



Western Digital

ANNUAL REPORT
AND FORM 10-K

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T H E C O M P A N Y

Western Digital Corporation enables people and businesses to collect, build and manage the digital information they need for effectiveness at work and enjoyment at leisure. The company facilitates the rapid collection of information, entertainment content and business data; supplies innovative solutions for storage; and provides data management, intelligence gathering and network management software. The quality and reliability of Western Digital products and services help to ensure the integrity and security of each customer's digital universe.

S H A R E H O L D E R S

Fellow Shareholders:

Western Digital Corporation's fiscal year 2000 was a year of renewal. The company gained new management leadership with a commitment to growth and margin expansion; substantially improved its performance and results in the personal storage business; found exciting new ways to apply its proven core competencies to emerging applications; and launched new operations and products to serve completely new markets, including network-attached storage, storage area network management, and supply chain intelligence.

Western Digital's traditional hard drive manufacturing operations met numerous challenges last year, including intense competition, sharp price cutting and occasional component shortages. In the Autumn of 1999, we carried out a recall of hard drives containing a faulty chip that might have failed under intensive, long-term use — a voluntary recall that demonstrated our brand's commitment to data integrity and further secured our excellent customer relations, but disrupted normal shipments for several quarters.

Our determined and energetic workforce met these challenges with improvements in quality, innovation and market responsiveness. To earn back business, WD accelerated product development in desktop hard drives, regaining its competitive time-to-market performance in 5400 RPM drives, and leading the industry with its 7200 RPM designs. Western Digital was first to market with a 7200 RPM, 10 GB-per-platter desktop drive, and repeated this performance with the 20 GB-per-platter drive.



We took a number of actions to improve the efficiencies and improve our focus in the hard drive business. We consolidated three drive manufacturing operations into a single, high-efficiency facility in Malaysia. Over the course of eight quarters, we reduced our labor and overhead costs by more than 50%. We exited the enterprise hard drive business, which was demanding huge investments in a market dominated by two larger competitors, and we shifted our resources in the enterprise space to Internet-related storage network management and supply chain data analysis where growth rates and margins are higher.

Cost and expense reduction efforts were redoubled with great effect: by year's end, operating expenses had fallen nearly 30%; over a two year period, operating expenses have been reduced 50%.

Today, Western Digital is again winning quality accolades and increased business volume from the industry's leading OEM companies. We have largely rebuilt our volume levels with the top five multinational PC suppliers, and attained number one supplier ratings at the world's two leading PC makers.

This spring, Western Digital aligned with a number of these leading PC makers and other IT industry leaders including AMD, Compaq, Gateway and Hewlett-Packard to form an open Internet exchange for PC components, eHITEX. This new B2B marketplace enables buyers and sellers involved in the computing and electronics-related industry to manage their supply chains more effectively, reduce costs, improve delivery of products and services, and increase customer satisfaction.

The rapid growth of cable and satellite broadcasting and digital music and video recording has opened vast new markets for Western Digital's specialized home entertainment products and core competencies. These non-traditional markets for hard drives are forecasted by IDC to grow at greater than 90% compound annual growth rate from 1999 through 2004. The company has active relationships with all of the major cable operators, set top box manufacturers and gaming box companies — the segments that are expected to provide the early growth in this exciting new market for hard drives. Equipped with WD-exclusive StreamWeaver™ and WhisperDrive™ technologies for data streaming and acoustics control in high-performance audio/visual applications, WD Performer™ hard drives are designed for each of these applications and other consumer products. A major endorsement for these drives was their selection by Microsoft WebTV Networks, Inc. for use in its UltimateTV service as part of an advanced RCA DIRECTV system.



In fiscal year 2000 and early 2001, Western Digital launched two promising operations addressing new markets. Connex, a developer of network storage solutions, enables companies to efficiently fulfill their departmental storage requirements, as well as evolve from simple network-attached storage systems to

enterprise-wide storage area networks. Connex is attracting a set of customers in targeted vertical markets with the introduction of its N3000™ NAS solution. The features, performance and security of this product have received excellent reviews from the field, where it is at work in a wide variety of industries and applications.

SageTree, a software company providing packaged analytic applications and professional services, entered the supply chain intelligence market in June. Its first major software product, SageQuest™ software, is a web-based, enterprise-wide analytic application that quickly won industry acclaim. SageTree is making its solution available to manufacturing companies seeking higher efficiencies across supply chains and product lifecycles. On emerging from its development phase, SageTree received a \$10 million investment from NCR Corporation, a data warehousing leader.

Western Digital ended the year with \$184 million in cash. We reduced our long-term debt by \$300 million and the remaining \$225 million balance represents convertible debentures that are convertible into WD common stock at the holder's option and generally payable in WD common stock or cash at the company's option. In September 2000, we signed an agreement with a lending group for a new \$125 million credit agreement.

We are continuing the tight controls that over the last eight quarters reduced our annual operating expense run rate by \$200 million and our cash conversion cycle by 16 days. Last year's improvement in WD's core operations permitted us to increase our funding of new ventures, making available \$40 million for investment in Connex, SageTree and other new ventures.

As we enter fiscal 2001, we are finding additional opportunities for profit improvement and ways to improve our value to customers in our traditional business. Our new venture investments are taking hold in their markets, providing the expectation for profit contributions, greater balance in our operations, and the possibility of leveraged financing opportunities.

Western Digital is building businesses in the high-growth global markets for personal storage, networked storage, storage management software, analytical software, home entertainment, e-business ventures and data communication. We have the seasoned technological expertise that people and businesses will need as they collect, build, manage and secure the information that becomes the new digital universe.

I look forward to keeping you informed of our progress on these fronts.

A handwritten signature in black ink, appearing to read "M.E. Massengill". The signature is fluid and cursive, with a large, stylized initial "M" and "E".

Matthew E. Massengill
President and Chief Executive Officer

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

FORM 10-K

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

For the fiscal year ended June 30, 2000

or

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

For the transition period from _____ to _____

Commission File Number 1-8703

WESTERN DIGITAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
Incorporation or organization)

92-2647125
(I.R.S. Employer Identification No.)

8105 Irvine Center Drive
Irvine, California
(Address of principal executive offices)

92618
(Zip Code)

Registrant's telephone number, including area code: **(949) 932-5000**

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

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

Title of each class:
Common Stock, \$.01 Par Value
Rights to Purchase Series A Junior
Participating Preferred Stock

Name of each exchange
on which registered:
New York Stock Exchange
New York Stock Exchange

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

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

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

As of August 31, 2000, the aggregate market value of the voting stock of the Registrant held by non-affiliates of the Registrant was \$863.4 million.

As of August 31, 2000, the number of outstanding shares of Common Stock, par value \$.01 per share, of the Registrant was 147,551,931.

Documents Incorporated by Reference

Information required by Part III is incorporated by reference to portions of the Registrant's Proxy Statement for the 2000 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2000 fiscal year.

