UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2004

OR

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

For the transition period from ____ to_____

Commission file number 1-8703

WESTERN DIGITAL CORPORATION

(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☑ No o

As of the close of business on January 28, 2005, 208.7 million shares of common stock, par value $.01 per share, were issued and outstanding.

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Western Digital Corporation (the "Company", "Western Digital" or "WD") has a 52 or 53-week fiscal year, which typically ends on the Friday nearest to June 30. However, approximately every six years, the Company reports a 53-week fiscal year to align its fiscal quarters with calendar quarters by adding a week to its fourth fiscal quarter. Unless otherwise indicated, references herein to specific years and quarters are to the Company's fiscal years and fiscal quarters, and references to financial information are on a consolidated basis.

The information on the Company's web site, http://www.westerndigital.com, is not incorporated by reference in this Quarterly Report on Form 10-Q.

Western Digital® is a registered trademark, and the Western Digital logo is a trademark, of Western Digital Technologies, Inc. and/or its affiliates. All other trademarks mentioned are the property of their respective owners.

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PART I. FINANCIAL INFORMATION

Item 1. *FINANCIAL STATEMENTS*

WESTERN DIGITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(in millions, except per share amounts; unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	DEC. 31, 2004	DEC. 26, 2003	DEC. 31, 2004	DEC. 26, 2003
Revenue, net	$ 954.9	$ 834.8	$ 1,778.5	$ 1,549.0
Cost of revenue	804.7	693.0	1,515.2	1,311.0
Gross margin	150.2	141.8	263.3	238.0
Operating expenses:				
Research and development	59.7	44.0	113.7	107.7
Selling, general and administrative	33.9	26.5	61.8	54.1
Total operating expenses	93.6	70.5	175.5	161.8
Operating income	56.6	71.3	87.8	76.2
Net interest and other income	0.8	—	0.8	0.3
Income before income taxes	57.4	71.3	88.6	76.5
Income tax provision	1.4	2.5	2.2	2.7
Net income	$ 56.0	$ 68.8	$ 86.4	$ 73.8
Income per common share:				
Basic	$ .27	$ .33	$ .42	$ .36
Diluted	$ .26	$ .32	$ .41	$ .34
Weighted average shares outstanding:				
Basic	205.1	205.4	205.1	204.8
Diluted	213.6	217.9	213.1	216.9

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

WESTERN DIGITAL CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(in millions, except par values; unaudited)

	DEC. 31, 2004	JUL. 2, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 492.5	$ 377.8
Accounts receivable, net	390.4	313.1
Inventories	118.3	148.6
Other	17.6	17.8
Total current assets	1,018.8	857.3
Property and equipment, net	330.1	274.7
Intangible and other assets	19.8	27.2
Total assets	$ 1,368.7	$ 1,159.2
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 521.5	$ 434.9
Accrued expenses	118.3	90.4
Accrued warranty — current portion	66.5	46.4
Current portion of long-term debt	19.9	15.2
Total current liabilities	726.2	586.9
Long-term debt	42.7	52.7
Other liabilities	31.5	32.0
Commitments and contingent liabilities		
Shareholders' equity:		
Preferred stock, $.01 par value; authorized — 5.0 shares; issued — none	—	—
Common stock, $.01 par value; authorized — 450.0 shares; issued — 208.8 shares	2.1	2.1
Additional paid-in capital	674.6	697.6
Accumulated deficit	(96.5)	(182.9)
Treasury stock — common shares at cost 1.6 and 2.7 shares, respectively	(11.9)	(29.2)
Total shareholders' equity	568.3	487.6
Total liabilities and shareholders' equity	$ 1,368.7	$ 1,159.2

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

WESTERN DIGITAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions; unaudited)

	SIX MONTHS ENDED	
	DEC. 31, 2004	DEC. 26, 2003
Cash flows from operating activities:		
Net income	$ 86.4	$ 73.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	61.5	47.2
In-process research and development expense	—	25.6
Changes in:		
Accounts receivable	(77.3)	(114.8)
Inventories	30.4	(49.0)
Other assets	0.2	(1.2)
Accounts payable	86.6	91.1
Accrued expenses	52.8	(14.6)
Other	(4.5)	(2.8)
Net cash provided by operating activities	236.1	55.3
Cash flows from investing activities:		
Capital expenditures, net	(105.5)	(64.1)
Asset acquisition, net of cash acquired	—	(94.8)
Net cash used for investing activities	(105.5)	(158.9)
Cash flows from financing activities:		
Proceeds from shares issued under employee plans	17.1	15.0
Repurchase of common stock	(23.3)	—
Repayment of long-term debt	(9.7)	—
Net proceeds from long-term debt	—	13.8
Net cash (used for) provided by financing activities	(15.9)	28.8
Net increase (decrease) in cash and cash equivalents	114.7	(74.8)
Cash and cash equivalents, beginning of period	377.8	393.2
Cash and cash equivalents, end of period	$ 492.5	$ 318.4
Supplemental disclosures of cash flow information:		
Cash paid during the period for income taxes	$ 1.1	$ 1.7
Cash paid during the period for interest	$ 1.0	$ 0.6
Supplemental disclosures of non-cash investing and financing activities:		
Equipment additions funded by capital lease obligations	$ 4.3	$ —
Liabilities assumed in asset acquisition	$ —	$ 77.2

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 the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K as of and for the year ended July 2, 2004. In the opinion of management, all adjustments necessary to fairly state the unaudited condensed consolidated financial statements have been made. All such adjustments are of a normal recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K as of and for the year ended July 2, 2004. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year. Certain prior periods' amounts have been reclassified to conform to current period presentation.

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

2. Supplemental Financial Statement Data (in millions)

	DEC. 31, 2004	JUL. 2, 2004
Inventories:		
Finished goods	$ 56.3	$ 70.6
Work in process	50.2	51.6
Raw materials and component parts	11.8	26.4
	$ 118.3	$ 148.6

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	DEC. 31, 2004	DEC. 26, 2003	DEC. 31, 2004	DEC. 26, 2003
Net Interest and Other Income:				
Interest income	$ 1.7	$ 0.6	$ 2.5	$ 1.2
Interest and other expense	(0.9)	(0.6)	(1.7)	(0.9)
	$ 0.8	$ —	$ 0.8	$ 0.3

The Company records a provision for estimated warranty costs as products are sold to cover the cost of repair or replacement of the hard drive during the warranty period. This provision is based on estimated future returns within the warranty period and costs to repair, using historical field return rates by product type and current average repair costs. Changes in the warranty provision for the three months and six months ended December 31, 2004 and December 26, 2003 were as follows (in millions):

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	DEC. 31, 2004	DEC. 26, 2003	DEC. 31, 2004	DEC. 26, 2003
Liability at beginning of period	$ 65.3	$ 52.0	$ 56.8	$ 52.9
Charges to operations	25.3	16.6	43.7	29.3
Utilization	(11.5)	(13.3)	(24.1)	(24.5)
Changes in estimate related to pre-existing warranties	2.4	(2.1)	5.1	(4.5)
Liability at end of period	$ 81.5	$ 53.2	$ 81.5	$ 53.2

Accrued warranty includes amounts classified in non-current liabilities of $15.0 million at December 31, 2004, $10.4 million at July 2, 2004 and $9.5 million at December 26, 2003.

3. Income per Share

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

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	DEC. 31, 2004	DEC. 26, 2003	DEC. 31, 2004	DEC. 26, 2003
Net income	$ 56.0	$ 68.8	$ 86.4	$ 73.8
Weighted average shares outstanding:				
Basic	205.1	205.4	205.1	204.8
Employee stock options and other	8.5	12.5	8.0	12.1
Diluted	213.6	217.9	213.1	216.9
Income per share:				
Basic	$ .27	$ .33	$ .42	$ .36
Diluted	$ .26	$ .32	$ .41	$ .34

For purposes of computing diluted income per share, common share equivalents with an exercise price that exceeded the average fair market value of common stock for the period are considered anti-dilutive and have been excluded from the calculation for employee stock options. These antidilutive common share equivalents totaled 15.7 million and 14.1 million for the three months ended December 31, 2004 and December 26, 2003, respectively, and 17.0 million and 13.8 million for the six months ended December 31, 2004 and December 26, 2003, respectively.

4. Stock Based Compensation

Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), establishes the financial accounting and reporting standards for stock-based compensation plans. As permitted by SFAS 123, the Company elected to continue accounting for stock-based employee compensation plans (including shares issued under the Company's stock option plans and Employee Stock Purchase Plan ("ESPP"), collectively called "Options") in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations ("APB Opinion No. 25"), and to follow the pro forma net income, pro forma income per share, and stock-based compensation plan disclosure requirements set forth in SFAS 123. The following table sets forth the computation of basic and diluted income per share for the three months and six months ended December 31, 2004 and December 26, 2003, and illustrates the effect on net income and income per share as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation.

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	DEC. 31, 2004	DEC. 26, 2003	DEC. 31, 2004	DEC. 26, 2003
Net income, as reported	$ 56.0	$ 68.8	$ 86.4	$ 73.8
Add: Stock-based employee compensation included in reported net income, net of related taxes	0.3	0.5	0.5	1.0
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(7.3)	(7.2)	(13.2)	(13.9)
Pro forma net income	$ 49.0	$ 62.1	$ 73.7	$ 60.9
Basic income per share:				
As reported	$ .27	$ .33	$ .42	$ .36
Pro forma	$ .24	$ .30	$ .36	$ .30
Diluted income per share:				
As reported	$ .26	$ .32	$ .41	$ .34
Pro forma	$ .23	$ .29	$ .35	$ .28

The pro forma income per share information is estimated using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. This model also requires the input of highly subjective assumptions including the expected stock price volatility and expected period until options are exercised. The pro forma impact of applying SFAS 123 at December 31, 2004 is not necessarily representative of future periods.

The fair value of Options granted during the six months ended December 31, 2004 and December 26, 2003 has been estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions:

	STOCK OPTION PLANS		ESPP	
	DEC. 31, 2004	DEC. 26, 2003	DEC. 31, 2004	DEC. 26, 2003
Option life (in years)	4.51	4.26	1.25	1.25
Risk-free interest rate	3.23%	1.70%	2.02%	1.09%
Stock price volatility	0.74	0.77	0.58	0.77
Dividend yield	—	—	—	—
Fair value	$ 5.33	$ 7.22	$ 2.81	$ 4.64

5. Short-term Borrowings and Long-term Debt

Short-term borrowings and long-term debt consisted of the following on December 31, 2004 (in millions):

Term loan	$ 43.8
Capital lease obligations	18.8
Total	62.6
Less amounts due in one year	(19.9)
	$ 42.7

Line of Credit

The Company has a $125 million five-year credit facility (“Senior Credit Facility”) that provides up to $75 million in revolving credit (subject to outstanding letters of credit and a borrowing base calculation) and a term loan of $50 million. Both the revolving credit facility and the term loan mature on September 19, 2008, and are secured by the Company’s accounts receivable, inventory, 65% of its stock in its foreign subsidiaries and other assets. At the option of the Company, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin.

The Senior Credit Facility prohibits the payment of cash dividends on common stock and contains specific financial covenants. The Company is required to maintain an available liquidity level of $300 million at the end of each quarter. Available liquidity is defined as cash plus eligible trade receivables. As of December 31, 2004, the Company was in compliance with this covenant. Should the Company’s available liquidity be less than $300 million, the Company would then be subject to minimum EBITDA (earnings before interest, taxes, depreciation and amortization) requirements and capital expenditure limitations.

The $50 million term loan requires quarterly principal payments of $3 million beginning in October 2004. Principal payments made on the term loan increase the amount of revolving credit available. At December 31, 2004, $78 million was available for borrowing, and the Company had $3 million in outstanding letters of credit.

