand, many industry analysts expect, as do we, that as broadcasting and communications are increasingly converted to digital technology from the older, analog technology, the technology of computers and consumer electronics and communication devices will converge, and hard drives will be found in many consumer products other than computers. For the quarter ended December 28, 2001 more than 10% of our unit sales were for consumer products other than computers, primarily gaming devices. If we are not successful in using our hard drive technology and expertise to develop new products for these emerging markets, it will likely harm our operating results.

*We depend on our key personnel.*

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

**Risk factors relating to Western Digital particularly**

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

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

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

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

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

In April 1999, we entered into a three-year volume purchase agreement with Komag under which we buy a substantial portion of our media components from Komag. In October 2001, we amended the volume purchase agreement to extend the initial term to six years. This strategic relationship has reduced our media component costs; however, it has increased our dependence on Komag as a supplier. Our future operating results may depend substantially on Komag’s ability to timely qualify its media components in our new development programs and to supply us with these components in sufficient volume to meet our production requirements. A significant disruption in Komag’s ability to manufacture and supply us with media could harm our operating results. Komag is currently in Chapter 11 reorganization proceedings, during which it is continuing its operations.

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

Under our “virtual vertical integration” business model, we do not manufacture any of the parts used in our hard drives. As a result, the success of our products depends on our ability to gain access to and integrate parts that are “best in class” from reliable component suppliers. To do so we must effectively manage our relationships with our strategic component suppliers. We must also effectively integrate different products from a variety of suppliers and manage difficult scheduling and delivery problems. Although we believe that our relationships with our current strategic suppliers are good, we are currently engaged in litigation with Cirrus, which until this year was the sole source of read-channel chips for our hard drives. As a result of the disputes that gave rise to the litigation, our business operations were at risk until another supplier could be designed into our products.

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

Most of our manufacturing volume comes from one facility in Malaysia. We have recently acquired a second, smaller manufacturing facility in Thailand. A fire, flood, earthquake or other disaster or condition affecting our Malaysian facility would result in a loss of sales and revenue and harm our operating results.

*Manufacturing our products abroad subjects us to numerous risks.*

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

- obtaining requisite United States and foreign governmental permits and approvals
- currency exchange rate fluctuations or restrictions
- political instability and civil unrest
- transportation delays or higher freight rates
- labor problems
- trade restrictions or higher tariffs

- exchange, currency and tax controls and reallocations

- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

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

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

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

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

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

The hard drive industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. We are currently evaluating notices of alleged patent infringement or notices of patents from patent holders. We also are a party to several judicial and other proceedings relating to patent and other intellectual property rights. If we conclude that a claim of infringement is valid, we may be required to obtain a license or cross-license or modify our existing technology or design a new non-infringing technology. Such licenses or design modifications can be extremely costly. We may also be liable for any past infringement. If there is an adverse ruling against us in an infringement lawsuit, an injunction could be issued barring production or sale of any infringing product. It could also result in a damage award equal to a reasonable royalty or lost profits or, if there is a finding of willful infringement, treble damages. Any of these results would likely increase our costs and harm our operating results.

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

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

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

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

- the timing of orders from and shipment of products to major customers

- our product mix

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

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

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

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

*The market price of our common stock is volatile.*

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

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

In addition, the stock market from time to time experiences extreme price and volume fluctuations that particularly affect the stock prices of many high technology companies. These fluctuations are often unrelated to the operating performance of the companies.

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

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

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

We have zero coupon convertible subordinated debentures due February 18, 2018 (the "Debentures") that, at the holder's option, will be repurchased by the Company, as of February 18, 2003, February 18, 2008 or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of repurchase. The payment on those dates, with the exception of a Fundamental Change, can be in cash, stock or any combination, at the Company's option. The issuance of stock to redeem the bonds could be dilutive to the existing stockholders.

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

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

## Item 3. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

### Disclosure About Foreign Currency Risk

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

Historically, the Company has focused on hedging its foreign currency risk related to the Singapore Dollar, the British Pound and the Malaysian Ringgit. With the establishment of currency controls and the prohibition of purchases or sales of the Malaysian Ringgit by offshore companies, the Company discontinued hedging its Malaysian Ringgit currency risk in 1999. Future hedging of this currency will depend on currency conditions in Malaysia. As a result of the closure of the Company's Singapore operations in 2000, the Company has also discontinued its hedging program related to the Singapore Dollar.