WESTERN DIGITAL CORPORATION
INDEX TO ANNUAL REPORT ON FORM 10-K
For the Fiscal Year Ended June 30, 2000

		<u>Page</u>
PART I		
Item 1.	Business	3
Item 2.	Properties	13
Item 3.	Legal Proceedings	13
Item 4.	Submission of Matters to a Vote of Security Holders	14
PART II		
Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters	15
Item 6.	Selected Financial Data	16
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	16
Item 7A	Quantitative and Qualitative Disclosures About Market Risk	28
Item 8.	Financial Statements and Supplementary Data	31
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	62
PART III		
Item 10.	Directors and Executive Officers of the Registrant	62
Item 11.	Executive Compensation	62
Item 12.	Security Ownership of Certain Beneficial Owners and Management	62
Item 13.	Certain Relationships and Related Transactions	62
PART IV		
Item 14.	Exhibits, Financial Statement Schedules, and Reports on Form 8-K	62

The Company has a 52 or 53-week fiscal year. In order to align its manufacturing and financial calendars, effective during the three months ended December 31, 1999, the Company changed its fiscal calendar so that each fiscal month ends on the Friday nearest to the last day of the calendar month. Prior to this change, the Company's fiscal month ended on the Saturday nearest to the last day of the calendar month. The change did not have a material impact on the Company's results of operations or financial position. The 1998, 1999 and 2000 fiscal years ended on June 27, July 3, and June 30, respectively, and consisted of 52 weeks for the fiscal years 1998 and 2000, and 53 weeks for the fiscal year 1999.

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

The Company's principal executive offices are located at 8105 Irvine Center Drive, Irvine, California 92618. The Company's telephone number is (949) 932-5000 and its web site is <http://www.westerndigital.com>. The information on the web site is not incorporated in this report.

PART I

Item 1. *Business*

General

Western Digital Corporation (the “Company” or “Western Digital”) designs, develops, manufactures and markets hard drives featuring leading-edge technology. A hard drive is a storage device found in most computers that stores data on one or more rotating magnetic disks that provide fast access to data that must be readily available to users of computers or other devices. The Company’s hard drives are designed for the desktop PC market and for the emerging market for hard drives specially designed for digital audio-visual applications, such as new digital video recording devices, digital cable set-top boxes, satellite television boxes, audio/visual juke boxes and video game devices. The Company’s hard drive products currently include 3.5-inch form factor hard drives ranging in storage capacity from 7.5 gigabytes (“GB”) to 45.0 GB. The Company sells its products worldwide to computer manufacturers for inclusion in their computer systems or subsystems and to distributors, resellers and retailers. The Company’s products are currently manufactured in Malaysia. In January 2000, the Company announced its decision to exit the market for hard drives manufactured for enterprise computer systems and closed its Rochester, Minnesota enterprise hard drive design center.

The Company continuously evaluates opportunities to extend its data storage product offerings and to expand beyond the traditional market for hard drives into new markets which meet certain predefined criteria. The Company considers new or high growth markets for data or content storage, management, and communication which have few entrenched competitors and offer the prospect of a sustained competitive advantage through unique or proprietary technology. In February 1999, the Company acquired Connex, Inc. (“Connex”), a San Jose-based startup company formed to develop storage solutions for the Windows NT and UNIX server environments for the rapidly changing storage market. Connex’s first product, the “N3000™” is a network attached storage (“NAS”) appliance targeted at workgroups and small departments where multiple users access shared data files over a local area network. Connex has also developed a suite of software products for the management of a storage area network (“SAN”). For further discussion of Connex, see under the heading “Products — Products Developed by Connex”, and see Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

In February 2000, the Company contributed the assets comprising its emerging business in analytical software for data warehouses to a newly formed subsidiary, SageTree, Inc. (“SageTree”). The Company formed this subsidiary in anticipation of the possibility of obtaining financing from outside the Company for the operation and development of this emerging business. In June 2000, SageTree received a direct investment from NCR Corporation in exchange for a minority interest in SageTree. SageTree has expanded the functionality of its software and now offers SageQuest™, a software package for enterprise-wide supply chain management, product lifecycle management and decision support in the manufacturing industry. For further discussion of SageTree, see Part II, Item 7, under the heading “Risk factors relating to Western Digital particularly.”

The Company will monitor the development of new markets related to data or content storage and storage management, and communication of digital content and network intelligence, and may from time to time offer new products or services to address appropriate new markets.

Industry

Desktop PC Market. According to International Data Corporation, the desktop computer segment is the largest segment of the worldwide personal computer market, accounting for approximately 78% of global personal computer shipments in calendar 1999. As a result, desktop computers were the leading source of demand for hard drives, accounting for more than 70% of all hard drive units shipped worldwide in calendar 1999, according to International Data Corporation. Over 90% of Western Digital’s hard drive unit shipments in 2000 were sold to this market. Desktop personal computers for entry level to experienced users are used in

both commercial and consumer environments. The demand for hard drive capacity continues to grow in part due to:

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

Future demand growth for desktop computer hard drives also may be driven by new and emerging hard drive markets. In August 2000, International Data Corporation forecasted that the worldwide desktop computer hard drive market would grow from approximately 133 million units in calendar 1999 to 247 million units in calendar 2004, reflecting a compound annual growth rate of approximately 13.2%. However, it forecasts that revenue growth will only be approximately 3.6% through calendar 2004, reflecting the impact of severe price competition. See Part II, Item 7, under the heading “Risk factors related to the hard drive industry in which we operate.”

Desktop PCs are used in a number of environments, ranging from homes to businesses and multi-user networks. Software applications are used on desktop PCs primarily word processing, spreadsheet, desktop publishing, database management, multimedia, entertainment and other related applications. Desktop PCs typically utilize the Enhanced Integrated Drive Electronics (“EIDE”) interface for their hard drives. The Company believes the minimum storage requirements in the past year for entry-level PCs were generally 6.8 GB to 10.2 GB of formatted capacity.

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

Users of desktop PCs, especially entry-level desktop PCs, have become increasingly price sensitive. In 1999 the market for desktop PC’s priced below \$1,000 grew significantly, and in 2000 the market for desktop PC’s priced below \$800 was the fastest growing segment of the market. These systems typically do not contain high performance hard drives, but the growth of these segments has placed downward price pressure on higher cost systems as well, thereby contributing to the increasing price pressures on desktop hard drives. The Company has development efforts underway to specifically address the entry-level consumer PC market. See Part II, Item 7, under the heading “Risk factors related to the hard drive industry in which we operate.”

Products

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

Desktop PC Products. The WD Caviar family currently consists of 1.0” high, 3.5-inch form factor products with capacities ranging from 7.5 GB to 45.0 GB and rotation speeds of 5400 and 7200 revolutions per minutes (“rpm”). In 1998 the Company introduced the Data Lifeguard™ feature, an exclusive data reliability

feature which is now implemented in all of the Company's hard drives. Data Lifeguard protects end-user data by automatically detecting, isolating, and repairing possible problem areas on the hard drive before data loss can occur. The WD Caviar products utilize the EIDE interface, providing high performance while retaining ease of use and overall low cost of connection. The type of EIDE interface currently used in substantially all of the Company's desktop PC hard drives is ATA/66, which signifies an internal data transfer rate of 66 megabytes per second, approximately twice as fast as the previous generation of EIDE interface. The Company currently sells a line of hard drives and related adapters which are designed to accommodate an interface known as "1394/Firewire/i.Link", for use primarily in connecting digital consumer electronic devices, such as digital video camcorders.