6. Read-Rite Asset Acquisition

In June 2003, Read-Rite Corporation (“Read-Rite”), then one of the Company’s suppliers of magnetic recording heads, commenced voluntary Chapter 7 bankruptcy proceedings. On July 31, 2003, Western Digital purchased substantially all of the assets of Read-Rite, including its wafer fabrication equipment in Fremont, California and manufacturing facility in Bang Pa-In, Thailand. The cost of the acquisition was $172.0 million and consisted of cash consideration of $94.8 million, assumed debt obligations of the Thailand operations of approximately $60.2 million, direct costs of the acquisition and other miscellaneous assumed obligations totaling $17.0 million. The Company accounted for this transaction as an asset acquisition. The estimated fair value of the assets acquired and liabilities assumed were as follows:

Current assets	$	17.4
Property and equipment		90.2
Purchased technology		38.8
In-process research and development		25.6
	$	172.0

As of the date of the acquisition, Read-Rite had two in-process research and development ("IPR&D") projects: 120 gigabyte per platter and 160 gigabyte per platter products. The fair value allocated to these projects as part of the acquisition was $17.8 million and $7.8 million, respectively. The multi-period excess earnings method, a discounted cash flow income approach, was used to determine the value allocated to the IPR&D. The rate utilized to discount the cash flows to their present values was based on the weighted average cost of capital and an additional risk premium based on an analysis of the technology and the IPR&D stages of completion. Based on these factors, 27% was used as the annual discount rate. These acquired IPR&D projects had not reached technological feasibility and had no alternative future use. Accordingly, the Company recorded the $25.6 million as a charge to research and development expense at the time of the acquisition.

Approximately $38.8 million of the purchase price related to purchased technology, which is being amortized over a weighted average period of three years. During the three months and six months ended December 31, 2004, the Company recorded $3.7 and $7.4 million of amortization expense related to these intangible assets. Amortization expense is estimated to be $14.4 million, $4.4 million, $3.4 million and $3.4 million for fiscal years 2005, 2006, 2007 and 2008, respectively.

7. Legal Proceedings

In June 1994, Papst Licensing ("Papst") brought suit against the Company in the United States District Court for the Central District of California, alleging infringement by the Company of five hard disk drive motor patents owned by Papst. In December 1994, Papst dismissed its case without prejudice. In July 2002, Papst filed a new complaint against the Company and several other defendants. The suit alleges infringement by the Company of seventeen of Papst's patents related to hard disk drive motors that the Company purchased from motor vendors. Papst is seeking an injunction and damages. The Company filed an answer on September 4, 2002, denying Papst's complaint. On December 11, 2002, the lawsuit was transferred to the United States District Court for the Eastern District of Louisiana and included in the consolidated pre-trial proceedings occurring there. The lawsuit was stayed pending the outcome of certain other related litigation. The Company believes that the outcome of this matter will not have a material adverse impact on the Company's financial statements. The Company intends to vigorously defend the suit.

In the normal course of business, the Company is subject to legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of monetary liability or financial impact with respect to these matters, including the matter described in the preceding paragraph, is subject to many uncertainties and is therefore not predictable with assurance, management believes that any monetary liability or financial impact to the Company from these matters, individually and in the aggregate, beyond that reserved for at December 31, 2004, would not be material to the Company's financial condition. However, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these legal proceedings, lawsuits and other claims could differ materially from those projected.

8. New Accounting Standards

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No.151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4" ("SFAS No. 151"), which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect the adoption of SFAS No. 151 to significantly impact our financial statements.

In December 2004, the FASB issued revised statement SFAS No. 123, "Share-Based Payment" (SFAS No. 123R), which supersedes APB Opinion No. 25 and replaces the current SFAS No. 123. SFAS No. 123R requires companies to expense the estimated fair value of employee stock options and similar awards and provides guidance on the valuation methods used in determining the estimated fair value. The provisions of SFAS No. 123R will be effective for annual and interim periods beginning after June 15, 2005. Under SFAS No. 123R, compensation expense for existing awards where the requisite service period has not been completed by the effective date will be charged to expense over the remaining service period using the same cost currently calculated for pro forma disclosure purposes under SFAS No. 123. The Company is in the process of determining the impact of SFAS 123R on its financial statements relating to stock-based awards granted after adoption.

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

This information should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual Report on Form 10-K as of and for the year ended July 2, 2004.

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

Forward-Looking Statements

This report contains forward-looking statements within the meaning of the 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. Examples of forward-looking statements include, but are not limited to, statements concerning growth of unit shipments of hard disk drives in the desktop personal computer ("PC"), consumer electronics ("CE") and mobile markets; increase in the demand for desktop PC hard disk drives; growth of the consumer market for multi-media applications, including audio-video products incorporating hard disk drives and drives for the CE sector; growth of the mobile computing market; the Company's expansion into the CE market; the Company's expansion into the sub-2.5-inch hard disk drive market, demand for sub-2.5-inch drives and expected ship dates for sub-2.5-inch drives, expansion of the Serial Advanced Technology Attachment ("SATA") interface in enterprise hard disk drives; the Company's current expectations regarding March quarter seasonal trends in the desktop market; the Company's current expectations regarding depreciation expense and working capital investments for the head manufacturing operations, capital expenditures including expected investments in mobile disk drive manufacturing capacity and expansion of head manufacturing operations and IT infrastructure upgrades, gross margin percentage for the March quarter, revenue for the March quarter, cash conversion cycle, inventory turns, cash and cash equivalents, utilization of liquidity and cash flows; and the impact of the acquisition of head manufacturing assets on the Company's long-term financial business model.

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 in this report under the caption "Risk Factors That May Affect Future Results" as well as the Company's other reports filed with the SEC. 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.

Our Company

Western Digital designs, develops, manufactures and markets hard disk drives for digital information storage. A hard disk drive is a device that stores data on one or more rotating magnetic disks to allow fast access to non-volatile data. The Company's hard disk drives are used in desktop PCs, notebook PCs, enterprise servers, network attached storage devices, an expanding list of CE products such as video game consoles, personal/digital video recorders and satellite and cable set-top boxes and as external storage devices. WD markets its hard disk drives directly to PC manufacturers, including large, brand name PC manufacturers such as Dell and Hewlett Packard; to CE manufacturers; and to distributors, resellers and retailers that serve a wide range of end users.

Western Digital builds hard disk drives in assembly facilities in Malaysia and Thailand. The Company also builds hard disk drive components such as printed circuit board assemblies, head stack assemblies, and head gimbal assemblies in its Malaysia and Thailand facilities. In July 2003, Western Digital acquired head manufacturing assets from Read-Rite, a former supplier, enabling it to build a substantial portion of its recording head requirements. WD procures its other component requirements from industry-leading technology companies, many of which work with the Company from design and development through manufacturing. WD believes that its operating model allows it to access leading-edge component technologies and cost-saving innovations while minimizing investment expenditures.

Western Digital provides quality products, superior customer service and flexibility by managing its technology deployment, manufacturing, cost, delivery, quality and reliability. WD builds to market demand using a highly flexible manufacturing model that emphasizes financial and asset efficiency, enabling it to supply high-quality products at price points that allow mass-market adoption. The Company is a leader in the desktop hard drive market and leverages its existing resources and capabilities to satisfy the increasing demand for hard drives in new market areas.

Business and Market Overview

The total market for hard disk drives on an annual basis is currently estimated at approximately 263 million units, or $22 billion a year. According to Gartner/Dataquest, Inc. ("Gartner") quarterly reports published in 2004, Western Digital, Seagate Technology, Maxtor Corporation and Hitachi Global Storage Technologies supplied approximately 80% of the total units for the hard disk drive market during 2004. The following table summarizes hard disk drive unit market growth projections according to Gartner for certain markets in which WD competes (in millions of units). Unless otherwise noted, all references to market share and industry data are according to the Gartner report published in November 2004.

	ESTIMATED UNITS		
	2004	2008	CAGR*
Selected Hard Disk Drive Markets:			
Desktop PC	156	181	4%
2.5-inch mobile	57	117	20%
Desktop - - Class CE	23	73	33%
1.0-inch and smaller CE	6	75	86%

* Compound annual growth rate

Hard disk drive unit growth is influenced greatly by developments in the PC market. WD believes that the demand for hard disk drives in the PC market has grown in part due to:

- The overall growth of PC sales;
- The increasing needs of individuals to store larger amounts of data on their PCs;
- The continuing development of software applications to manage multimedia content; and
- The increasing availability of broadband connections to the Internet, allowing downloading content from the Internet onto PC hard disk drives.

The Company believes the rate of hard disk drive unit growth in the desktop PC market is being influenced by several factors, including maturing PC markets in North America and Western Europe, an increase in first-time buyers of PCs in Eastern Europe and Asia, the lengthening of PC replacement cycles and in increasing preference for notebook systems.

The mobile computing market, which includes notebook computers, is expected to grow faster than any other PC segment as performance and price continue to improve. Western Digital entered the mobile hard disk drive market in September 2004, commencing volume production of its WD Scorpio™ family of 2.5-inch hard disk drives for notebook PCs.

Many consumer applications currently employ similar hard disk drive technology as is found in PCs. Western Digital currently ships 3.5-inch form factor hard drives to manufacturers of personal/digital video recorders and electronic game devices. WD presently believes it can continue to expand shipments into these markets using much of its existing hard disk drive technology.

As the market for consumer applications expands, additional investments by the Company may be required. For example, CE devices such as handheld digital audio players currently utilize sub-2.5-inch form factor hard drives. Western Digital recently announced its entry into the miniature hard drive market with a new 1.0-inch 6 gigabyte product, expected to ship in the second calendar quarter of 2005.

The enterprise market for hard disk drives focuses on customers that make workstations, servers, network attached storage devices, storage area networks, and other computing systems or subsystems. Western Digital is pursuing revenue opportunities in this market through its application of the SATA interface. The SATA interface contains many of the same benefits of the small-computer-systems-interface, or SCSI — the predominant interface currently used in most enterprise hard disk drive applications. According to its annual report published in May 2004, TrendFOCUS, Inc. ("TrendFOCUS") estimates that 43% of enterprise hard disk drive unit shipments will use the SATA interface by calendar year 2007.

Second Quarter Overview

WD's net revenue for the quarter ended December 31, 2004 totaled $955 million, an increase of 14% over the prior year and 16% over the September quarter. WD shipped 16.2 million units, including approximately 1.6 million units to the CE market. The industry and WD experienced strong seasonal demand throughout the December quarter, leading to more stable pricing, higher gross margins and improved shipment linearity for the Company as compared to the September quarter. Gross margin percentage for the December quarter was 15.7% as compared to 13.7% for the September quarter and 17.0% for the quarter ended December 26, 2003. Operating income was $56.6 million in the December quarter compared to $31.2 million in the September quarter and $71.3 million in the quarter ended December 26, 2003. WD generated $236 million in cash flow from operations during the six months ended December 31, 2004, finishing the quarter with $493 million in cash and cash equivalents, an increase of $115 million from the July 2, 2004 balance.

Historically, industry desktop unit volumes decline on average by approximately 5% from the December quarter to the March quarter. Also, industry desktop ASPs traditionally decline by about 4-5% in the March Quarter. In the desktop market, the Company currently anticipates traditional March quarter seasonal trends. Given these factors, as of the date of this Form 10Q filing, the Company estimates revenue for the March quarter will be between $885 and $915 million. Gross margin is the biggest variable in the Company's financial results. Seasonal trends typically drive lower gross margins in the March quarter as compared to the December quarter. As of the date of this form 10-Q filing, WD estimates that gross margin percentage for the March quarter will be approximately 14.5%.