As of December 28, 2001, the Company had outstanding the following purchased foreign currency forward exchange contracts (in millions, except average contract rate):

| | DECEMBER 28, 2001 | | |
|---|---|---|---|
| | CONTRACT AMOUNT | WEIGHTED AVERAGE CONTRACT RATE | UNREALIZED GAIN (LOSS) |
| | (U.S. DOLLAR EQUIVALENT AMOUNTS) | | |
| FOREIGN CURRENCY FORWARD CONTRACTS: | | | |
| British Pound Sterling | 1.1 | 1.45 | — |

During the three and six months ended December 29, 2000 and December 28, 2001, total realized transaction and forward exchange contract currency gains and losses were not material to the consolidated financial statements. Based on historical experience, the Company does not expect that a significant change in foreign exchange rates would materially affect the Company's consolidated financial statements.

**Disclosure About Other Market Risks**

*Fixed Interest Rate Risk*

At December 28, 2001, the market value of the Company's 5.25% zero coupon convertible subordinated debentures due in 2018 was approximately $102.6 million, compared to the related book value of $102.4 million. The convertible debentures will be repurchased by the Company, at the option of the holder, as of February 18, 2003, February 18, 2008, or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of redemption. The payment on those dates, with the exception of a Fundamental Change, can be in cash, stock or any combination, at the Company's option.

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

*Variable Interest Rate Risk*

At the option of WDT, borrowings under the Senior Credit Facility would bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. This is the only borrowing facility that does not have a fixed-rate of interest. The Senior Credit Facility requires WDT to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. As of the date hereof, there were no borrowings under the Senior Credit Facility.

*Fair Value Risk*

The Company owns approximately 1.2 million shares of Vixel common stock. As of December 28, 2001, the market value of the Vixel shares was $2.2 million. The Company determines, on a quarterly basis, the fair market value of the Vixel shares and records an unrealized gain or loss resulting from the difference in the fair market value of the shares as of the previous quarter end and the fair market value of the shares on the measurement date. As of December 28, 2001, a $2.2 million total accumulated unrealized gain has been recorded in accumulated other comprehensive income. If the Company sells all or a portion of this common stock, any unrealized gain or loss on the date of sale will be recorded as a realized gain or loss in the Company's results of operations. As a result of market conditions, the market value of the shares had increased from $2.2 million as of December 28, 2001 to $4.4 million as of January 25, 2002. Due to market fluctuations, a decline in the stock's fair market value could occur.

## PART II. OTHER INFORMATION

### Item 1. *LEGAL PROCEEDINGS*

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

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

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

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

On May 22, 2001, Cambrian Consultants, Inc. ("Cambrian") filed a complaint against the Company in the United States District Court, Central District of California. The suit alleges infringement by the Company of a Cambrian patent. On July 20, 2001, the Company filed an answer denying the allegations contained in Cambrian's complaint and a counter claim asserting that Cambrian's patent was invalid. The Court ordered an accelerated discovery schedule and scheduled the case for trial on March 26, 2002. On January 4, 2002, the Company entered into a settlement agreement with Cambrian, settling all claims in the litigation, and on January 7, 2002 the Court entered a dismissal of the action. The settlement was not material to the Company's consolidated financial position, results of operations or liquidity.

On July 5, 2001, the Company (and its Malaysian subsidiary) filed suit against Cirrus Logic, Inc. ("Cirrus") in California Superior Court for the County of Orange for breach of contract and other claims resulting from Cirrus' role as a strategic supplier of read channel chips for the Company's hard drives. The Company also stopped making payments to Cirrus for past deliveries of chips and terminated all outstanding purchase orders from Cirrus for such chips. The Company's complaint alleges that Cirrus' unlawful conduct caused damages in excess of any amounts that may be owing on outstanding invoices or arising out of any alleged breach of the outstanding purchase orders. On August 20, 2001, Cirrus filed an answer and cross-complaint. Cirrus denied the allegations contained in the Company's complaint and asserted counterclaims against the Company for, among other things, the amount of the outstanding invoices and the Company's alleged breach of the outstanding purchase orders. The disputed payable, which is included in the Company's balance sheet in accounts payable, is approximately $27 million. Cirrus claims that the canceled purchase orders, which are not reflected in the Company's financial statements, total approximately $26 million. On October 9, 2001, the Court granted Cirrus' Motion for Judgment on the Pleadings, with leave to amend, and on November 8, 2001, the Company filed its First Amended Complaint. Cirrus demurred to the First Amended Complaint, and on December 18, 2001, the Court denied Cirrus' demurrer. On November 2, 2001, Cirrus filed Applications for Right to Attach Orders and for Writs of Attachment against the Company and its Malaysian subsidiary in the amount of $25.2 million as security for the approximately $27 million allegedly owed for read-channel chips purchased from Cirrus that is disputed by the Company. On December 20, 2001, the Court granted Cirrus'