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

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

The Company offers customized design capabilities and unique hard drive technologies for consumer applications; however, where practical, the Company intends to leverage its existing product line architectures for the various products for the audio-visual market. The Company is currently offering the WD Performer™ hard drive line, designed for use in consumer audio-video applications. It is also developing hard drives and products incorporating hard drive technology for consumer electronics products including digital cable set-top boxes, satellite television boxes, audio-visual juke boxes and video game devices. Because the market for these products has not yet developed, it is too early to project the likely size and growth of such market. For further discussion of this product development effort, see Part II, Item 7, under the heading "Risk factors relating to Western Digital particularly."

Products Developed by Connex. Connex offers a network attached storage appliance, the N3000™, featuring a fully integrated controller, up to six hard drives, an integrated tape for backup, automatic connectivity for remote management, and plug-and-play installation capability. The system includes Connex's storage management software. Connex is offering an expanded version of this product, the N3100™, which features up to eight hard drives. The systems are marketed to workgroups and small departments where multiple users access shared data files over a local area network. Connex has also developed a suite of software products for the management of a storage area network. A storage area network is a network of storage devices connected by Fibre Channel or other high-speed network, which allows an enterprise to store and manage large amounts of data in a centralized method off of an enterprise's local area network. Connex's SANavigator™ product, manages the overall SAN, discovers SAN devices, physically and logically maps devices, manages data paths, launches other applications, monitors the health of the SAN and remedies problems through an intuitive, easy-to-use graphical user interface. Connex sells its products through distributors and value-added resellers and is targeting select original equipment manufacturers. Its hardware products are manufactured by third parties under contract manufacturing arrangements, in accordance with

Connex's designs and specifications. For further discussion of Connex, see Part II, Item 7, under the heading "Risk factors relating to Western Digital particularly."

Products Developed by SageTree. SageTree offers analytical software, branded SageQuest™, and services for enterprise-wide supply chain intelligence, product lifecycle intelligence and decision support in the manufacturing industry. The SageQuest™ software is a Web-based suite of packaged analytic applications designed for the manufacturing industry. The applications collect and synthesize dissimilar data across an enterprise and transform the data into customized, accurate reports that assist management in solving business and operational issues. This allows rapid analysis and management of a manufacturer's products and components at all stages of the product lifecycle, including products in manufacturing and in the field. The applications use advanced analytics and data warehousing technology to create "supply chain intelligence". The objectives of supply chain intelligence include improved manufacturing yield, product quality and reliability, and customer satisfaction. The Company expects to begin selling SageQuest software in 2001.

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

Technology and Product Development

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

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

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

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

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

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

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

The integrated circuits on the printed circuit board typically include a drive interface and a controller. The drive interface receives instructions from the computer, while the controller directs the flow of data to or from the disks and controls the heads. The location of data on each disk is logically maintained in concentric tracks which are divided into sectors. The computer sends instructions to the controller to read data from or write data to the disks based on track and sector locations. Guided by instructions from the controller, the head stack assembly is pivoted and swung across the disk by a head actuator or motor until it reaches the selected track of a disk, where the data is recorded or retrieved.

Industry standard interfaces are utilized to allow the disk drive to communicate with the computer. Currently, the primary interface for desktop PCs is EIDE. Increasingly, work station computers are using the EIDE interface as well. As computer performance continues to improve, the hard drive will need to deliver information faster than this interface can handle. Accordingly the desktop PC industry plans to transition to

higher speed interfaces to handle the higher data transfer rates. The Company is working to develop products that will support these higher speed interfaces.

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

Head technology is one of the variables affecting areal density. The desktop hard drive industry has completed a transition to magnetoresistive head technology, which allows significantly higher storage capacities than the previously utilized thin-film head technology. Magnetoresistive heads have discrete read and write structures which provide more signal than the older thin-film inductive heads. This allows significantly higher areal densities, which increases storage capacity per disk and improves manufacturing margin and product reliability. The Company completed the transition to magnetoresistive head technology in 1999 and in 2000 completed the transition to the next generation of head technology, known as giant magnetoresistive. Certain of the Company's competitors in the desktop PC hard drive market moved more quickly than the Company into magnetoresistive head technology, achieving time-to-market leadership at higher capacity points; however, the Company was a leader in the transition to giant magnetoresistive head technology. The Company began volume shipments of its first giant magnetoresistive-based hard drive products for the desktop PC market in the third quarter of 1999, and currently all of the Company's desktop product offerings employ giant magnetoresistive head technology.

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

Sales and Distribution

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

Manufacturers. Sales to manufacturers accounted for 69%, 70% and 65% of consolidated revenues in 1998, 1999 and 2000, respectively. The Company's major computer manufacturer customers include Apple Computer, Compaq Computer, Dell Computer, Fujitsu, Gateway, Hewlett-Packard, IBM, Intel, Micron Electronics and NEC. During 1998, 1999 and 2000, sales to Compaq accounted for 14%, 21%, and 21% of revenues, respectively. The Company believes that its success depends on its ability to maintain and improve its strong relationships with the leading computer manufacturers. Western Digital, Quantum, Maxtor and Seagate have historically had the highest market share with these manufacturers. The increase in the number of qualified suppliers to the leading manufacturers, combined with the continued growth of the sub-\$1,000 PC market, has placed continuous downward pressure on hard drive prices. This pressure, in turn, has reduced average gross margins for hard drive suppliers.

The leading PC computer manufacturers have been gaining market share, which has increased their purchasing leverage over component suppliers. In calendar year 1999, the top ten desktop personal computer manufacturers accounted for more than 40% of all shipments and a significant amount of the growth in the

desktop PC market. As a result, maintaining customer satisfaction with these leading computer manufacturers has become even more critical.

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

The business models of computer manufacturers are in the process of changing, and these changes have impacted and will continue to impact Western Digital's sales, inventory and distribution patterns. The forecast-driven, long-production-run logistics model, which most of the computer industry has used, exposes manufacturers and others in the distribution chain to the risk of carrying excess or obsolete inventories. The historical model limits the computer manufacturers' flexibility to react to rapid technology changes and component pricing fluctuations. In response, the leading manufacturers require their hard drive suppliers to maintain a small base stock of finished product in locations adjacent to the customers' manufacturing facilities. In addition, some of the Company's customers have implemented a supply chain logistics model that combines "build-to-order" (computer manufacturer does not build until there is an order backlog) and "contract manufacturing" (computer manufacturer contracts assembly work to a contract manufacturer who purchases components and assembles the computer based on the computer manufacturer's instructions.) The Company then ships hard drives directly to the assembler for installation at its location. The Company has adapted its logistics model to effectively align with these industry shifts. These changes require greater skill in managing finished goods inventory and more flexibility in manufacturing, both of which in turn require even closer relationships between the Company and its computer manufacturer and contract manufacturer customers. To meet these challenges the Company is expanding its use of Internet technology and web-based supply chain planning tools. In June 2000, the Company invested as a founder in a start-up company, eHitex, Inc., formed by major suppliers and purchasers of components for personal computer manufacturing to operate an Internet marketplace for such components. For an additional discussion of the changes in customer models, refer to Part II, Item 7, under the headings "Risk factors related to Western Digital particularly," and "Risk factors related to the hard drive industry in which we operate."