Results of Operations

The following table sets forth, for the periods indicated, summary information from the Company's statements of income (dollars in millions):

	THREE MONTHS ENDED				SIX MONTHS ENDED			
	DEC. 31, 2004		DEC. 26, 2003		DEC. 31, 2004		DEC. 26, 2003	
Revenue, net	$954.9	100.0%	$834.8	100.0%	$1,778.5	100.0%	$1,549.0	100.0%
Gross margin	150.2	15.7	141.8	17.0	263.3	14.8	238.0	15.4
Total operating expenses	93.6	9.8	70.5	8.4	175.5	9.9	161.8	10.4
Operating income	56.6	5.9	71.3	8.5	87.8	4.9	76.2	4.9
Net income	56.0	5.9	68.8	8.2	86.4	4.9	73.8	4.8

Net Revenue

Net revenue was $955 million for the three months ended December 31, 2004, an increase of 14%, or $120 million, from the three months ended December 26, 2003. Total unit shipments increased to 16.2 million for the second quarter of 2005 as compared to 12.7 million for the second quarter of 2004. This increase resulted from higher desktop market share, strong overall demand for hard disk drives in the desktop PC market and WD's increasing focus on the CE market. The growth in units was partially offset by a $7 per unit decline in average selling prices ("ASPs") to $59 per unit for the second quarter of 2005 compared to $66 per unit for the second quarter of 2004. Historically, ASPs in the desktop hard disk drive industry have generally declined annually in the 10-20% range.

Western Digital increased sales to original equipment manufacturer ("OEM") customers during the three months ended December 31, 2004 by 32% to $559 million, as compared to $423 million for the three months ended December 26, 2003. Revenue by sales channel for the second quarter of 2005 was 58% from OEMs, 35% from distributors and 7% from the retail channel, compared to 51%, 43% and 6%, respectively, for the second quarter of 2004. WD also continues to focus resources on emerging geographic markets such as Eastern Europe and Asia. Revenue by geographic region for the second quarter of 2005 was 38% from the Americas, 32% from Europe and 30% from Asia, compared to 41%, 31% and 28%, respectively, for the second quarter of 2004.

For the six months ended December 31, 2004, net revenue was $1.8 billion, an increase of 15%, or $229 million, from the six months ended December 26, 2003. During this period, total unit shipments increased to 30.4 million from 24.0 million during the same period last year, while ASPs decreased to $59 per unit from $65 per unit.

Gross Margin

Gross margin percentage decreased to 15.7% for the three months ended December 31, 2004 from 17.0% for the three months ended December 26, 2003. The decline in gross margin percentage was primarily due to more competitive pricing conditions and an increase in the percentage of shipments to OEM customers, which typically have lower ASPs and gross margins. This decline was partially offset by improvements in the Company's cost structure as a result of its acquisition of Read-Rite's head manufacturing assets in July 2003 and ongoing manufacturing cost efficiencies. For the six months ended December 31, 2004, gross margin percentage decreased to 14.8% from 15.4% for the six months ended December 26, 2003. This net decrease in gross margin percentage was a result of the aforementioned factors. Gross margin for the six-months ended December 26, 2003 included non-recurring charges of $18.1 million incurred in July 2003 relating to the head manufacturing asset acquisition.

Operating Expenses

Research and development (“R&D”) expense was $59.7 million for the three months ended December 31, 2004, an increase of 36%, or $15.7 million, from the three months ended December 26, 2003. The increase of $15.7 million in R&D expense was due to an increase in expenses related to employee incentive compensation programs, head design and increasing development efforts for new products. R&D expense for the six months ended December 31, 2004 was $114 million, an increase of $6.0 million or 5.6%, from the same period last year. The increase in R&D was primarily due to the aforementioned factors. R&D expense for the six-months ended December 26, 2003 included $25.6 million of IPR&D charges incurred in the first quarter of 2004 related to the Read-Rite asset acquisition.

Selling, general, and administrative (“SG&A”) expense was $33.9 million for the three months ended December 31, 2004, an increase of $7.4 million, or 28% from the three months ended December 26, 2003. The increase of $7.4 million in SG&A expense was primarily due to an increase in employee incentive compensation programs and an expansion of sales headcount in geographic regions where PC demand is rapidly increasing such as Eastern Europe and Asia. For the six months ended December 31, 2004, SG&A expense was $61.8 million, an increase of $7.7 million or 14% from the comparable period of the prior year. The increase was a result of the aforementioned factors. SG&A expense for the six-months ended December 26, 2003 included $1.4 million of non-recurring acquisition-related charges that occurred in the first quarter of 2004.

Income Tax Provision

The income tax provision was $1.4 million and $2.2 million for the three and six months ended December 31, 2004, respectively. The effective tax rate was 2.5% for the three and six months ended December 31, 2004. This differs from the U.S. federal statutory rate of 35% primarily because of tax holidays in Malaysia and Thailand. These tax holidays are in effect in Thailand through 2011 and in Malaysia through 2014.

Liquidity and Capital Resources

Western Digital had cash and cash equivalents of $493 million at December 31, 2004 as compared to $378 million at July 2, 2004. Net cash provided by operating activities during the six-month period ended December 31, 2004 was $236 million as compared to $55.3 million for the same period last year. Net cash flows from operating activities resulted from net income, excluding depreciation and amortization and cash generated by working capital improvements. This represents the Company’s principal source of cash. Operating cash flows included net cash provided by working capital of $88.2 million for the six months ended December 31, 2004, as compared to net cash used to fund working capital of $91.3 million for the same period last year. The improvement in net cash from working capital was primarily due to improved accounts receivable, inventory and accounts payable management.

Western Digital’s working capital requirements depend upon the effective control of its cash conversion cycle. The cash conversion cycle for the six month period ended December 31, 2004, which consisted of 41 days sales outstanding (“DSO”) plus 16 days inventory outstanding (“DIO”) less 64 days payable outstanding (“DPO”), was negative seven days as compared to negative one day for the six months ended December 26, 2003. The improvement in the cash conversion cycle was due to improved shipment linearity within the quarter and lower inventory balances due to increased customer demand. WD expects its financial business model will continue to generate a negative cash conversion cycle for the forseeable future.

Net cash used in investing activities for the six months ended December 31, 2004 was $106 million as compared to $159 million for the same period in the prior year. During the six months ended December 31, 2004, cash used in investing activities consisted of net capital expenditures. The net cash used in investing activities for the first six months of 2004 consisted of $94.8 million for the Read-Rite asset acquisition and $64.1 million of net capital expenditures. The increase in net capital expenditures in the six month period ended December 31, 2004 was primarily a result of assets purchased to upgrade the Company’s head manufacturing capabilities, increase desktop and mobile hard disk drive production capabilities and for the normal replacement of existing assets. For 2005, capital expenditures are expected to increase to approximately $250 million from $150 million for 2004. The increase in capital expenditures is expected to consist primarily of investments in mobile hard disk drive manufacturing capacity, continued expansion of head manufacturing operations and IT infrastructure upgrades.

Net cash used in financing activities for the six months ended December 31, 2004 was $15.9 million as compared to net cash provided by financing activities of $28.8 million for the same period in the prior year. The net cash used in financing activities in the six month period ended December 31, 2004 consisted of $23.3 million used in the Company's stock repurchase program and $9.7 million in payments on outstanding debt, partially offset by $17.1 million received upon issuance of stock under employee plans. The net cash provided by financing activities for the six months ended December 26, 2003 consisted primarily of $15.0 million received upon issuance of common stock under employee plans and $13.8 million in net proceeds from long-term debt.

Capital Commitments

Line of Credit — The Company has a $125 million five-year credit facility ("Senior Credit Facility") that provides up to $75 million in revolving credit (subject to outstanding letters of credit and a borrowing base calculation) and a term loan of $50 million. Both the revolving credit facility and the term loan mature on September 19, 2008, and are secured by the Company's accounts receivable, inventory, 65% of its stock in its foreign subsidiaries and other assets. At the option of the Company, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin.

The Senior Credit Facility prohibits the payment of cash dividends on common stock and contains specific financial covenants. The Company is required to maintain an available liquidity level of $300 million at the end of each quarter. Available liquidity is defined as cash plus eligible trade receivables. As of December 31, 2004, the Company was in compliance with this covenant. Should the Company's available liquidity be less than $300 million, the Company would then be subject to minimum EBITDA (earnings before interest, taxes, depreciation and amortization) requirements and capital expenditure limitations.

The $50 million term loan requires quarterly principal payments of $3 million beginning in October 2004. Principal payments made on the term loan increase the amount of revolving credit available. At December 31, 2004, $78 million was available for borrowing, and the Company had $3 million in outstanding letters of credit.

Purchase Orders — In the normal course of business to reduce the risk of component shortages, Western Digital enters into purchase orders with suppliers for the purchase of hard disk drive components used to manufacture its products. These purchase orders generally cover forecasted component supplies needed for production during the next quarter, become payable upon receipt of the components, and generally may be changed or canceled at any time prior to shipment of the components. In some cases WD may be obligated to pay for certain costs related to changes to, or cancellation of, a purchase order, such as costs incurred for raw materials or work in process. The Company has entered into long-term purchase agreements for components with certain vendors. Future purchases under these agreements are not fixed and determinable as they depend on WD's overall unit volume requirements and are contingent upon the prices, technology and quality of the supplier's products remaining competitive. See below under the heading "Risk Factors That May Affect Future Results" for a discussion of related risks.

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

Stock Repurchase Program — WD announced a stock repurchase program on May 5, 2004. Under the program, the Company may purchase on the open market up to $100 million of its common stock depending on market conditions and other corporate considerations. Stock repurchases are expected to be funded by operating cash flow. Some of the repurchased shares will offset the dilutive impact of common stock issued under employee stock option and share purchase programs. During the six month period ended December 31, 2004, WD repurchased 3.1 million shares of common stock at a total cost of $23.3 million. Since the inception of the program, through February 7, 2005, the Company has repurchased 5.1 million shares for a total cost of $39.3 million (including commissions). WD may continue to opportunistically repurchase its stock as it deems appropriate and market conditions allow.

Western Digital believes its current cash and cash equivalents 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, WD's ability to sustain its working capital position is dependent upon a number of factors that are discussed below under the heading "Risk Factors That May Affect Future Results." The Company currently anticipates that it will continue to utilize its liquidity and cash flows to improve the efficiency and capability of its existing hard disk drive and head manufacturing operations.

Critical Accounting Policies

Western Digital has prepared the accompanying unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States for interim financial information. The preparation of the financial statements requires the use of judgment and estimates that affect the reported amounts of revenues, expenses, assets and liabilities. Western Digital has adopted accounting policies and practices that are generally accepted in the industry in which it operates. The Company believes the following are its most critical accounting policies that affect significant areas and involve management's judgment and estimates. If these estimates differ significantly from actual results, the impact to the condensed consolidated financial statements may be material.

Revenue and Accounts Receivable

In accordance with standard industry practice, Western Digital has agreements with resellers that provide limited price protection for inventories held by resellers at the time of published list price reductions. In addition, WD may have agreements with resellers that provide for stock rotation on slow-moving items and other incentive programs. In accordance with current accounting standards, the Company recognizes revenue upon shipment or delivery to resellers and records a reduction to revenue for estimated price protection and other programs in effect until the resellers sell such inventory to their customers. Adjustments are based on anticipated price decreases during the reseller holding period, estimated amounts to be reimbursed to qualifying customers, as well as historical pricing information. If end-market demand for hard disk drives declines significantly, the Company may have to increase sell-through incentive payments to resellers, resulting in an increase in price protection allowances, which could adversely impact operating results.