Applications but required Cirrus to post undertakings in the amount of $0.5 million on each Writ before issuance. Neither the Right to Attach Orders nor the Writs of Attachment have been filed by Cirrus or issued by the Court as the Company and its Malaysian subsidiary are in discussions with Cirrus concerning a negotiated posting of security in satisfaction of Cirrus' Writs. If the parties are unable to reach agreement, the Company and its Malaysian subsidiary will comply with the Court's final order. The parties have begun discovery and expect that such discovery will continue for the next several months. Based on its initial investigation and the limited discovery done to date, the Company does not believe that the ultimate resolution of this matter will have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

In November 2001, Dynacore Holding Corporation ("Dynacore") filed suit against the Company and several other defendants in the United States District Court for the Southern District of New York. The suit alleges that the Company's 1394 external hard drives fall within the scope of the subject matter of Dynacore's patent covering communication between nodes within a network, wherein nodes have both enhanced and common capabilities. During January 2002, the Company filed an answer denying Dynacore's complaint and alleged counterclaims. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

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

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

**Item 2.** ***CHANGES IN SECURITIES AND USE OF PROCEEDS***

During the three months ended December 28, 2001, the Company engaged in transactions pursuant to which it exchanged an aggregate principal amount at maturity of $30.0 million of the Company's Zero Coupon Convertible Subordinated Debentures due 2018, for an aggregate of 1,546,296 shares of the Company's common stock and $6,262,500 in cash. These transactions were undertaken in reliance upon the exemption from the registration requirements of the Securities Act afforded by Section 3(a)(9) thereof, as exchanges of securities by the Company with its existing security holders. No commission or other remuneration was paid or given directly or indirectly for soliciting such exchanges. These exchanges were consummated in private, individually negotiated transactions with institutional investors.

**Item 4.** ***SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS***

The annual meeting of shareholders was held on November 29, 2001. The shareholders elected the following seven directors to hold office until the next annual meeting and until their successors are elected and qualified:

| | Number of Votes | |
|---|---|---|
| | For | Withheld |
| Peter D. Behrendt | 166,627,844 | 1,389,329 |
| I. M. Booth | 166,597,198 | 1,419,975 |
| Kathleen A. Cote | 166,564,640 | 1,452,533 |
| Henry T. DeNero | 166,697,954 | 1,319,219 |
| Matthew E. Massengill | 166,765,869 | 1,251,304 |
| Roger H. Moore | 166,719,441 | 1,297,732 |
| Thomas E. Pardun | 166,683,598 | 1,333,575 |

In addition, the shareholders approved the following proposals:

| | | Number of Votes | | |
|---|---|---|---|---|
| | | For | Against | Abstentions |
| 1. | To approve the amendment to the Company's certificate of incorporation to increase the number of authorized shares of the Company's common stock from 225,000,000 to 450,000,000 shares | 151,686,082 | 15,887,884 | 443,207 |
| 2. | To ratify the selection of KPMG LLP as independent accountants for the Company for the fiscal year ended June 28, 2002. | 166,970,052 | 631,860 | 415,261 |

**Item 6.** ***EXHIBITS AND REPORTS ON FORM 8-K***

(a) ***Exhibits:***

| | |
|---|---|
| 10.47.5 | Fifth Amendment to Credit Agreement among Western Digital Technologies, Inc., the lenders identified therein and General Electric Capital Corporation and Bank of America, N.A., dated as of December 21, 2001.* |
| 10.54 | Letter agreement dated October 19, 2001, by and between the Company and D. Scott Mercer. |

(b) ***Reports on form 8-K:***

On October 25, 2001, the Company filed a current report on Form 8-K to file its press release dated October 25, 2001, announcing its financial results for its first quarter of the 2002 fiscal year.