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

Distributors. The Company uses a select group of distributors to sell its products to small computer manufacturers, value-added resellers, resellers and systems integrators. The Company's major distributor customers include ASI, CHS, Decision Support Systems, ELD, Ingram Micro, Merisel, Servex, Synnex and Tech Data. Distributors and retailers combined accounted for approximately 31%, 30%, and 35% of disk drive revenue for 1998, 1999, and 2000, respectively. Distributors generally enter into non-exclusive agreements with the Company for purchase and redistribution of product on a quick turnover basis. Purchase orders are placed and revised on a weekly basis.

Retailers. The Company sells its retail-packaged products directly to a select group of major retailers such as computer superstores, warehouse clubs and computer electronics stores and authorizes sales through distributors to smaller retailers. Major retailers to whom the Company sells directly include Best Buy, Carrefour, Circuit City, CompUSA, Dixons, Office Depot and Vobis. Retailers accounted for approximately

5%, 6%, and 5% of revenue for 1998, 1999, and 2000, respectively. The Company's current retail customer base is in the United States and Canada. The retail channel complements the Company's other sales channels while helping to build brand awareness for the Company and its products. Retailers supply the aftermarket "upgrade" sector in which end-users purchase and install products to upgrade their computers. The Company grants certain of its retailers price protection and limited rights to return product on a rotation basis. The Company also sells its retail-packaged products through the Internet, at its Web Site, <http://www.westerndigital.com>.

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

The Company's international sales, which include sales to foreign subsidiaries of U.S. companies, represented 43%, 45%, and 53% of revenues for fiscal years 1998, 1999 and 2000, respectively. Sales to international customers may be subject to certain risks not normally encountered in domestic operations, including exposure to tariffs, various trade regulations and fluctuations in currency exchange rates. See Part II, Item 7, under the heading "Risk factors relating to Western Digital particularly."

For information concerning revenue recognition, sales by geographic region and significant customer information, see Notes 1 and 7, respectively, of Notes to Consolidated Financial Statements.

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

Competition

In the desktop product market, the Company competes primarily with Fujitsu, IBM, Maxtor, Quantum, Samsung and Seagate.

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

The Company believes that it cannot differentiate its hard drive products solely on attributes such as storage capacity; therefore, the Company also differentiates itself by designing and incorporating into its hard drives desirable product performance attributes and by emphasizing rapid response with its computer manufacturer and distribution customers and brand equity with its end users. These product performance attributes include seek time, data transfer rates, intelligent caching, failure prediction, remote diagnostics, acoustics and data recovery. Rapid response requires accelerated design cycles, customer delivery and production flexibility, which contribute to customer satisfaction. Data storage has become strategically critical for computer end users. Consequently, the Company believes that trust in a manufacturer's reputation has become an important factor in the selection of a hard drive, particularly within such a rapidly changing technology environment. The Company believes it has strong brand equity with its end users.

The Company's market share eroded in 1998, primarily due to competitive conditions in the hard drive industry (with resulting cutbacks in production), the timing of the Company's transition from thin film to

magnetoresistive head technology and certain manufacturing and performance issues encountered as the Company extended thin film head technology to its limits. The Company completed its transition to magnetoresistive technology in 1999 and completed its transition to giant magnetoresistive technology in 2000. During the first quarter of 2000, the Company lost market share as a result of a previously announced product recall; however, the Company recovered some of its market share as it regained a leadership position in quality and time-to-market during the remainder of 2000.

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

In the network attached storage market, Connex competes primarily with established server companies like Compaq and Dell and with network attached storage makers Hewlett Packard and ProComm. The Company expects that the products under development by Connex will face significant competition from established manufacturers of servers and of network attached storage devices. For an additional discussion of the challenges facing Connex, see Part II, Item 7, under the heading “Risk factors related to Western Digital particularly.”

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

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

Service and Warranty

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

Manufacturing

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

Hard drive manufacturing is a complex process involving the assembly of precision components with narrow tolerances and extensive testing to ensure reliability. The assembly process occurs in a “clean room” environment which demands skill in process engineering and efficient utilization of the “clean room” layout in

order to reduce the high operating costs of this manufacturing environment. The Company's clean room manufacturing process consists of modular production units, each of which contains a number of work cells. With the completed transition to magnetoresistive head technology for desktop PC hard drives, the Company has recently increased its factory yields on desktop PC hard drives to its historically high levels.

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

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

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

Research and Development

The Company devotes substantial resources to development of new products and improvement of existing products. The Company focuses its engineering efforts on coordinating its product design and manufacturing processes in order to bring its products to market in a cost-effective and timely manner. Research and development expenses totaled \$203.7, \$217.0, and \$163.2 million in 1998, 1999 and 2000, respectively. Research and development expenditures included approximately \$22.0 million, primarily related to the initiation of the IBM relationship in 1998, and approximately \$12.0 million related to the acquisition of Connex in 1999.

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

Materials and Supplies

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

Unlike some of its competitors, the Company acquires all of the components for its products from third-party suppliers. In general, the Company tries to have at least two or three suppliers for each of its component requirements. For example, the Company currently buys giant magnetoresistive heads from IBM, Read-Rite and SAE. Media requirements are purchased from several outside vendors including Komag, IBM and HMT Technology. Komag and HMT Technology have publicly announced a plan to merge. In connection with the sale of its media manufacturing division to Komag in April 1999, the Company entered into a three-year volume purchase agreement with Komag. Under this Agreement, the Company is obligated to purchase a substantial portion of its requirements for hard disk media from Komag. The Agreement does not require the Company to purchase a fixed minimum amount of media from Komag.

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

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

Backlog

At September 18, 2000, the Company's backlog, consisting of orders scheduled for delivery within the next twelve months, was approximately \$294 million, compared with a backlog at August 21, 1999 of approximately \$388 million. The Company expects all this backlog to be delivered within the current fiscal year. Historically, a substantial portion of the Company's orders has been for shipments within 30 to 60 days of the placement of the order. The Company generally negotiates pricing, order lead times, product support requirements and other terms and conditions prior to receiving a computer manufacturer's first purchase order for a product. Manufacturers' purchase orders typically may be canceled with relatively short notice to the Company, with little or no cost to the customer, or modified by customers to provide for delivery at a later date. Also, certain of the Company's sales to computer manufacturers are made under "just-in-time" delivery contracts that do not generally require firm order commitments by the customer until the time of sale. Therefore, backlog information as of the end of a particular period is not necessarily indicative of future levels of the Company's revenue and profit and may not be comparable to earlier periods.

Patents, Licenses and Proprietary Information

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

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

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

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

Environmental Regulation

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

Employees

As of June 30, 2000, the Company employed a total of 7,321 full-time employees worldwide. This represents a reduction in headcount of approximately 30% since July 3, 1999, as the Company responded to the industry downturn and its decrease in sales by restructuring and exiting the enterprise hard drive market. The Company employed 1,090 employees in the United States, 6,040 employees in Malaysia, 85 in Singapore, and 106 at its international sales offices as of such date.

Many of the Company's employees are highly skilled, and the Company's continued success depends in part upon its ability to attract and retain such employees. Accordingly, the Company offers employee benefit programs which it believes are at least equivalent to those offered by its competitors. Despite these programs, the Company has, along with most of its competitors, experienced difficulty at times in hiring and retaining certain skilled personnel. In critical areas, the Company has utilized consultants and contract personnel to fill these needs until full-time employees could be recruited. The Company has never experienced a work

stoppage, none of its domestic employees are represented by a labor organization, and the Company considers its employee relations to be good.