Western Digital establishes an allowance for doubtful accounts by analyzing specific customer accounts and assessing the risk of loss based on insolvency, disputes or other collection issues. In addition, the Company routinely analyzes the different receivable aging categories and its bad debt loss history and establishes reserves based on a combination of past due receivables and expected future losses. If the financial condition of a significant customer deteriorates resulting in its inability to pay its accounts when due, an increase in the Company's allowance for doubtful accounts would be required, which could negatively affect operating results.

Western Digital records provisions against revenue and cost of revenue for estimated sales returns in the same period that the related revenue is recognized. The Company bases these provisions on existing product return notifications as well as historical returns by product type (see "Warranty"). If actual sales returns exceed expectations, an increase in the sales return provision would be required, which could negatively affect operating results.

Warranty

Western Digital records an accrual for estimated warranty costs when revenue is recognized. Warranty covers costs of repair or replacement of the hard disk drive over the warranty period, which generally ranges from one to five years. The Company has comprehensive processes with which to estimate accruals for warranty, which include specific detail on hard disk drives in the field by product type, historical field return rates and costs to repair. If actual product return rates or costs to repair returned products increase above expectations, an increase in the warranty provision would be required, which could negatively affect operating results.

Inventory

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

Western Digital evaluates inventory balances for excess quantities and obsolescence on a regular basis by analyzing backlog, estimated demand, inventory on hand, sales levels and other information, and writes down inventory balances for excess and obsolete inventory based on the analysis. Unanticipated changes in technology or customer demand could result in a decrease in demand for one or more of the Company's products, which may require an increase in inventory write-downs that could negatively affect operating results.

Litigation and Other Contingencies

Western Digital applies Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," to determine when and how much to accrue for and disclose related to legal and other contingencies. Accordingly, the Company accrues loss contingencies when management, in consultation with its legal advisors, concludes that a loss is probable and reasonably estimable. (Refer to Part I, Item 1, Notes to Condensed Consolidated Financial Statements, Note 7 "Legal Proceedings" included in this Quarterly Report on Form 10-Q). The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management's estimates.

Deferred Tax Assets

Western Digital's deferred tax assets, which consist primarily of net operating loss and tax credit carryforwards, are fully reserved due to management's determination that it is more likely than not that these assets will not be realized. This determination is based on the weight of available evidence, the most significant of which is the Company's loss history in the related tax jurisdictions. Should this determination change in the future, some amount of deferred tax assets could be recognized, resulting in a tax benefit or a reduction of future tax expense.

New Accounting Standards

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No.151, "Inventory Costs, an Amendment of ARB No. 43, Chapter 4" (SFAS No. 151), which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not expect the adoption of SFAS No. 151 to significantly impact our financial statements.

In December 2004, the FASB issued revised statement SFAS No. 123, "Share-Based Payment" (SFAS No. 123R), which supersedes APB Opinion No. 25 and replaces the current SFAS No. 123. SFAS No. 123R requires companies to expense the estimated fair value of employee stock options and similar awards and provides guidance on the valuation methods used in determining the estimated fair value. The provisions of SFAS No. 123R will be effective for annual and interim periods beginning after June 15, 2005. Under SFAS No. 123R, compensation expense for existing awards where the requisite service period has not been completed by the effective date will be charged to expense over the remaining service period using the same cost currently calculated for pro forma disclosure purposes under SFAS No. 123. The Company is in the process of determining the impact of SFAS 123R on its financial statements relating to stock-based awards granted after adoption.

Risk Factors That May Affect Future Results

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

The hard disk drive industry historically has experienced declining ASPs. Although the rate of decline has moderated in recent years, there can be no assurance that this trend will continue. Our ASPs tend to decline even when competitors lower prices as a result of decreased costs or to absorb excess capacity, liquidate excess inventories, restructure or attempt to gain market share.

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

Storage capacity of the hard disk drive, as manufactured by us, is determined by the number of disks and each disk's areal density. Areal density is a measure of the amount of data that can be stored on the recording surface of the disk. The higher the areal density, the more information can be stored on a single platter. Historically, we have been able to achieve a large percentage of cost reduction through increases in areal density. Increases in areal density mean that the average drive we sell has fewer heads and disks for the same capacity and, therefore, may result in a lower component cost. However, because increases in areal density have become more difficult in the hard disk drive industry, such increases may require increases in component costs. In addition, other opportunities to reduce costs may not continue at historical rates. Our inability to achieve cost reductions could adversely affect our operating results.

Our operating results depend on optimizing time-to-market and time-to-volume, overall quality, and costs of new and established products.

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

- maintain overall quality of products on new and established programs,

- maintain competitive cost structures on new and established products,

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

our operating results would be adversely affected.

Product life cycles in the desktop hard disk drive market require continuous technical innovation associated with higher areal densities.

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

Increases in areal density may outpace customers' demand for storage capacity.

The rate of increase in areal density may be greater than the increase in our customers' demand for aggregate storage capacity. This could lead to our customers' storage capacity needs being satisfied with more lower-cost single-surface drives, thereby decreasing our revenue. As a result, even with increasing aggregate demand for storage capacity, our ASPs could decline, which could adversely affect our results of operations.

Product life cycles influence our financial results.

Product life cycles have been extending since the middle of calendar year 2002 due in large part to a decrease in the rate of hard disk drive areal density growth. However, there can be no assurance that this trend will continue. If longer product life cycles continue, we may need to develop new technologies or programs to reduce our costs on any particular product in order to maintain competitive pricing for such product. This may result in an increase in our overall expenses and a decrease in our gross margins, both of which could adversely affect our operating results. If product life cycles shorten, it may be more difficult to recover the cost of product development before the product becomes obsolete. Our failure to recover the cost of product development in the future could adversely affect our operating results.

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

We regularly engage in new product qualification with our customers. To be considered for qualification, we must be among the leaders in time-to-market with our new products. Once a product is accepted for qualification testing, failures or delays in the qualification process can result in our losing sales to that customer until the next generation of products is introduced. The effect of missing a product qualification opportunity is magnified by the limited number of high volume computer manufacturers, most of which continue to consolidate their share of the PC market. If product life cycles continue to be extended due to a decrease in the rate of areal density growth, we may have a significantly longer period to wait before we have an opportunity to qualify a new product with a customer, which could harm our competitive position. These risks are increased because we expect cost improvements and competitive pressures to result in declining gross margins on our current generation products.

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

Currently the hard disk drive industry uses giant magnetoresistive head technology, which allows significantly higher storage capacities than the previously utilized thin-film head technology. However, the industry is developing new recording technologies that may enable greater recording densities than currently available using magnetoresistive head technology, including perpendicular, current perpendicular-to-plane, and tunneling junction technology. If the industry experiences a fundamental shift in recording technology, hard disk drive manufacturers would need to timely adjust their designs and processes to accommodate the new technology in order to remain competitive. As a result, we could incur substantial costs in developing new technologies, media, and tools to remain competitive. We may also become more dependent on suppliers to ensure our access to components that accommodate the new technology. These results would increase our operating costs, which may negatively impact our operating results.

Our current competitors or a future competitor may gain a technology advantage that we cannot match.

It may be possible for our current or future competitors to gain an advantage in product technology, manufacturing technology, or process technology, which may allow them to offer products or services that have a significant advantage over the products and services that we offer. Advantages could be in capacity, performance, reliability, serviceability, or other attributes. If we are unable to match these technology advantages due to the proprietary nature of the technology, limitations on process capability or other factors, we could be at a competitive disadvantage to those competitors.

Advances in magnetic, optical, semiconductor or other data storage technologies also 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.

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

The price of hard disk drives has fallen over time due to increases in supply, cost reductions, technological advances and price reductions by competitors seeking to liquidate excess inventories or attempting to gain market share. In addition, rapid technological changes often reduce the volume and profitability of sales of existing products and increase the risk of inventory obsolescence. These factors, taken together, result in significant and rapid shifts in market share among the industry's major participants. In addition, product recalls can lead to a loss of market share, which could adversely affect our operating results.

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

Demand for our hard disk drives depends on the demand for systems manufactured by our customers and on storage upgrades to existing systems. The demand for systems has been volatile in the past and often has had an exaggerated effect on the demand for hard disk drives in any given period. As a result, the hard disk drive market has experienced periods of excess capacity, which has led to intense price competition. If intense price competition occurs, we may be forced to lower prices sooner and more than expected, which could result in lower revenue and gross margins.

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

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

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

Over the past few years the consumer market for desktop computers has shifted significantly towards lower priced systems. In its September 2004 report, Gartner forecasted that systems priced below $500 will be the fastest growing segment of the desktop computer market between calendar years 2003 through 2008. If we are not able to offer a competitively priced hard disk drive for the low-cost PC market, our share of that market will likely fall, which could harm our operating results.

The market for hard disk drives is also fragmenting into a variety of devices and products. Many industry analysts expect, as do we, that as communications are increasingly converted to digital technology from the older, analog technology, the technology of computers and consumer electronics will continue to converge, and hard disk drives will be found in many consumer products other than computers. For example, although general market acceptance remains in its early stages, the use of hard disk drives has expanded into the game console market. However, there can be no assurance that hard disk drives will continue to be incorporated into game consoles, or that the market for these products will grow.

In addition, we expect that the consumer market for multi-media applications, including audio-video products incorporating a hard disk drive will continue to grow. However, because this market remains relatively new, accurate forecasts for future growth remain challenging. Moreover, some of the devices, such as personal video recorders and digital video recorders, may require attributes not currently offered in our products, which may result in a need to expend capital to develop new interfaces, form factors, technical specifications or hard disk drive features, increasing our overall operational expense. If we are not successful in using our hard disk drive technology and expertise to develop new products for the emerging consumer electronics market, or if we are required to incur significant costs in developing such products, it may harm our operating results.

If we do not successfully expand into new hard disk drive market segments, our business may suffer.

To remain a significant supplier of hard disk drives, we will need to offer a broad range of hard disk drive products to our customers. We currently offer a variety of 3.5-inch form factor hard disk drives for the desktop computer market, and we recently began shipping 2.5-inch form factor hard disk drives for the mobile market. However, demand for hard disk drives may shift to products in smaller form factors. We recently announced our entry into the sub-2.5-inch hard disk drive market with a family of 1.0-inch drives which we expect to ship in the second calendar quarter of 2005, however some of our competitors already offer smaller form factor drives. In addition, the enterprise and desktop PC industries are transitioning to higher speed interfaces such as SATA to handle higher data transfer rates. We currently offer SATA products; however, the transition of technology and the introduction of new products are challenging and create risks. While we continue to develop new products and look to expand into other applications such as consumer electronics products, the success of our new product introductions is dependent on a number of factors, including difficulties faced in manufacturing ramp, market acceptance, effective management of inventory levels in line with anticipated product demand, and the risk that our new products will have quality problems or other defects in the early stages of introduction that were not anticipated in the design of those products. If we fail to successfully develop and manufacture new products, customers may decrease the amount of our products that they purchase, and we may lose business to our competitors who offer these products or who use their dominance in the enterprise or mobile market to encourage sales of hard disk drives.

If we do not successfully expand into the 2.5-inch and sub-2.5-inch markets, our business may suffer.

We recently began shipping 2.5-inch form factor hard disk drives for the mobile market and expect to ship 1.0-inch disk drives in the second calendar quarter of 2005. Although many of our customers who purchase 3.5-inch form factor hard disk drives also purchase the 2.5-inch form factor drives, the markets are characterized by different competitors, different sales channels and different overall requirements. If we are unable to adapt to these differences, we would have a competitive disadvantage to companies that are successful in this regard, and our business and financial results could suffer. In addition, if we incur significant costs in manufacturing and selling the 2.5-inch and sub-2.5-inch form factor hard disk drives, and if we are unable to recover those costs from sales of the products, then we may not be able to compete successfully in this market and our operating results may suffer.