* Certain portions of this exhibit have been omitted pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WESTERN DIGITAL CORPORATION
Registrant

/s/ Scott Mercer

D. Scott Mercer
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 8, 2002

## EXHIBIT INDEX

| EXHIBIT NUMBER | DESCRIPTION |
|---|---|
| 10.47.5 | Fifth Amendment to Credit Agreement among Western Digital Technologies, Inc., the lenders identified therein and General Electric Capital Corporation and Bank of America, N.A., dated as of December 21, 2001.* |
| 10.54 | Letter agreement dated October 19, 2001, by and between the Company and D. Scott Mercer. |

* Certain portions of this exhibit have been omitted pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission.

Certain confidential information has been omitted from this Exhibit 10.47.5 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "***" at each place in this Exhibit 10.47.5 where the omitted information appeared in the original.

Exhibit 10.47.5

# FIFTH AMENDMENT TO CREDIT AGREEMENT

THIS FIFTH AMENDMENT TO CREDIT AGREEMENT ("Amendment") is entered into as of December 21, 2001, by and among WESTERN DIGITAL TECHNOLOGIES, INC., a Delaware corporation formerly known as Western Digital Corporation ("Borrower"), the other credit parties party hereto (each individually a "Credit Party" and collectively, the "Credit Parties"), the lenders signatory hereto (each individually a "Lender" and collectively the "Lenders"), GENERAL ELECTRIC CAPITAL CORPORATION, a Delaware corporation, as administrative agent for Lenders (in such capacity, "Agent"), and BANK OF AMERICA, N.A., as documentation agent for Lenders ("Documentation Agent"; Agent and Documentation Agent are collectively referred to as "Co-Agents" and each, a "Co-Agent").

## RECITALS

A. Borrower, the other Credit Parties party thereto, Lenders, and Co-Agents have entered into the Credit Agreement dated as of September 20, 2000, as amended by the First Amendment to Credit Agreement dated as of March 8, 2001, the Second Amendment to Credit Agreement dated as of March 23, 2001, the Third Amendment to Credit Agreement dated as of April 7, 2001, and the Fourth Amendment to Credit Agreement dated as of September 26, 2001 (collectively, "Credit Agreement"), pursuant to which Co-Agents and Lenders are providing financial accommodations to or for the benefit of Borrower upon the terms and conditions contained therein. Unless otherwise defined herein, capitalized terms or matters of construction defined or established in Annex A to the Credit Agreement shall be applied herein as defined or established therein.

B. Borrower has requested in the letter attached hereto as Appendix A that Co-Agents and Lenders amend, and consent to certain matters under, the Credit Agreement, and Co-Agents and Lenders are willing to do so subject to the terms and conditions of this Amendment.

## AGREEMENT

NOW, THEREFORE, in consideration of the continued performance by Borrower and each other Credit Party of their respective promises and obligations under the Credit Agreement and the other Loan Documents, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Borrower, the other Credit Parties signatory hereto, Lenders, and Co-Agents hereby agree as follows:

1. Ratification and Incorporation of Credit Agreement. Except as expressly modified under this Amendment, (a) each Credit Party hereby acknowledges, confirms, and ratifies all of the terms and conditions set forth in, and all of its obligations under, the Credit Agreement, and (b) all of the terms and conditions set forth in the Credit Agreement are incorporated herein by this reference as if set forth in full herein.

2. Amendment to Credit Agreement and Other Loan Documents. The following definition is hereby added to Annex A to the Credit Agreement:

> "Fifth Amendment" means the Fifth Amendment to Credit Agreement dated as of December 21, 2001.

3. Consent Under Credit Agreement. Notwithstanding the provisions of Sections 6.1 and 6.5 of the Credit Agreement, at the request of Borrower, Co-Agents and Requisite Lenders hereby consent to the following: (1) the formation by WD (Malaysia) SDN BHD ("WDM") of Western Digital (Thailand) Company Limited ("WD Thailand"), a corporation organized and existing under the laws of Thailand, which shall be a wholly-owned Subsidiary of WDM; (2) the contribution of $*** in

paid-in capital by WDM to WD Thailand at the time of formation of WD Thailand; and (3) the acquisition of certain assets of Fujitsu (Thailand) Company Ltd. ("Fujitsu") located in Thailand (the "Fujitsu Assets") by WD Thailand (clauses (1), (2) and (3) are referred to collectively as the "Proposed Transactions") on the following conditions:

(a) the purchase price payable by WD Thailand (excluding reasonable transaction costs) pursuant to the Asset Purchase Agreement between WD Thailand and Fujitsu dated December 17, 2001 in connection with the purchase of the Fujitsu Assets ("Asset Purchase Agreement") shall be $*** (the "Purchase Price") which Purchase Price shall consist of (i) payment of $*** at closing, (ii) one or more promissory notes entered into by WD Thailand in favor of Fujitsu in the aggregate principal amount of $*** ("Note"), and (iii) the assumption by WD Thailand of the Assumed Liabilities (as defined below) in an amount not to exceed $***;

(b) the Fujitsu Assets shall be free and clear of all Liens;

(c) no Indebtedness, Guaranteed Indebtedness, contingent obligations or other liabilities shall be incurred or assumed by WD Thailand, WDM or Borrower in connection with the Proposed Transactions other than (i) the Purchase Price, (ii) the bank guarantee securing the Note, issued by CitiBank Malaysia in favor of Fujitsu (to be collateralized by a deposit by WD Thailand of $*** with CitiBank Malaysia), (iii) the Assumed Liabilities assumed by WD Thailand, and (iv) the conditional right of first refusal granted by WD Thailand to Fujitsu to repurchase the land and improvements ("Property") purchased by WD Thailand from Fujitsu pursuant to the Asset Purchase Agreement in the event that WD Thailand ceases to do business in the Navanakorn Industrial Estate and determines to sell the Property;

(d) WD Thailand shall be treated as an Excluded Subsidiary solely for the purpose of the calculation of clause (f) of the definition of "Permitted Excluded Subsidiary Transactions"; and

(e) the acquisition of the Fujitsu Assets shall have been approved by the board of directors of each of Fujitsu and Holdings.

Effective upon satisfaction of each of the conditions set forth in paragraph 4 below, Co-Agents and Lenders acknowledge that the Proposed Transactions shall be permitted under the Loan Documents on the terms and conditions set forth in this letter agreement and shall not constitute a breach or default under the Loan Documents so long as (i) WD Thailand shall remain a wholly-owned Subsidiary of WDM, (ii) the aggregate amount of capital paid or payable to WD Thailand by Borrower and WDM as of any date shall not exceed $***, (iii) the fair market value of the assets of WD Thailand shall not be in excess of $***, and (iv) neither Borrower, WDM nor any of their respective Subsidiaries (other than WD Thailand) shall have any obligations pursuant to the "provident fund" under Thai Labor Protection Act B.E. 2541, as amended. If Borrower, WDM or WD Thailand fails to comply with either clauses (i), (ii) or (iii) of the preceding sentence, then such failure shall constitute an Event of Default under the Loan Documents. For purposes of this Amendment, "Assumed Liabilities" means the amount of severance payments potentially due to the Transferring Employees (as defined below) pursuant to the Thai Labor Protection Act as a result of their various lengths of employment with Fujitsu for which WD Thailand has agreed to be responsible pursuant to the Asset Purchase Agreement. For purposes of this Amendment, "Transferring Employees" means those employees of Fujitsu whose employment is to be transferred to WD Thailand as listed in the Asset Purchase Agreement and who execute an employee transfer agreement as required by the Asset Purchase Agreement.

*** Confidential portions of this agreement omitted pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission.

4. Conditions to Effectiveness. The effectiveness of this Amendment is subject to satisfaction of each of the following conditions:

(a) receipt by Co-Agents of this Amendment duly executed by Borrower, each of the other Credit Parties, Co-Agents and Requisite Lenders;

(b) payment of $25,000 by Borrower to Agent, for the ratable benefit of Lenders; and

(c) the absence of any Defaults or Events of Default as of the date hereof.

5. Disclosure Schedules. On or before January 31, 2002, Borrower shall deliver to Co-Agents revised versions of Disclosure Schedules (3.8), (3.22), (6.3), (6.6) and (6.7). Failure by Borrower to comply with the foregoing covenant shall constitute an Event of Default under the Loan Documents.

6. Entire Agreement. This Amendment, together with the Credit Agreement and the other Loan Documents, is the entire agreement between the parties hereto with respect to the subject matter hereof. This Amendment supersedes all prior and contemporaneous oral and written agreements and discussions with respect to the subject matter hereof.