Item 2. *Properties*

The Company's worldwide headquarters, located on leased property in Irvine, California, house management, research and development, administrative and sales personnel. The Company has extended the current lease of this facility through January 2001. During the fourth quarter of 2000, the Company signed a new 10-year lease agreement and plans to relocate its worldwide headquarters to a facility in Lake Forest, California, commencing in November 2000. The Company leases facilities in San Jose, California and Irvine, California, for research and development activities. The San Jose leases expire at various times beginning in December 2002 through July 2006. The Irvine research and development facility lease expires in September 2010. Western Digital owns a manufacturing facility in Kuala Lumpur, Malaysia. During 2000 the Company sold approximately 34 acres of land in Irvine, California, upon which it had previously planned to build a new corporate headquarters, for \$26 million (the approximate cost of the land). The Company also sold its enterprise drive manufacturing facility in Tuas, Singapore for \$11.0 million (for a gain of \$3.1 million) and its Rochester, Minnesota enterprise research and development facility for \$29.7 million (for a loss of \$1.9 million).

The Company also leases office space in various other locations throughout the world primarily for sales and technical support. The Company's present facilities are adequate for its current needs, although the process of upgrading its facilities to meet technological and market requirements is expected to continue. The hard drive industry does not generally require long lead time to develop and begin operations in new manufacturing facilities.

Item 3. *Legal Proceedings*

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

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

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

On October 23, 1998, Censtor Corporation ("Censtor") initiated an arbitration proceeding against the Company in California, alleging that it is owed royalties under a license agreement between Censtor and the Company. In response, the Company filed a complaint in federal court in California seeking a determination that the patents at issue are invalid. The federal court action has been stayed pending completion of the

arbitration procedures. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

On June 9, 2000 a suit was brought against the Company in California State Superior Court on behalf of a class of former employees of the Company who were terminated as a result of a reduction in force in December 1999. The complaint asserts claims for unpaid wages, fraud, breach of fiduciary duty, breach of contract, and unfair business practices. The Company has removed the suit to federal court in California on the ground that all of the claims are preempted by the Employee Retirement Income Security Act of 1974. The Company denies the material allegations of the complaint and intends to vigorously defend this action. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

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

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

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

No matters were submitted to a vote of security holders during the fourth quarter of 2000.

Executive Officers of the Registrant

The names, ages and positions of all the executive officers of the Company as of September 15, 2000 are listed below, followed by a brief account of their business experience during the past five years. Executive officers are normally appointed annually by the Board of Directors at a meeting of the directors immediately following the Annual Meeting of Shareholders. There are no family relationships among these officers nor any arrangements or understandings between any officer and any other person pursuant to which an officer was selected.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Matthew E. Massengill	39	President and Chief Executive Officer
Arif Shakeel	45	Executive Vice President, General Manager of Hard Drive Solutions
Charles W. Frank, Jr.	52	Senior Vice President, Chief Technical Officer
Steven G. Campbell	44	Senior Vice President, Engineering
Teresa A. Hopp	41	Senior Vice President and Chief Financial Officer
W. Michael Williams	41	Senior Vice President and General Manager, Connex, Inc.
Michael A. Cornelius	58	Vice President, Law and Administration, and Secretary
Steven M. Slavin	49	Vice President, Taxes and Treasurer
David Fetah	40	Vice President, Human Resources

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

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

Ms. Hopp joined the Company in 1998 as Vice President, Finance. Prior to joining the Company, she was an audit partner at Ernst & Young, her employer for 17 years. She was promoted to her current position in December 1999.

Mr. Michael Williams joined the Company in September 1998 as General Manager, Enterprise Storage Group. He assumed his current position in February 1999. Prior to joining the Company, he was a founder and served as Vice President, Engineering, of Ridge Technologies, a manufacturer of enterprise-class storage systems and subsidiary of Adaptec, from July 1997. Ridge Technologies was the predecessor to Connex, Inc. Prior to this, Mr. Williams served in various engineering and management positions at Apple Computer for 10 years.

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

PART II

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

Western Digital’s common stock is listed on the New York Stock Exchange (“NYSE”) under the symbol “WDC.” The approximate number of holders of record of common stock of the Company as of September 25, 2000 was 3,902.

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

The high and low sales prices of the Company’s common stock, as reported by the NYSE, for each quarter of 1999 and 2000 are as follows:

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>
1999				
High	\$13 ¹ / ₂	\$18 ⁹ / ₁₆	\$21 ⁷ / ₁₆	\$9 ⁷ / ₈
Low	8	7 ¹ / ₈	8 ¹ / ₂	6 ¹ / ₄
2000				
High	\$ 7 ⁹ / ₁₆	\$ 4 ¹ / ₂	\$ 8 ¹³ / ₁₆	\$7 ⁷ / ₈
Low	3 ¹ / ₂	2 ³ / ₄	3 ¹⁵ / ₁₆	3 ¹⁵ / ₁₆

Item 6. Selected Financial Data**Financial Highlights**

	Years Ended				
	June 29, 1996	June 28, 1997	June 27, 1998	July 3, 1999	June 30, 2000
	(in millions, except per share and employee data)				
Revenues, net	\$2,865.2	\$4,177.9	\$3,541.5	\$2,767.2	\$1,957.6
Gross profit (loss)	382.1	650.3	100.1	(2.8)	8.1
Operating income (loss)	77.5	301.6	(295.8)	(476.8)	(379.3)
Net income (loss)	\$ 96.9	\$ 267.6	\$ (290.2)	\$ (492.7)	\$ (188.0)
Earnings (loss) per share:					
Basic	\$ 1.05	\$ 3.07	\$ (3.32)	\$ (5.51)	\$ (1.53)
Diluted	\$ 1.01	\$ 2.86	\$ (3.32)	\$ (5.51)	\$ (1.53)
Working capital	\$ 280.2	\$ 364.2	\$ 463.5	\$ 131.4	\$ 6.3
Total assets	\$ 984.1	\$1,307.1	\$1,442.7	\$1,022.4	\$ 615.6
Total long-term debt	\$ —	\$ —	\$ 519.2	\$ 534.1	\$ 225.5
Shareholders' equity (deficiency)	\$ 453.9	\$ 620.0	\$ 317.8	\$ (153.8)	\$ (109.8)
Number of employees	9,628	13,384	13,286	10,503	7,321

No cash dividends were paid for the years presented.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**Forward-Looking Statements**

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

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

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

Overview

Western Digital is a longtime leader in the data storage industry and is leveraging its core strengths to extend its data storage product offerings and expand beyond the traditional market for hard drives into new markets which meet certain predefined criteria. The Company considers new or high growth markets for data or content storage, management, and communication which have few entrenched competitors and offer the prospect of a sustained competitive advantage through unique or proprietary technology.