We depend on our key personnel and skilled employees.

Our success depends upon the continued contributions of our key personnel and skilled employees, many of whom would be extremely difficult to replace. Worldwide competition for skilled employees in the hard disk drive industry is intense. Volatility or lack of positive performance in our stock price may adversely affect our ability to retain key personnel or skilled employees who have been granted stock options. If we are unable to retain our existing key personnel or skilled employees, or hire and integrate new key personnel or skilled employees, our operating results would likely be harmed.

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 the second quarter of 2005, one customer, Dell, accounted for more than 10% of our revenue, and sales to our top 10 customers, including Dell, accounted for 49% of revenue. 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. In addition, if customer pressures require us to reduce our pricing such that our gross margins are diminished, we could decide not to sell our products to a particular customer, which could result in a decrease in our revenue.

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

Because we depend on a limited number of suppliers for certain hard disk drive components and manufacturing equipment, an increase in the cost of such components or equipment, an extended shortage of required components or equipment, failure of a key supplier's business process, or the failure of key suppliers to remain in business, adjust to market conditions, or to meet our quality, yield or production requirements could significantly harm our operating results. A number of the components used by us are available from only a single or limited number of qualified outside suppliers, and may be used across multiple product lines. In addition, some of the components (or component types) used in our products are used in other devices, such as mobile telephones and digital cameras. If there is a significant simultaneous upswing in demand for such a component (or component type) from several high volume industries, resulting in a supply reduction, or a component is otherwise in short supply, or if a supplier fails to qualify or has a quality issue with a component, we may experience delays or increased costs in obtaining that component. In addition, if a component becomes unavailable, we could suffer significant loss of revenue.

To reduce the risk of component shortages, we attempt to provide significant lead times when buying these components. As a result, we may be subject to cancellation charges if we cancel orders, which may occur when we make technology transitions.

In some cases, not only are we dependent on a limited number of suppliers, but we also have entered into contractual commitments that require us to buy a substantial number of components from certain suppliers. Our future operating results may depend substantially on our suppliers' ability to timely qualify their components in our programs, and their ability to supply us with these components in sufficient volume to meet our production requirements. A significant disruption in any of these suppliers' ability to manufacture and supply us with the components could harm our operating results.

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

Some of our customers have adopted a subcontractor model that increases our credit risk and could result in an increase in our operating costs.

Some of our OEM customers have adopted a subcontractor model that requires us to contract directly with companies that provide manufacturing services to our OEM customers. Because these subcontractors are generally not as well capitalized as our direct OEM customers, this subcontractor model exposes us to increased credit risks. Our agreements with our OEM customers may not permit us to increase our product prices to alleviate this increased credit risk. Any credit losses we may suffer as a result of this increased risk would increase our operating costs, which may negatively impact our operating results.

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

As a result of our head manufacturing operations, we are developing and manufacturing a substantial portion of the heads used in the hard disk drives we manufacture. Consequently, we are more dependent upon our own development and execution efforts and less able to take advantage of head technologies developed by other head manufacturers. There can be no assurance, however, that we will be successful in timely and cost-effectively developing and manufacturing heads for products using perpendicular recording technology, or other future technologies. We also may not achieve acceptable manufacturing yields using such technologies necessary to satisfy our customers' product needs, or we may encounter quality problems with the heads we manufacture. In addition, we may not have access to external sources of supply without incurring substantial costs. If we fail to develop new technologies in a timely manner, or if we encounter quality problems with the heads we manufacture, and if we do not have access to external sources of supply that incorporate new technologies, we would have a competitive disadvantage to companies that are successful in this regard, and our business and financial results could suffer.

We experience additional costs and risks in connection with our head manufacturing operations.

Our vertical integration of head manufacturing has resulted in a fundamental change in our operating structure, as we are now manufacturing heads for use in the hard disk drives we manufacture. Consequently, we make more capital investments than we would if we were not vertically integrated and carry a higher percentage of fixed costs than assumed in our prior financial business model. For example, capital expenditures related to the head manufacturing operations are expected to average approximately $100 million on an annual basis. If the overall level of production decreases for any reason, and we are unable to reduce our fixed costs to match sales, our head manufacturing assets may face under-utilization that may impact our results of operations. We are therefore subject to additional risks related to overall asset utilization, including the need to operate at high levels of utilization to drive competitive costs, and the need for assured supply of components, especially hard disk drive media, that is optimized to work with our heads.

In addition, we may incur additional risks, including:

- we may not have sufficient head sources in the event that we are unable to manufacture a sufficient supply of heads to satisfy our needs;
- third party head suppliers may not work with us or may not work with us on the same terms and conditions we have previously enjoyed;
- we may be subject to claims that our manufacturing of heads may infringe certain intellectual property rights of other companies; and
- it may be difficult and time-consuming for us to locate suitable manufacturing equipment for our head manufacturing processes and replacement parts for such equipment.

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

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

Under our business model, we do not manufacture any of the component parts used in our hard disk drives, other than heads. As a result, the success of our products depends on our ability to gain access to and integrate parts that are "best in class" from reliable component suppliers. To do so, we must effectively manage our relationships with our major component suppliers. We must also effectively integrate different products from a variety of suppliers, each of which employs variations on technology, which can impact, for example, feasible combinations of heads and media components. In August 2003, we settled litigation we were engaged in with a supplier who previously was the sole source of read channel devices for our hard disk drives. As a result of the disputes that gave rise to the litigation, our profitability was at risk until another supplier's read channel devices could be designed into our products. Similar disputes with other strategic component suppliers could adversely affect our operating results.

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

Although we receive forecasts from our customers, they are not obligated to purchase the forecasted amounts. We consider these forecasts in determining our component needs and our inventory requirements. If we fail to accurately forecast our customers' product demands, we may have inadequate or excess inventory of our products or components, which could adversely affect our operating results.

Our failure to timely and efficiently transition our enterprise resource planning software from the version we currently use to a new version could adversely affect our business and financial results.

We use enterprise resource planning software in the operation of our business and maintenance of business and financial data related to our daily operations. We are in the process of upgrading this software and we anticipate transitioning to new enterprise resource planning software during the next year. We may experience unexpected difficulties in transitioning to the new software, including difficulties related to the failure or inefficient operation of the new software. Such difficulties or failures could result in our inability to access business and financial information stored on the system or the loss of such information. Any inability to access, or loss of, such information could affect our daily operations, including our ability to ship products and invoice our customers, which could have a significant adverse impact on our business, financial condition and results of operations.

We have two high-volume hard-drive manufacturing facilities and two facilities supporting our head manufacturing operations, which subjects us to the risk of damage or loss of any of these facilities.

Our hard disk drives are manufactured in facilities in Malaysia and in Thailand. In addition, we operate a head wafer fabrication and research and development facility in Fremont, California and a slider fabrication, head gimbal assembly, head stack assembly, and research and development facility in Thailand. A fire, flood, earthquake or other disaster, condition or event that adversely affects any of these facilities or our ability to manufacture could result in a loss of sales and revenue and harm our operating results.

Terrorist attacks may adversely affect our business and operating results.

The continued threat of terrorist activity and other acts of war or hostility, including the war in Iraq, have created uncertainty in the financial and insurance markets and have significantly increased the political, economic and social instability in some of the geographic areas in which we operate. Acts of terrorism, either domestically or abroad, could create further uncertainties and instability. To the extent this results in disruption or delays of our manufacturing capabilities or shipments of our products, our business, operating results and financial condition could be adversely affected.

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;
- increasing labor and overhead costs; and
- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

Because we manufacture our products abroad, our operating costs are subject to fluctuations in foreign currency exchange rates. Further fluctuations in the exchange rate of the Thai Baht, a floating currency, or a determination by the Malaysian government to repeg the Malaysian Ringgit or convert it to a floating currency, could result in an increase in our operating costs, which may negatively impact our operating results.

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 a result of the Malaysian currency controls, we are no longer hedging the Malaysian currency risk. Currently, we hedge the Thai Baht, Euro and British Pound Sterling.

There has been a trend toward a weakening U.S. dollar relative to most foreign currencies. If this trend continues the U.S. dollar equivalents of unhedged manufacturing costs could increase because a significant portion of our production costs are foreign-currency denominated. Conversely, there would not be an offsetting impact to revenues since revenues are substantially U.S. dollar denominated.

Environmental costs could harm our operating results.

We may be subject to various state, federal and international laws and regulations governing the environment, including those restricting the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling and disposal of certain products. Such laws and regulations have been passed in several jurisdictions in which we operate, including various European Union member countries. For example, the European Union has enacted the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive ("RoHS"). RoHS prohibits the use of certain substances, including lead, in certain products, including hard disk drives, put on the market after July 1, 2006. Similar legislation may be enacted in other locations where we manufacture or sell our products. We will need to ensure that we comply with such laws and regulations as they are enacted, and that our component suppliers also timely comply with such laws and regulations. If we fail to timely comply with such legislation, our customers may refuse to purchase our products, which would have a materially adverse effect on our business, financial condition and results of operations.

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

The nature of our business and our reliance on intellectual property and other proprietary information subjects us to the risk of significant litigation.

The hard disk drive industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may result in adverse rulings or decisions. We may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on our business, financial condition or results of operations.

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

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

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

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

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

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

In addition, some of our competitors are offering more favorable warranty terms on certain products that compete with our products. If we change our warranty policy in response to competitive pressures, it could result in increased warranty expenditures, which could negatively affect our operating results.

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

We often ship a high percentage (at times in excess of 50%) of our total quarterly sales in the third month of the quarter, which makes it difficult for us to forecast our financial results prior to the end of the quarter. In addition, our quarterly projections and results may be subject to significant fluctuations as a result of a number of other factors including:

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

Rapidly changing market conditions in the hard disk 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 costs related to product defects;
- price protection adjustments and other sales promotions and allowances on products sold to retailers, resellers and distributors;
- inventory adjustments for write-down of inventories to lower of cost or market value (net realizable value);
- reserves for doubtful accounts;

- accruals for product returns;
- accruals for litigation and other contingencies; and
- reserves for deferred tax assets.

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 disk drive, data and content management, storage and communication industries; and
- changes in financial estimates by securities analysts relating specifically to us or the hard disk drive industry in general.

In addition, general economic conditions may cause the stock market to experience extreme price and volume fluctuations from time to time that particularly affect the stock prices of many high technology companies. These fluctuations often appear to be unrelated to the operating performance of the companies.

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

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

Due to the risks described herein, in the future we may be unable to maintain adequate financial resources for capital expenditures, expansion or acquisition activity, working capital and research and development. We have a credit facility, which matures on September 19, 2008. If we decide to increase or accelerate our capital expenditures or research and development efforts, or if results of operations do not meet our expectations, we could require additional debt or equity financing. However, we cannot ensure that additional financing will be available to us or available on acceptable terms. An equity financing could also be dilutive to our existing stockholders.

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. 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 and product costs denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on the results of operations. The resulting impact from these hedge contracts is to offset a majority of the currency gains and losses in the Company's local currency operating expenses. The contract maturity dates do not exceed six months. The Company does not purchase short-term forward exchange contracts for trading purposes. Currently, the Company focuses on hedging its foreign currency risk related to the Thai Baht, Euro, and British Pound Sterling.