7. Representations and Warranties. Borrower and each other Credit Party hereby represents and warrants that the representations and warranties contained in the Credit Agreement were true and correct in all material respects when made and, except to the extent that (a) a particular representation or warranty by its terms expressly applies only to an earlier date or (b) Borrower or any other Credit Party, as applicable, has previously advised Co-Agents in writing as contemplated under the Credit Agreement, are true and correct in all material respects as of the date hereof.

8. Reaffirmation by Guarantors. Each Credit Party that is also a Guarantor, by its execution of this Amendment, consents to the terms hereof and ratifies and reaffirms all of the provisions of the Guaranties.

9. Miscellaneous.

(a) Counterparts. This Amendment may be executed in identical counterpart copies, each of which shall be an original, but all of which shall constitute one and the same agreement. Delivery of an executed counterpart of a signature page to this Amendment by facsimile transmission shall be effective as delivery of a manually executed counterpart thereof.

(b) Headings. Section headings used herein are for convenience of reference only, are not part of this Amendment, and are not to be taken into consideration in interpreting this Amendment.

(c) Recitals. The recitals set forth at the beginning of this Amendment are true and correct, and such recitals are incorporated into and are a part of this Amendment.

(d) Effect. Upon the effectiveness of this Amendment, from and after the date hereof, each reference in the Credit Agreement to "this Agreement," "hereunder," "hereof," or words of like import shall mean and be a reference to the Credit Agreement as amended hereby and each reference in the other Loan Documents to the Credit Agreement, "thereunder," "thereof," or words of like import shall mean and be a reference to the Credit Agreement as amended hereby.

(e) No Novation. Except as expressly provided in Sections 2 and 3 of this Amendment, the execution, delivery, and effectiveness of this Amendment shall not (i) limit, impair, constitute a waiver of, or otherwise affect any right, power, or remedy of any Co-Agent or any Lender under the Credit Agreement or any other Loan Document, (ii) constitute a waiver of any provision in the Credit Agreement or in any of the other Loan Documents, or (iii) alter, modify, amend, or in any way affect any of the terms, conditions, obligations, covenants, or agreements contained in the Credit Agreement or any other Loan Document, all of which are ratified and affirmed in all respects and shall continue in full force and effect.

(f) Conflict of Terms. In the event of any inconsistency between the provisions of this Amendment and any provision of the Credit Agreement, the terms and provisions of this Amendment shall govern and control.

[Remainder of Page Intentionally Left Blank]

IN WITNESS WHEREOF, this Fifth Amendment to Credit Agreement has been duly executed as of the date first written above.

GENERAL ELECTRIC CAPITAL CORPORATION,
as Administrative Agent, a Co-Agent and a Lender

By: ______________________________________________
Robert S. Yasuda
Duly Authorized Signatory

BANK OF AMERICA, N.A.,
as Documentation Agent, a Co-Agent and a Lender

By: ______________________________________________
Name:_____________________________________________
Title: ___________________________________________

THE CIT GROUP/BUSINESS CREDIT, INC.,
as a Lender

By: ______________________________________________
Name:_____________________________________________
Title: ___________________________________________

WESTERN DIGITAL TECHNOLOGIES, INC.,
a Delaware corporation formerly known as
Western Digital Corporation

By: ______________________________________________
Name:_____________________________________________
Title: ___________________________________________

WESTERN DIGITAL (U.K.), LTD.,
a corporation organized under the laws of the
United Kingdom

By: ______________________________________________
Name:_____________________________________________
Title: ___________________________________________

WESTERN DIGITAL (I.S.) LIMITED,
a corporation organized under the laws of Ireland

By: ______________________________________________
Name:_____________________________________________
Title: ___________________________________________

Exhibit 10.54

[WESTERN DIGITAL LETTERHEAD]

October 19, 2001

Mr. D. Scott Mercer
848 Nash Road
Los Altos CA 94024

Dear Scott:

It is with great pleasure that we at Western Digital Corporation (the "Company") extend this offer of employment to you. Your position will be Senior Vice President and Chief Financial Officer, reporting to me. As you know, this is an interim position, as we are conducting a search for a Chief Financial Officer and you will assist us in that search. This is an exempt, at-will position and will pay an annualized base salary of $337,500.00 paid bi-weekly.