The hard drive industry, the Company's primary business, is intensely competitive and has experienced a great deal of growth, entry and exit of firms, and technological change over the past several years. This industry is characterized by short product life cycles, dependence upon highly skilled engineering and other personnel, significant expenditures for product development and recurring periods of oversupply. As a result of operating losses incurred in 1998, the Company initiated restructuring programs for its hard drive operations in 1999 and 2000 to reduce costs and improve operating efficiency. During 1999, the Company combined its Personal Storage Division and Enterprise Storage Group into a single hard drive operating unit, closed its Tuas, Singapore facility and moved production of its enterprise drives to the Company's nearby manufacturing facility in Chai-Chee, Singapore. The combination resulted in a \$41.0 million charge to operations in the third quarter of 1999. Also during 1999, the Company sold its Santa Clara disk media operations to Komag, recording a charge to operations of \$20.0 million, in the fourth quarter of 1999.

During 2000, the Company reorganized its operational and management responsibilities, transferred its hard drive production from Singapore to Malaysia and closed its Singapore operations. These actions resulted in a net reduction of worldwide headcount of approximately 1,600 and net charges to operations of \$52.6 million. Also in 2000, the Company exited the enterprise hard drive market, shifting its strategic focus and resources in the enterprise storage market to data content management systems and management software for storage systems. In connection with this decision, the Company closed its Rochester, Minnesota enterprise hard drive design center. Approximately 402 employees were terminated and restructuring and other charges totaling \$72.9 million were recorded.

During the first quarter of 2000, the Company announced a recall of its 6.8GB per platter series of WD Caviar® desktop hard drives because of a reliability problem resulting from a faulty power driver chip manufactured by a third-party supplier. As a result, revenues of approximately \$100 million were reversed and the Caviar product line was shut down for approximately two weeks, eliminating approximately \$70 million of forecasted revenue. In addition, charges totaling \$37.7 million for estimated costs to recall and repair the affected drives were recorded to cost of revenues in 2000.

In February 1999, the Company acquired its Connex subsidiary for approximately \$12.0 million. Connex delivers enterprise-class storage functionality for the department and mid-sized business markets, including storage management software, network attached storage and storage area networks. In 2000, the Company formed Sagetree, Inc. ("Sagetree"), to design and market packaged analytical applications and related services for supply chain and product lifecycle intelligence. In addition, the Company is developing products for consumer audio and video applications. Total operating losses for Connex, Sagetree and other developing new ventures amounted to \$38.9 million in 2000.

Results of Operations

Summary of 1998, 1999 and 2000 Comparison

The following table sets forth, for the periods indicated, items in the Company's statements of operations expressed as a percentage of total revenue.

	Years ended		
	June 27, 1998	July 3, 1999	June 30, 2000
Revenues, net	100.0%	100.0%	100.0%
Costs and expenses:			
Cost of revenues	97.2	100.1	99.6
Research and development	5.7	7.8	8.3
Selling, general and administrative	5.4	7.1	7.1
Restructuring charges	—	2.2	4.4
Total costs and expenses	<u>108.3</u>	<u>117.2</u>	<u>119.4</u>
Operating loss	(8.3)	(17.2)	(19.4)
Net interest and other income (expense)	<u>0.1</u>	<u>(0.6)</u>	<u>0.2</u>
Loss before income taxes and extraordinary item	(8.2)	(17.8)	(19.2)
Benefit for income taxes	<u>0.1</u>	—	<u>1.0</u>
Loss before extraordinary item	(8.1)	(17.8)	(18.2)
Extraordinary gain from redemption of debentures	—	—	8.5
Net loss	<u>(8.1)%</u>	<u>(17.8)%</u>	<u>(9.7)%</u>

The Company reported losses before taxes and extraordinary gains of \$292.0, \$492.7 and \$374.4 million in 1998, 1999 and 2000, respectively. The 1998 loss included charges of \$140.0 million in cost of revenues for the Company's transition to magnetoresistive head technology, and \$30.0 million in research and development expenses for start up of a technology agreement and terminated engineering programs. The 1999 loss included charges of approximately \$77.0 million for incremental thin-film warranty provisions, approximately \$7.5 million in Malaysian currency losses, \$12.0 million of in-process research and development write-offs associated with the acquisition of Connex and restructuring charges of \$61.0 million for the consolidation of the Company's personal storage and enterprise storage divisions and the sale of its media operation. The 2000 loss included net restructuring charges totaling \$85.8 million for the closure of the Company's Singapore operations and exit from the enterprise hard drive market. The 2000 loss also included charges to cost of revenues of \$34.8 million for vendor settlements, incremental warranty, and inventory write-downs associated with the exit from the enterprise market and \$37.7 million for costs to repair recalled drives. Excluding the aforementioned restructuring and other charges, losses before taxes and extraordinary gains were \$122.0, \$335.2 and \$216.1 million in 1998, 1999 and 2000, respectively. The increase in losses from 1998 to 1999 resulted from a \$774.3 million, or 21.9%, decrease in revenues, a 4.1% decrease in gross margin percentage and a \$27.6 million, or 7.5% increase in operating expenses. The decrease in losses from 1999 to 2000 resulted from a 1.4% increase in gross margin percentage on lower revenues (\$809.6 million, or a 29.3% decrease over 1999) and a \$91.9 million, or 23.4%, decrease in operating expenses. In addition, the 2000 loss included \$38.9 million in operating losses for Connex, Sagetree and other early stage ventures compared with \$8.2 million in 1999 and \$0 in 1998.

Net Revenue

Consolidated net revenues in 1999 of \$2.8 billion decreased 21.9%, or \$0.8 billion, from 1998 as a result of a 5% decrease in unit shipments stemming from the Company's transition to magnetoresistive head technology, combined with lower average selling prices (ASP's). Consolidated net revenues of \$2.0 billion in 2000, decreased \$0.8 billion or 29.3% from 1999, due to the Company's decision in the third quarter of 2000 to exit the enterprise hard drive market, a decline in the ASP's of desktop hard drive products due to an intensely

competitive market, and a decline in desktop hard drive unit shipments of approximately 8%, due largely to the product recall in the first quarter of 2000.

Gross Profit

Gross profit totaled \$100.0 million, or 2.8% of revenue in 1998, negative \$2.8 million, or (0.1)% of revenue in 1999 and \$8.1 million, or 0.4% of revenue in 2000. Gross profit for 1998 included \$140.0 million of special charges to cost of revenues to accelerate the Company's transition to magnetoresistive head technology. Gross profit for 1999 included \$77.0 million of special charges to cost of revenues for incremental thin-film warranty provision related to a higher lifetime return rate being applied to a larger base of products as a result of the transition in desktop product line technology. Gross profit for 2000 includes \$72.5 million of special charges to costs of revenues, related directly to the exit from the enterprise hard drive market and the product recall. Excluding special charges, gross profit was \$240.0 million, or 6.8% of revenue, \$74.2 million, or 2.7% of revenue and \$80.6 million, or 4.1% of revenue, for 1998, 1999 and 2000, respectively. The reduction of gross profit margin from 1998 to 1999 (excluding special charges) was primarily due to continued competitive pricing pressure in the desktop hard drive market and lower sales of higher margin enterprise hard drive products. The increase in the gross profit margin from 1999 to 2000 (excluding special charges) was primarily the result of lower manufacturing costs due to the consolidation of desktop hard drive production to a single, highly utilized facility in Malaysia, offset by lower volumes and lower ASPs.

Operating Expenses

Research and development expense was \$217.0 million in 1999, an increase of \$13.3 million from 1998. The increase was primarily due to the third quarter \$12.0 million charge for in-process research and development related to the acquisition of Connex. Research and development expense for 2000 was \$163.2 million, a decrease of \$53.8 million from 1999. The decrease was primarily due to the Company's exit from the enterprise hard drive market and expense reduction efforts, partially offset by increased spending at Connex, Sagetree, and other new ventures.