As of December 31, 2004, the Company had outstanding the following purchased foreign currency forward exchange contracts (in millions, except weighted average contract rate):

	December 31, 2004		
	Contract Amount	Weighted Average Contract Rate*	Unrealized Gain (Loss)
Foreign currency forward contracts:			
Thai Baht	$ 131.6	39.01	$ (0.2)
Euro	$ 5.2	0.74	—
British Pound Sterling	$ 1.8	0.52	—

* Expressed in units of foreign currency per dollar.

During the three months ended December 31, 2004 and December 26, 2003, total realized transaction and forward exchange contract currency gains and losses were not material to the consolidated condensed financial statements.

Disclosure About Other Market Risks

Variable Interest Rate Risk

At the option of the Company, borrowings under the Senior Credit Facility would bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin. If LIBOR or the base rate increases, the Company's interest payments could also increase. At December 31, 2004 the Company had a $50 million term loan outstanding under the Senior Credit Facility. A one percent increase in the variable rate of interest on the Senior Credit Facility would increase interest expense by approximately $0.5 million annually.

Item 4. *CONTROLS AND PROCEDURES*

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to provide reasonable assurance that the Company would meet its disclosure obligations.

There has been no change in the Company's internal controls over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. *LEGAL PROCEEDINGS*

Refer to Part I, Item 1, Notes to Condensed Consolidated Financial Statements, Note 7 “Legal Proceedings” included in this Quarterly Report on Form 10-Q which is hereby incorporated by reference.

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

(c) The following table provides information about repurchases by the Company of its common stock during the quarter ended December 31, 2004:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Value of Shares that May Yet be Purchased Under the Program(1)
October 2, 2004 — October 29, 2004	1,009,600	$ 8.19	1,009,600	$ 60,918,212
October 30, 2004 — November 26, 2004	—	$ —	—	$ 60,918,212
November 27, 2004 — December 31, 2004	—	$ —	—	$ 60,918,212
Total	1,009,600	$ 8.19	1,009,600	$ 60,918,212

(1) On May 5, 2004, the Company announced that its Board of Directors had authorized the Company to repurchase up to $100 million of the Company’s common stock in open market transactions. The program does not have an expiration date.

The Company’s $125 million credit facility prohibits the Company from paying cash dividends on its common stock.

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

The annual meeting of shareholders was held on November 18, 2004. The shareholders elected the following nine directors to hold office until the next annual meeting and until their successors are elected and qualified:

	FOR	WITHHELD
Peter D. Behrendt	180,541,281	8,815,008
Kathleen A. Cote	187,086,294	2,269,995
Henry T. DeNero	187,085,897	2,270,392
William L. Kimsey	187,099,764	2,256,525
Michael D. Lambert	180,557,901	8,798,388
Matthew E. Massengill	187,009,672	2,346,617
Roger H. Moore	180,466,085	8,890,204
Thomas E. Pardun	185,924,488	3,431,801
Arif Shakeel	187,994,678	1,361,611

In addition, the shareholders approved the following proposals:

	FOR	AGAINST	ABSTAIN	BROKER NON-VOTES
1. To approve the Western Digital Corp. 2004 Performance Incentive Plan	101,508,062	21,633,044	2,023,296	64,191,887
2. To ratify the selection of KPMG LLP as independent accountants for the Company for the fiscal year ending July 1, 2005	186,681,845	2,377,275	297,169	—

Item 5. ***OTHER INFORMATION***

(a) At a meeting on November 17, 2004 the Compensation Committee of the Board of Directors of the Company established the performance goals for the cash bonus awards under the Western Digital Corporation Incentive Compensation Plan (the “Plan”) for the second half of fiscal year 2005. The Committee determined that funding of the Plan would be based upon accomplishment of specific EPS and cash flow targets, in various combinations. These goals were recommended to, and approved by, the non-management members of the Board of Directors on November 18, 2004. A summary description of the criteria is also filed as Exhibit 10.31 to this report.

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Item 6. ***EXHIBITS***

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, filed with the office of the Secretary of State of the State of Delaware on April 6, 2001 (Incorporated by reference to the Company’s Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on April 6, 2001)
3.2	Certificate of Amendment of Certificate of Incorporation of Western Digital Corporation, filed with the office of the Secretary of State of the State of Delaware on January 8, 2002 (Incorporated by reference to the Company’s Registration Statement on Form S-8 (File No. 333-107227), as filed with the Securities and Exchange Commission on July 22, 2003)
3.3	Amended and Restated By-laws of Western Digital Corporation, adopted as of May 19, 2004 (Incorporated by reference to the Company’s Annual Report on Form 10-K (File No. 1-08703), as filed with the Securities and Exchange Commission on September 14, 2004)
10.5	Amended and Restated Western Digital Corporation Non-Employee Directors Stock-For-Fees Plan, effective as of November 18, 2004†
10.6	Amended and Restated Western Digital Corporation Non-Employee Director Restricted Stock Unit Plan, effective March 28, 2003 and amended and restated November 18, 2004†
10.31	Description of Performance Goals for Cash Bonus Awards Under the Western Digital Corporation Incentive Compensation Plan†
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002†
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002†
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002†

† New exhibit filed with this Report.

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/ Stephen D. Milligan

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

/s/ Joseph R. Carrillo

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

Date: February 8, 2005

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† New exhibit filed with this Report.

EXHIBIT 10.5

AMENDED AND RESTATED WESTERN DIGITAL CORPORATION

NON-EMPLOYEE DIRECTORS STOCK-FOR-FEES PLAN

This plan (1) was implemented in 1992, (2) was amended and restated effective as of January 9, 1997 to require directors to take half their annual retainer fee in stock, permit deferrals of cash or stock under the plan, and make certain other changes to conform the plan to the new version of Rule 16b-3 and ease administration, (3) was amended and restated effective as of January 27, 2000, to require directors to take $20,000 of their annual retainer fee in stock, increase the premium to 25% for deferral of annual retainers or meeting fees received in the form of common stock and provide a premium of 15% for deferral of annual retainers or meeting fees received in the form of cash, (4) was amended and restated effective as of November 14, 2002, to extend the term of the plan to December 31, 2012, and (5) was amended and restated effective as of November 18, 2004, to eliminate (i) the requirement that directors receive half of their annual retainer fee in stock, and (ii) the requirement that the Company pay non-employee directors a 15% premium on cash annual retainer fees or cash meeting fees that the director elects to defer under the Company's Deferred Compensation Plan.

1. PURPOSE.

The purposes of this Western Digital Corporation Non-Employee Director Stock-For-Fees Plan (the "PLAN") are to advance the interests of Western Digital Corporation (the "COMPANY") and its stockholders by increasing ownership by the Company's non-employee directors of the Company's Common Stock, thereby aligning their interests more closely with the interests of the Company's other stockholders, and to make available to the Company the cash that would otherwise have been paid to non-employee directors receiving Common Stock in lieu of fees hereunder.

2. ADMINISTRATION.

The Plan shall be administered by the Company, which shall have the power to construe the Plan, to resolve all questions arising under the Plan, to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable, and otherwise to carry out the terms of the Plan, but only to the extent not contrary to the express provisions of the Plan. The determinations, interpretations, and other actions of the Company of or under the Plan or with respect to any Common Stock granted pursuant to the Plan shall be final and binding for all purposes and on all persons. Neither the Company nor any officer or employee thereof shall be liable for any action or determination taken or made under the Plan in good faith. Notwithstanding the foregoing, the Company shall have no authority or discretion as to the persons who will receive Common Stock granted pursuant to the Plan, the number of shares of Common Stock to be issued under the Plan, the time at which such grants are made, the number of shares of Common Stock to be granted at any particular time, or any other matters that are specifically governed by the provisions of the Plan.

3. PARTICIPATION IN THE PLAN.

Directors of the Company who are not employees of the Company or any subsidiary of the Company ("ELIGIBLE DIRECTORS") shall be eligible to participate in the Plan. Each Eligible Director shall, if required by the Company, enter into an agreement with the Company in such form as the Company shall determine consistent with the provisions of the Plan for purposes of implementing the Plan or effecting its purposes. In the event of any inconsistency between the provisions of the Plan and any such agreement, the provisions of the Plan shall govern.

4. STOCK SUBJECT TO THE PLAN.

(a) Number of Shares. The shares that may be issued under the Plan shall be authorized and unissued shares or treasury shares of the Company's Common Stock (the "COMMON STOCK"). The maximum aggregate number of shares that may be issued under the Plan shall be four hundred thousand (400,000), subject to adjustment upon changes in capitalization of the Company as provided in Section 4(b). The maximum aggregate number of shares issuable under the Plan may be increased from time to time by approval of the Company's Board of Directors, and by the stockholders of the Company if stockholder approval is required pursuant to the applicable rules of any stock exchange, or, in the opinion of the Company's counsel, any other law or regulation binding upon the Company.

(b) Adjustments. If the Company shall at any time increase or decrease the number of its issued and outstanding shares of Common Stock (whether by reason of reorganization, merger, consolidation, recapitalization, stock dividend, stock split, combination of shares, exchange of shares, change in corporate structure, or otherwise), then the number of shares of Common Stock still available for issue hereunder shall be increased or decreased appropriately and proportionately.

5. STOCK ELECTIONS.

Each Eligible Director may make an "ELECTION" to receive Common Stock in lieu of any or all of (i) the annual retainer fee otherwise payable to him or her in cash for that calendar year, and/or (ii) the meeting attendance fees otherwise payable to him or her in cash for that calendar year. Such Election for any calendar year must be in writing and must be delivered to the Secretary of the Company not later than the end of the immediately preceding calendar year. In addition, newly elected or appointed Eligible Directors shall make an interim Election as of the date they join the board, which interim Election shall govern until the immediately ensuing calendar year. Separate Elections must be made for each calendar year; if an Eligible Director does not make a written Election for any particular calendar year, then such Eligible Director shall be deemed to have elected to receive all meeting fees and his or her retainer fee for that calendar year in cash.

6. ISSUANCE OF COMMON STOCK.

(a) Timing and Amounts of Issuances.

(i) Common Stock issuable to an Eligible Director in lieu of annual retainer or meeting fees shall be issued not later than ten days after the date such annual retainer or meeting fees, as the case may be, would have been paid if paid in cash.

(ii) The number of shares of Common Stock issuable in lieu of cash annual retainer fees (whether or not deferred) shall be determined by dividing the amount of cash fees being replaced by Common Stock by the Fair Market Value (as defined below) of the Common Stock on the first trading day of the calendar year for which the annual retainer is being paid (or January 27 in the case of 2000) or, in the case of an annual retainer being paid to a newly appointed or elected Eligible Director for a partial year, on the date such Eligible Director joins the board.

(iii) The number of shares of Common Stock issuable in lieu of cash meeting fees (whether or not deferred) shall be determined by dividing the amount of cash fees being replaced by Common Stock by the Fair Market Value of the Common Stock on the date of the meeting for which the fee is paid.

(b) Fractional of Shares. No fractional shares shall be issued under the Plan. The portion of annual retainer or meeting fees that would be paid in Common Stock but for the proscription on fractional shares shall be paid in cash along with any portion of the fee (or the next subsequent fee) that the Eligible Director has elected to receive in cash. For directors electing no cash for a particular calendar year, fractional share equivalent cash balances shall be held by the Company until the end of that calendar year and then distributed in cash to the Eligible Director without interest.

(c) Fair Market Value. For the purposes of the Plan, the "FAIR MARKET VALUE" of the Common Stock as of any issuance or deferral date shall be the closing price of the Common Stock on the New York Stock Exchange (or another national stock exchange or the NASDAQ National Market System, if the Common Stock trades thereon but not on the NYSE) as of such date (or, if no such shares were traded on such date, as of the next preceding day on which there was such a trade, provided that the closing price on such preceding date is not less than 100% of the fair market value of the Common Stock, as determined in good faith by the Company, on the date of issuance). If at any time the Common Stock is no longer traded on a national stock exchange or the NASDAQ National Market System, the Fair Market Value of the Common Stock as of any issuance date shall be as determined by the Company in good faith in the exercise of its reasonable discretion.