Contingent upon approval by the Board of Directors, we will recommend a stock option grant amount of 225,000 shares, subject to the provisions of Western Digital's Stock Option Agreement and stock option plan. This grant will have our customary three (3) year vesting schedule, which is 25% after six months, 25% after 12 months, 25% after 24 months and 25% after 36 months. Vesting will cease upon termination of your service as Senior Vice President and Chief Financial Officer of the Company.

In addition to the above stock option grant, we will also recommend to our Board of Directors a restricted stock grant of 150,000 shares. As with the above stock option grant, this grant is contingent upon Board approval and will be subject to the Western Digital Broad Based Stock Incentive Plan and agreement. Forty percent (40%) or 60,000 of these restricted shares will vest on 1/31/03. The remaining sixty percent (60%) or 90,000 shares will vest the following year on 1/31/04. Vesting will cease upon termination of your service as Senior Vice President and Chief Financial Officer of the Company.

You will be eligible to participate in-full for first half of Fiscal Year 2002, July through December, Incentive Compensation Plan (ICP). Funding will be based on corporate business results. Your participation and potential pay out will be based on your individual accomplishments and is contingent upon approval by the Western Digital Compensation Committee. Your potential ICP payout will be 65% of base salary.

You will be eligible for participation in the Company's Change in Control Severance Plan and will be covered by the Company's customary indemnification policies for elected officers. In addition to your Incentive Compensation Plan participation, you will be eligible to receive a one- time Chief Financial Officer transition bonus in the amount of up to $120,000. You will be paid this bonus at the time you and the Company transition you out of your Chief Financial Officer role and install a new full-time employee status Chief Financial Officer. Payment of this bonus will be at the sole discretion of the President and Chief Executive Officer. Your eligibility for this bonus requires your employee status as Chief Financial Officer during the entire time of transition to a new Chief Financial Officer.

The Company will provide you with furnished apartment style housing in the Orange County, California area, where the Company's headquarters is located, for the period of your employment, but not to exceed twelve months from your start date.

If you are not replaced as Chief Financial Officer prior to the twelve month period, this housing provision may be renegotiated or extended upon mutual agreement depending on the circumstances at that time. Cost considerations associated with this provision, such as apartment rent, furniture rental, etc. will be mutually agreed upon by you and the Company.

During the period of your employment, but not to exceed 12 months, the Company will reimburse you for reasonable travel expenses between your home in Los Altos, California and Orange County, California on a weekly basis. Reimbursement of these expenses will follow the guidelines outlined in the Company's travel and expense policy. This offer is contingent upon successful completion of all pre-employment criteria as outlined on Western Digital's Application for Employment, which is enclosed for completion and your signature.

As a condition of employment, immediately upon date of hire, you will be required to sign an Employee Agreement governing the inventions, proprietary information and such other subject matter that the company considers vital to protect its operation. Your employment will be "at will," which means that there will be no fixed duration to your employment relationship. You can terminate your employment at any time and for any reason, and the Company can terminate your employment at any time for any reason.

You will be eligible on your first day of employment for Beneflex, our flexible benefits plan that allows you to choose the coverage that fits your needs. As a Senior Vice President, you will receive an additional $5,000 medical expense allowance per benefit year. This allowance can be used to cover out-of-pocket expenses not covered in the medical plan you choose. You will be eligible to join the Western Digital Savings (401k) Plan immediately. You will receive a complete benefits summary during your orientation on your first day of employment.

Your vacation and sick leave accruals will be at the fifty percent (50%) level. As a rehired employee, a calculation will be performed taking into account your original start date and your break in service. This will result in creation of an "affiliation date" that will give you credit for time served in relation to your vacation accrual.

Additionally, as a Senior Vice President, you will be eligible to receive reimbursement of up to $5,000 for financial planning services provided to you by a service provider of your choice. This allowance is subject to federal and state supplemental tax rates.

On your first day of employment, at 8:00 a.m. at 20511 Lake Forest Drive, in Lake Forest, you will be required to provide authentic documents that establish identity and employment eligibility. Please refer to the attached List of Acceptable Documents. We are required by law to verify this information and will need one document from List A or two documents, one from List B and one from List C.

Please return the signed and dated original indicating your acceptance within one week from the date of this letter. A copy has been enclosed for your records. If you have any questions, please do not hesitate to call.

Sincerely,

/s/ Matthew E. Massengill

Matthew E. Massengill
President & CEO

ACCEPTANCE: /s/ Scott Mercer
-------------------------------------------------------------------
Signature Date

DATE YOU PLAN TO START WORK:
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