Selling, general and administrative ("SG&A") expense was \$196.0 million in 1999, an increase of \$3.8 million from 1998. The increase was primarily the result of a \$7.5 million charge on terminated Malaysian Ringgit hedging contracts recorded in 1999, partially offset by decreased marketing expenditures. SG&A expense in 2000 was \$138.3 million, a decrease of \$57.6 million from 1999. The decrease in SG&A expense was primarily due to the Company's exit from the enterprise hard drive market, expense reductions in its desktop hard drive business, a \$11.0 million accrual reduction in the fourth quarter of 2000 and the nonrecurrence of a \$7.5 million charge on the terminated hedging contracts recorded in 1999. The decrease was partially offset by increased spending at Connex, Sagetree and other of the Company's developing ventures in 2000.

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

Net interest and other income (expense) was \$3.8 million, (\$15.9) million and \$4.9 million in 1998, 1999 and 2000, respectively. The change from 1998 to 1999 was primarily due to a full year's accrual of original issue discount on the Company's convertible debentures and a full year of interest expense incurred on a \$50.0 million term loan. The increase in net interest and other income in 2000 was due to a \$14.8 million gain on disposition of certain investment securities and lower interest expense due to lower average debt balances resulting from the payment in 2000 of an outstanding term loan of \$50.0 million and redemption of convertible bonds, offset by a reduced amount of interest income due to lower cash and cash equivalent balances.

During 2000, the Company recognized extraordinary gains of \$166.9 million upon retirement of convertible debentures. The Company issued 26.7 million shares of common stock in exchange for \$735.6 million in face value of its convertible debentures (with a book value of \$284.1 million) which were retired in non-cash transactions. These redemptions were private, individually negotiated transactions with certain institutional investors.

The Company recorded an income tax benefit of \$1.8 million in 1998 for the expected benefit of loss carrybacks, partially offset by provisions for income taxes recorded in certain jurisdictions where the Company had positive earnings, and an income tax benefit of \$19.5 million in 2000 for adjustment of its current tax accruals and certain deferred tax amounts. These accruals were previously established over time and primarily relate to unremitted income of foreign subsidiaries. However, due to the significant increase of net operating loss carryforwards in recent years and reevaluation of the accruals after the substantial international restructurings in 2000, the Company believes these accruals are no longer necessary. In 1999, no tax benefit was recorded because additional loss carrybacks were not available and management believed it was “more likely than not” that the deferred tax benefits generated would not be realized (see Note 5 of Notes to Consolidated Financial Statements).

Liquidity and Capital Resources

The Company had cash and cash equivalents of \$226.1 million at July 3, 1999 and \$184.0 million at June 30, 2000. Net cash used in operations was \$139.5 million during 1999 as compared to \$152.0 million during 2000. Excluding cash used for restructuring and product recall activities, cash used for operations was \$122.8 million during 1999 as compared to \$104.5 million during 2000. Cash used for restructuring activities during 1999 was \$16.7 million and consisted of expenditures for severance and outplacement and facility renovation costs. Cash used for restructuring and other nonrecurring activities was \$47.5 million during 2000 and consisted of expenditures for severance and outplacement, lease cancellations and product recall costs.

The Company’s cash conversion cycle decreased 12 days in 1999 and another 17 days in 2000. The conversion cycles consist of the following: days of sales outstanding (“DSO”) of 44 in 1999 and 28 in 2000; days of payables outstanding (“DPO”) of 50 in 1999 and 52 in 2000; and days of inventory on hand of 22 in 1999 and 23 in 2000. Despite this improvement, the cash flows provided by changes in working capital accounts decreased from \$147.3 million in 1999 to \$67.5 million in 2000 due to an approximate 30% decrease in 2000 revenues and corresponding cost of revenues as compared to 1999, and the utilization in 2000 of significant accruals recorded in 1999 and 2000 for thin-film warranty, restructuring and other charges.

Other uses of cash during 2000 included the repayment of bank debt of \$50.0 million, strategic cost-method investments of \$12.9 million and net capital expenditures of \$22.0 million. Other sources of cash during 2000 included proceeds of \$111.8 million received upon issuance of 24.6 million shares of the Company’s stock under the Company’s equity facility, \$10.0 million received by Sagetree upon issuance of preferred stock, \$6.2 million received in connection with stock option exercises and Employee Stock Purchase Plan purchases, and \$66.8 million received from sales of real property.

Capital expenditures in 1999 amounted to \$106.6 million to upgrade and expand the Company’s production capability, replace existing assets, and further develop the Company’s information systems. The Company received \$15.3 million in connection with stock option exercises and Employee Stock Purchase Plan purchases in 1999.

The Company anticipates that capital expenditures in 2001 will not be more than \$50.0 million and will relate to accommodating new product lines, normal replacement of existing assets and expansion of production capabilities in Malaysia. The Company also anticipates cash expenditures of not more than \$20.0 million to be paid in the first half of 2001 related to restructuring and special charges accrued during 2000, primarily for settlements with vendors on existing purchase orders related to the Company’s exit from the enterprise hard drive market.

In February 1998, the Company received gross proceeds of \$460.1 million (before the Initial Purchasers’ discount) from an offering of zero coupon convertible subordinated debentures due February 18, 2018 (the “Debentures”). The Debentures are subordinated to all senior debt; are redeemable at the option of the Company any time after February 18, 2003 at the issue price plus accrued original issue discount to the date of redemption; and at the holder’s option, will be repurchased by the Company, as of February 18, 2003, February 18, 2008 or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of repurchase. (The repurchase

price may be paid in cash or common stock, at the Company's option.) The Debentures are convertible into shares of the Company's common stock at the rate of 14.935 shares per \$1,000 principal amount at maturity. The principal amount at maturity of the Debentures when issued was \$1.3 billion. During 2000, the Company issued 26.7 million shares of common stock in exchange for Debentures with a book value of \$284.1 million, and an aggregate principal amount at maturity of \$735.6 million. These redemptions were private, individually negotiated transactions with certain institutional investors and resulted in extraordinary gains of \$166.9 million. As of June 30, 2000, the book value of the remaining outstanding Debentures was \$225.5 million and the aggregate principal amount at maturity was \$561.6 million. Between July 1, 2000 and September 26, 2000, the Company issued 6.3 million shares of common stock in exchange for Debentures with a book value of \$49.8 million and an aggregate principal amount at maturity of \$122.7 million. As of September 26, 2000, the aggregate principal amount at maturity was \$438.9 million.

Subsequent to June 30, 2000, the Company entered into a new three-year Senior Credit Facility for its hard drive solutions division ("HDS"), replacing a previous facility that had matured on March 31, 2000. The new Senior Credit Facility provides up to \$125 million in revolving credit (subject to a borrowing base calculation), is secured by HDS's accounts receivable, inventory, 65% of the stock in its foreign subsidiaries and other assets. At the option of HDS, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. The Senior Credit Facility requires HDS to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants. As of the date hereof, the Company was in compliance with these covenants and there were no borrowings under the Facility.