(d) Issuance of Certificates. As promptly as practicable following each issuance of Common Stock hereunder, the Company shall issue to the recipient Eligible Director a stock certificate or certificates registered in his or her name representing the number of shares of Common Stock issued.

7. DEFERRAL.

(a) Election to Defer. An Eligible Director may elect to defer the receipt of any cash or stock annual retainer or meeting fees payable during the period to which an Election applies. Any such deferral election by an Eligible Director shall specify whether the fees to be deferred are fees that the Eligible Director is required or has elected to receive in Common Stock, and shall be made and take effect at the times specified in the Company's Deferred Compensation Plan (the "DEFERRED COMPENSATION PLAN"). The deferral shall not change the form (cash versus Common Stock) in which the fee is to be paid at the end of the deferral period, notwithstanding the fact that during the deferral period fees ultimately payable in Common Stock may be general unsecured obligations of the Company to the Eligible Director.

(b) Common Stock Premium. The Company shall pay a 25% premium to each Eligible Director who elects to defer annual retainer or meeting fees to be received in Common Stock. The number of shares of Common Stock deferred and the premium thereon shall be calculated by multiplying the amount of cash fees being replaced by Common Stock and deferred by 1.25, and then dividing that product by the Fair Market Value of the Common Stock on the date set forth in Section 6(a)(ii) or Section 6(a)(iii) for annual retainer or meeting fees, respectively. Any premium Common Stock shall be subject to the same deferral election, and deliverable to the Eligible Director on the same terms, as the Common Stock upon which the premium is paid.

(c) Plan Shares. All shares issued or issuable under the Plan, including deferred shares and shares issuable as premiums on deferrals, shall be deducted from the shares available under the Plan at the time first issued or deferred, provided that shares deferred and not ultimately issued and delivered to the Eligible Director shall be returned to the pool of available shares under the Plan.

(d) Deferred Compensation Plan. Deferral of Eligible Directors' fees, whether payable in cash or Common Stock and including any premiums, shall be administered pursuant to the Deferred Compensation Plan.

8. SECURITIES LAWS.

(a) Investment Representations. The Company may require any Eligible Director to whom an issuance of securities is made or a deferred delivery obligation is undertaken as a condition of receiving securities pursuant to such issuance or obligation to give written assurances in substance and form satisfactory to the Company and its counsel to the effect the such person is acquiring the securities for his or her own account for investment and not with any present intention of selling or otherwise distributing the same in violation of applicable securities laws, and to such other effects as the Company deems necessary or appropriate to comply with federal and applicable state securities laws.

(b) Listing, Registration, and Qualification. Anything to the contrary herein notwithstanding, each issuance of securities shall be subject to the requirement that, if at any time the Company or its counsel shall determine that the listing, registration, or qualification of the securities subject to such issuance upon any securities exchange or under any state or federal law, or the consent or approval of any governmental or regulatory body, is necessary or advisable as a condition of, or in connection with, such issuance of securities, such issuance shall not occur in whole or in part unless such listing, registration, qualification, consent, or approval shall have been effected or obtained on conditions acceptable to the Company. Nothing herein shall be deemed to require the Company to apply for or to obtain such listing, registration, or qualification.

(c) Restrictions on Transfer. The securities issued under the Plan shall be restricted by the Company as to transfer unless the grants are made under a registration statement that is effective under the Securities Act of 1933, as amended, or unless the Company receives an opinion of counsel satisfactory to the Company to the effect that registration under state or federal securities laws is not required with respect to such transfer.

9. WITHHOLDING TAXES.

Whenever shares of Common Stock are to be issued under the Plan, the Company shall have the right prior to the delivery of any certificate or certificates for such shares to require the recipient to remit to the Company an amount sufficient to satisfy federal, state and local withholding tax requirements attributable to the issuance. In the absence of payment by an Eligible Director to the Company of an amount sufficient to satisfy such withholding taxes, or an alternative arrangement with the Eligible Director that is satisfactory to the Company, the Company may make such provisions as it deems appropriate for the withholding of any such taxes which the Company determines it is required to withhold.

10. AMENDMENT OF THE PLAN.

The Board of Directors of the Company may suspend or terminate the Plan or any portion thereof at any time, and may amend the Plan from time-to-time in any respect the Board of Directors may deem to be in the best interests of the Company; provided, however, that no such amendment shall be effective without approval of the stockholders of the Company if stockholder approval of the amendment is then required pursuant to the applicable rules of any securities exchange, or, in the opinion of the Company's counsel, any other law or regulation binding on the Company.

11. EFFECTIVE DATE AND DURATION OF THE PLAN.

The Plan shall, subject to approval by the Company's stockholders at the Company's 1992 Annual Meeting, be effective January 1, 1993. The Plan shall terminate at 11:59 p.m. on December 31, 2012, unless sooner terminated by action of the Board of Directors. Elections may be made under the Plan prior to its effectiveness, but no issuances under the Plan shall be made before its effectiveness or after its termination.

12. GOVERNING LAWS.

The Plan and all rights and obligations under the Plan shall be construed in accordance with and governed by the laws of the State of California, excluding its conflicts of laws principles.

EXHIBIT 10.6

AMENDED AND RESTATED WESTERN DIGITAL CORPORATION

NON-EMPLOYEE DIRECTORS RESTRICTED STOCK UNIT PLAN

Effective March 28, 2003
Amended and Restated as of November 18, 2004

1. Purpose.

The purpose of this Western Digital Corporation Non-Employee Directors Restricted Stock Unit Plan is to enable the Company to make Awards to its Non-employee Directors of Restricted Stock Units (each, as defined below), to attract, retain and motivate its Non-employee Directors and to further align their interests with the interests of the Company's other stockholders.

2. Definitions.

As used herein, the following terms shall have the meanings ascribed thereto below:

(a) "ACCOUNT" means an unfunded bookkeeping account maintained by the Company for an Award to track vesting and value thereof pursuant to Section 5.

(b) "ADMINISTRATOR" means the Board, unless the Board has delegated authority to the Committee, in which event the Administrator shall mean the Committee.

(c) "AWARD" means an Initial Grant, an Annual Grant or a Partial Grant of Restricted Stock Units under the Plan.

(d) "BOARD" means the Board of Directors of the Company.

(e) "COMMITTEE" means the Compensation Committee of the Board consisting solely of two (2) or more Non-employee Directors.

(f) "COMMON STOCK" means the common stock of the Company.

(g) "COMPANY" means Western Digital Corporation, a Delaware corporation, or any successor assuming or substituting Awards pursuant to Section 4(b)(iii).

(h) "DEFERRED COMPENSATION PLAN" means the Company's Amended and Restated Deferred Compensation Plan, as amended from time to time.

(i) "DISABILITY" means a period of disability during which a Participant qualifies for permanent disability benefits under the Company's long-term disability plan, or, if the Participant does not participate in such a plan, a period of disability during which the Participant would have qualified for permanent disability benefits under such a plan had the Participant been a participant in such a plan, as determined in the sole discretion of the Administrator. If the Company does not sponsor such a plan, or discontinues to sponsor such a plan, Disability shall be determined by the Administrator in its sole discretion.

(j) "FAIR MARKET VALUE" per share of Common Stock, as of any date, means the closing price for a share of Common Stock reported for that date on the New York Stock Exchange (or such other national stock exchange or quotation system on which shares of Common Stock are then listed or quoted) or, if no shares of Common Stock are traded on the New York Stock Exchange (or such other stock exchange or quotation system) on the date in question, then the closing price for the next preceding date on which there was such a trade on the New York Stock Exchange (or such other stock exchange or quotation system). If at any time the Common Stock is no longer traded on a national stock exchange or quotation system, the Fair Market Value of the Common Stock as of the date in question shall be as determined by the Administrator in good faith.

(k) "NON-EMPLOYEE DIRECTOR" means a director who is both a "non-employee director" as defined in Rule 16b-3 under the Securities Exchange Act of 1934, as amended, and an "outside director" within the meaning of Section 162(m) of the Internal Revenue Code of 1986, as amended.

(l) "NOTICE OF AWARD" shall mean a Notice of Award in the form established from time to time by the Administrator setting forth the number of Restricted Stock Units awarded thereunder.

(m) "PARTICIPANT" means any Eligible Director to whom an Award has been made.

(n) "PLAN" means this Western Digital Corporation Non-Employee Directors Restricted Stock Unit Plan, as amended from time to time.

(o) "REMOVAL" means removal of a Participant from the Board, with or without cause, in accordance with the Company's Certificate of Incorporation, Bylaws or Delaware General Corporate Law.

(p) "RESTRICTED STOCK UNIT" is an unfunded bookkeeping entry representing the cash equivalent of the Fair Market Value of one share of Common Stock.

(q) "45 DAY AVERAGE PRICE" shall mean the average of the Fair Market Value of a share of Common Stock for the forty-five (45) trading days prior to and including the applicable measurement date, subject, in the discretion of the Administrator, to any adjustments for stock splits or other transactions affecting the Common Stock during such period.

3. Participation in the Plan.

(a) Non-employee Directors of the Company ("Eligible Directors") shall be eligible to participate in the Plan. Each Eligible Director shall, if required by the Company, enter into an agreement with the Company in such form as the Company shall determine consistent with the provisions of the Plan for purposes of implementing the Plan or effecting its purposes. In the event of any inconsistency between the provisions of the Plan and any such agreement, the provisions of the Plan shall govern.

4. Credits

(a) General. Upon the effectiveness of the Plan, the Company, shall grant to each then Eligible Director 2,100 Restricted Stock Units (the "Initial Grant," provided that Initial Grants made on or after January 1, 2005 shall instead consist of 4,527 Restricted Stock Units), and shall grant to each Eligible Director on each January 1 thereafter 2,100 Restricted Stock Units (the "Annual Grant," provided that Annual Grants made on or after January 1, 2005 shall instead consist of 4,527 Restricted Stock Units). If a person first becomes an Eligible Director at any time following the date of the effectiveness of the Plan, the Company shall pro-rate the Initial Grant and grant such Eligible Director the number of Restricted Stock Units equal to the product of (i) the Initial Grant divided by 365 and (ii) the number of days from the date such person became an Eligible Director to the date of the next Annual Grant (a "Partial Grant"). The Company shall establish a separate Account for each Award. No fractional Restricted Stock Units shall be granted, and any fractional Restricted Stock Unit shall be rounded up to the nearest whole number. Each Award shall be evidenced by a Notice of Award issued by the Company.

(b) Additional Credits.

(i) Whenever the Company shall pay any dividends (other than in Common Stock) upon issued and outstanding Common Stock, or make any distribution (other than in Common Stock) with respect thereto, there shall be credited to each Account of a Participant a number of Restricted Stock Units determined by multiplying the "fair value" of any dividend (or other distribution) made by the Company with respect to one share of its Common Stock by the number of Restricted Stock Units in that Account and then dividing that product by the Fair Market Value of a share of Common Stock on the date of payment of such dividend or distribution. In the case of a cash dividend or distribution, the "fair value" thereof shall be the amount of such cash, and, in the case of any other dividend or distribution, the "fair value" thereof shall be such amount as shall be determined in good faith by the Administrator.

(ii) If the Company pays any dividend or distribution upon its issued and outstanding Common Stock payable in additional shares of such Common Stock there shall be credited to each Account of a Participant a number of Restricted Stock Units equal to the product obtained by multiplying (i) the number of Restricted Stock Units in that Account at the time of payment of such dividend or distribution by (ii) the number of shares of Common Stock issued as a stock dividend or distribution by the Company with respect to one share of its Common Stock.

(iii) In the event of a stock split, reverse stock split, recapitalization, reorganization, consolidation or like change in the capital structure of the Company affecting the Common Stock not addressed by Section 4(b)(i) or 4(b)(ii), if the Administrator shall determine that such change equitably requires an adjustment or adjustments in the number or kind of Restricted Stock Units then allocated to

Participants' Accounts, or other computations or amounts under the Plan based upon Common Stock or its value, such adjustments shall be made by the Administrator in its sole discretion and shall be conclusive and binding for all purposes of the Plan. In the event of a liquidation of the Company, or a merger, reorganization, or consolidation of the Company with any other corporation in which the Company is not the surviving corporation or the Company becomes a wholly-owned subsidiary of another corporation, if the surviving corporation in any such merger, reorganization, or consolidation does not assume the Award or agree to issue a substitute award in place thereof, then any unvested Restricted Stock Units shall vest in full and become payable in accordance with Section 5(c) of the Plan immediately prior to such liquidation, merger, reorganization, or consolidation.

(iv) No fractional Restricted Stock Units shall be credited to an Account pursuant to this Section 4(b), and any fractional Restricted Stock Unit that otherwise would be credited shall be rounded up to the nearest whole number.

(c) Cessation of Credits. There shall be no further credits to an Account after the Restricted Stock Units in such Account fully vest, or to any Account or Accounts of a Participant after he or she ceases to be a director of the Company for any reason.

5. Vesting and Payment.

(a) Vesting. Participants shall have no vested interest in Restricted Stock Units prior to vesting thereof. Restricted Stock Units shall vest 100% on the third anniversary of the date of the Award, provided that the Participant has remained a director of the Company for the entire period from the date of grant to the date of vesting. If a Participant has served as a director of the Company for at least 48 continuous months and is at least 55 years old when such director ceases to be a director of the Company for any reason other than Removal (a "Retired Director"), all unvested Restricted Stock Units of such Retired Director shall vest effective upon such director's termination as a director of the Company and become payable in accordance with Section 5(c) of the Plan. If a Participant ceases to be a director of the Company for any reason other than Removal prior to being eligible to become a Retired Director, then all of such Participant's unvested Restricted Stock Units granted within the first twelve months immediately prior to the date of such termination shall terminate without vesting; 1/3 of all of such Participant's unvested Restricted Stock Units granted within the second twelve month period prior to such termination shall immediately vest and become payable in accordance with Section 5(c) of the Plan; and 2/3 of all of such Participant's unvested Restricted Stock Units granted within the third twelve month period prior to such termination shall immediately vest and become payable in accordance with Section 5(c) of the Plan. Any Restricted Stock Units that have not vested at the time of, or do not vest upon, a Participant ceasing to be a director of the Company shall terminate and be forfeited.

(b) Acceleration upon Death or Disability. Notwithstanding Section 5(a), if a Participant ceases to be a director of the Company due to death or Disability, then, subject to Section 5(g), all of such Participant's Restricted Stock Units shall immediately vest in full and become payable in accordance with Section 5(c) of the Plan.

(c) Payment Amount and Maximum Payment Amount. Subject to Sections 5(f) and (g) herein, within fifteen (15) business days after the Restricted Stock Units in an Account have vested, the Company shall pay to the Participant, in cash, an amount equal to the product of the number of Restricted Stock Units in that Account on the date of vesting and the 45 Day Average Price as of the date of vesting (the "Payment Amount"), provided, however, that in no event shall the Payment Amount for any Account exceed 200% of the value of the Account on the date of the Award, with such value on the date of the Award calculated as the product of the number of Restricted Stock Units in that Account on the date of the Award and 45 Day Average Price as of the date of the Award. Notwithstanding the foregoing, if a Participant ceases to be a director of the Company for any reason other than death or Disability prior to being eligible to become a Retired Director, in no event shall the Payment Amount for any Account of such Participant that vests as a result of such termination exceed the value of the Account on the date of the Award, with such value on the date of the Award calculated as the product of the number of Restricted Stock Units in that Account on the date of the Award and the 45 Day Average Price as of the date of the Award.

(d) Payments Only to the Director. Payments pursuant to the Plan shall be made only to the Participant or his or her heirs or successors pursuant to Section 11 upon his or her death.

(e) Payments Only in Cash. All payments to Participants hereunder shall be in cash.

(f) Deferral. To the extent permitted under the Deferred Compensation Plan, a Participant may elect to defer receipt of any or all payments due under the Plan with respect to such Award. Such elections shall be made, and any such deferral shall be effected and administered, in accordance with the Deferred Compensation Plan.

6. Administration.

(a) Administrator. The Plan shall be administered by the Administrator, which shall have the power to construe the Plan, to resolve all questions arising under the Plan, to adopt and amend such rules and regulations for the administration of the Plan as it may deem desirable, and otherwise to carry out the terms of the Plan, but only to the extent not contrary to the express provisions of the Plan. The determinations, interpretations, and other actions of the Administrator of or under the Plan or with respect to any Restricted Stock Units granted pursuant to the Plan shall be final and binding for all purposes on all persons. None of the Administrator, the Company nor any officer or employee thereof shall be liable for any action or determination taken or made under the Plan in good faith.

(b) Amendment, Modification, Suspension and Termination of the Plan. The Board may from time to time in its discretion amend, modify, suspend, or terminate, in whole or in part, any or all provisions of the Plan, including but not limited to modifying the vesting periods for the Restricted Stock Units to provide for shorter or longer vesting period or the number of Restricted Stock Units granted. The Board may amend, modify, suspend or terminate outstanding Awards, provided, however, outstanding Awards shall not be amended, modified, suspended or terminated in such a manner as to impair any rights of the recipient of the Award without the consent of such recipient. If any such amendment or modification to an outstanding Award reduces the vesting period, then any election that had been made to defer receipt of any or all payments due under the Plan with respect to such Award pursuant to the Deferred Compensation Plan shall be disregarded.

7. Taxes.

The Company shall be authorized to withhold from any grant, credit, payment or settlement of Restricted Stock Units the amount of any taxes required to be withheld in respect of such grant, payment or settlement or any credit of dividend equivalents under such Restricted Stock Units or under the Plan and to take such other action as may be necessary in the opinion of the Administrator to satisfy all obligations for the payment of such taxes.

8. No Rights as a Stockholder.

Participants shall have no dividend, voting, or any other rights as a stockholder of the Company with respect to any Restricted Stock Unit.

9. No Property Rights.

The grant of an Award pursuant to the Plan shall not be deemed the grant of a property interest in any assets of the Company. An Award evidences only a general obligation of the Company to comply with the terms and conditions of the Plan and make payments in accordance with the Plan from the assets of the Company that are available for the satisfaction of obligations to creditors. The Company shall not segregate any assets in respect of any Award or Account. The rights of the recipient of Restricted Stock Units to benefits under the Plan shall be solely those of a general, unsecured creditor of the Company.

10. Reorganization.

The receipt of an Award under the Plan shall not affect the right of the Company to reclassify, recapitalize or otherwise change its capital or debt structure or to merge, consolidate, convey any or all of its assets, dissolve, liquidate, windup or otherwise reorganize.

11. Assignment.

No right or interest to or in the Plan, or any payment or benefit to a Participant shall be assignable by the Participant except by will or the laws of descent and distribution. No right, benefit or interest of the Participant hereunder shall be subject to anticipation, alienation, sale, assignment, encumbrance, charge, pledge, hypothecation or set off in respect of any claim, debt or obligation, or to execution, attachment, levy or similar process or assignment by operation of law. Any attempt, voluntarily or involuntarily, to effect any action specified in the immediately preceding sentences shall, to the full extent permitted by law, be null, void and of no effect; provided, however, that this provision shall not preclude a Participant hereunder from designating one or more beneficiaries to receive any amount that may be payable to the Participant after his or her death and shall not preclude the legal representatives of the Participant's estate from assigning any right hereunder to the person or persons entitled thereto under his or her will, or, in the case of intestacy, to the person or persons entitled thereto under the laws of intestacy applicable to his or her estate.

12. No Right to Continued Board Membership.

The grant of Restricted Stock Units shall not be construed as giving a Participant the right to be retained as a director of the Company. The Board may at any time fail or refuse to nominate a Participant for election to the Board, the stockholders of the Company may at any election fail or refuse to elect any Participant to the Board, or a Participant may be subject to Removal, in each case, free from any liability or claim under the Plan or any Restricted Stock Unit except as expressly set forth herein.

13. Effective Date and Duration of the Plan.

The Plan shall be effective April 1, 2003. The Plan shall terminate upon the approval of the Board. Deferral elections pursuant to Section 5(f) may be made under the Plan prior to its effectiveness, but no issuances under the Plan shall be made before its effectiveness or after its termination.

14. Invalid Provisions.

If any provision of the Plan is held to be illegal, invalid or unenforceable under present or future laws effective during the term of the Plan, such provision shall be fully severable; the Plan shall be construed and enforced as if such illegal, invalid or unenforceable provision had never been a part of the Plan; and the remaining provisions of the Plan shall remain in full force and effect and shall not be affected by the illegal, invalid or unenforceable provision or severance from the Plan. Furthermore, in lieu of such illegal, invalid or unenforceable provision there shall be added automatically as part of the Plan a provision as similar in terms to such illegal, invalid or unenforceable provision as is possible and still be legal, valid and enforceable.

15. Governing Laws.

The Plan and all rights and obligations under the Plan shall be construed in accordance with and governed by the laws of the State of California, excluding its conflicts of laws principles.

Exhibit 10.31

DESCRIPTION OF PERFORMANCE GOALS FOR CASH BONUS AWARDS UNDER THE WESTERN DIGITAL CORPORATION INCENTIVE COMPENSATION PLAN

Under the Western Digital Corporation Incentive Compensation Plan (the "Plan") the Company may grant cash bonus awards to the Company's executive officers based on Company's achievement of predetermined performance goals. For executive officers, a target bonus amount has been established as a percentage of base salary ranging from 45% to 100% of base salary. If the predetermined performance goals are met, then the Plan may fund based on target amounts and may vary from 0% to 200% of target. However, individual participation in the Plan is based on individual performance, and actual awards may vary upward or downward.

At a meeting on November 17, 2004 the Compensation Committee of the Board of Directors of the Company established the performance goals for the cash bonus awards under the Plan for the second half of fiscal year 2005. The Committee determined that funding of the Plan would be based upon accomplishment of specific EPS and cash flow targets, in various combinations. These goals were recommended to, and approved by, the non-management members of the Board of Directors on November 18, 2004.

Exhibit 31.1

Certification of Principal Executive Officer

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Matthew E. Massengill, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Western Digital Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 8, 2005

/s/ Matthew E. Massengill

Matthew E. Massengill
Chief Executive Officer

Exhibit 31.2

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

I, Stephen D. Milligan, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Western Digital Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 8, 2005

/s/ Stephen D. Milligan

Stephen D. Milligan
Chief Financial Officer

Exhibit 32.1

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

Certification of Chief Executive Officer

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

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the period ended December 31, 2004 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 8, 2005

/s/ Matthew E. Massengill

Matthew E. Massengill
Chief Executive Officer

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

Exhibit 32.2

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

Certification of Chief Financial Officer

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

(i) the accompanying Quarterly Report on Form 10-Q of the Company for the period ended December 31, 2004 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: February 8, 2005

/s/ Stephen D. Milligan

Stephen D. Milligan
Chief Financial Officer

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