Under an existing shelf registration statement (the "equity facility"), the Company may issue shares of common stock to institutional investors for cash. The equity facility provides for up to \$190.0 million in cash proceeds of which \$111.8 million had been utilized as of June 30, 2000. Shares sold under the facility are at the market price of the Company's common stock less a discount ranging from 2.75% to 4.25%. Between July 1, 2000 and September 5, 2000, the Company issued 6.1 million shares for cash proceeds of \$27.6 million. As of September 21, 2000, \$139.4 million of the equity facility had been utilized.

The Company had a shareholders' deficiency of \$109.8 million as of June 30, 2000 and expects to continue to incur operating losses in 2001. However, at June 30, 2000, the Company had cash and cash equivalent balances of \$184.0 million and working capital of \$6.3 million. The Company has achieved significant reductions in manufacturing labor and overhead, capital expenditures and operating expenses resulting from the sale in late 1999 of the Company's media operations, the closure in 2000 of the Company's two Singapore based manufacturing facilities and its enterprise design center and the reduction in worldwide headcount from 10,503 at July 3, 1999 to 7,321 at June 30, 2000. In addition, the Company had the following additional sources of liquidity available:

- As of September 21, 2000, \$50.6 million remaining available under the equity facility;
- As of September 21, 2000, a Senior Credit Facility providing up to \$125 million in revolving credit (subject to a borrowing base calculation); and
- Other equity investments that may be disposed of during the next twelve months, including 6.5 million shares of Komag common stock (of which 4.9 million shares were sold during September 2000 for net proceeds of \$15.0 million) and 1.3 million shares of Vixel common stock. The combined market value of the remaining 1.6 million Komag shares which can be sold in the next twelve months and the 1.3 million shares of Vixel common stock is approximately \$15.4 million as of September 21, 2000 (an additional 3.2 million shares of Komag common stock will become available for disposition in October 2001).

Based on the above factors, the Company believes its current cash and cash equivalent balances, its existing equity and credit facilities, and other liquidity sources currently available to it, will be sufficient to meet its working capital needs through 2001. There can be no assurance that the Senior Credit Facility or the equity facility will continue to be available to the Company. Also, the Company's ability to sustain its working

capital position is dependent upon a number of factors that are discussed below under the heading “Risk factors relating to Western Digital particularly.”

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards No. 133, “Accounting for Derivative Instruments and Hedging Activities” (“SFAS 133”). SFAS 133 was effective for all fiscal quarters for fiscal years beginning after June 15, 1999. In August 1999, the FASB issued Statement of Financial Accounting Standards No. 137, “Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133, an amendment of FASB Statement No. 133” (“SFAS 137”), which defers the effective date of SFAS 133 to all fiscal quarters for fiscal years beginning after June 15, 2000. In June 2000, the FASB issued Statement of Financial Accounting Standards No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment of FASB Statement No. 133”. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments embedded in other contracts and for hedging activities. The application of these statements is not expected to have a material impact on the Company’s consolidated financial position, results of operations or liquidity, and the Company does not anticipate recording a significant adjustment as a result of the transition to these statements.

In December 1999, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin 101 (“SAB101”) “Revenue Recognition in Financial Statements”. This Staff Accounting Bulletin summarizes certain of the staff’s views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company will be required to follow the guidance in SAB101 no later than its fourth quarter of 2001, with restatement of earlier quarters in 2001 required, if necessary. The SEC has recently indicated it intends to issue further guidance with respect to adoption of specific issues addressed by SAB101. Until such time as this additional guidance is issued, the Company is unable to assess the impact, if any, SAB101 may have on its consolidated financial position or results of operations.

In March 2000, the FASB issued Interpretation No. 44 “Accounting for Certain Transactions Involving Stock Compensation — an interpretation of APB Opinion No. 25” (“FIN 44”). This Interpretation clarifies the definition of an employee for purposes of applying Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”), the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequence of various modifications to the terms of a previously fixed stock option or award, and the accounting for an exchange of stock compensation awards in a business combination. This Interpretation is effective July 1, 2000, but certain conclusions in this Interpretation cover specific events that occur after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 is not expected to have a material impact on the Company’s consolidated financial position, results of operations or liquidity.

Year 2000

On January 1, 2000, the Company incurred nominal impact on its products, equipment, computer systems and applications as a result of the Year 2000 issue. The Company attributes this to its Year 2000 readiness efforts. As of December 31, 1999, systems remediation and integration testing and development of the Company’s contingency plans had been completed. Supplier management is an ongoing process, and no material impact was felt from lack of supplier readiness at January 1, 2000. Although the Company did not experience any material problems related to the Year 2000 issue, there can be no assurances that problems relating to the Year 2000 issue will not manifest themselves in the future. Expenditures related to the Year 2000 project, excluding normal replacement of existing capital assets, totaled approximately \$12.2 million.

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

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

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

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

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

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

Over the past few years hard drive areal density (the gigabytes of storage per disk) has increased at a much more rapid pace than previously, and we expect this trend to continue. Higher areal densities mean that fewer heads and disks are required to achieve a given drive capacity. This has significantly shortened product life cycles, since each generation of drives is more cost effective than the previous one. Shorter product cycles make it more difficult to recover the cost of product development.

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

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

Our average selling prices are declining.

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

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

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

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

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

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

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

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

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

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

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

We depend on our key personnel.

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

Risk factors relating to Western Digital particularly

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

A majority of our revenue comes from a few customers. For example, during 2000, sales to our top 10 customers accounted for approximately 57% of revenues. These customers have a wide variety of suppliers to choose from and therefore can make substantial demands on us. Even if we successfully qualify a product with a customer, the customer generally is not obligated to purchase any minimum volume of products from us and is able to terminate its relationship with us at any time. Our ability to maintain strong relationships with our

principal customers is essential to our future performance. If we lose a key customer, or if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, our operating results would likely be harmed. For example, this occurred early in the third quarter of 2000 in our enterprise hard drive market and is one of the factors which led to our decision to exit the enterprise hard drive market and close our Rochester, Minnesota facility.

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

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

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

In April 1999, we entered into a three year volume purchase agreement with Komag under which we buy a substantial portion of our media components from Komag. This strategic relationship has reduced our media component costs; however, it has increased our dependence on Komag as a supplier. Our future operating results will depend substantially on Komag's ability to timely qualify its media components in our new development programs and to supply us with these components in sufficient volume to meet our production requirements. Any disruption in Komag's ability to manufacture and supply us with media would likely harm our operating results.

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

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

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

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

Manufacturing our products abroad subjects us to numerous risks.

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

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

- labor problems
- trade restrictions or higher tariffs
- exchange, currency and tax controls and reallocations
- loss or non-renewal of favorable tax treatment under agreements or treaties with foreign tax authorities.

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

Our plan to broaden our business in data and content management, storage and communication takes us into new markets.

We have recently entered the storage subsystem market through our Connex subsidiary. In this market we are facing the challenges of building volume and market share in a market which is new to us but which has several established and well-funded competitors. There is already significant competition for skilled engineers, both in the hardware and software areas, in this market. Our success will depend on Connex's ability to develop, introduce and achieve market acceptance of new products, applications and product enhancements, and to attract and retain skilled engineers. Additionally, our competitors in this market have established intellectual property portfolios. Our success will also depend on our ability to license existing intellectual property or create new innovations. Moreover, our competitors' established intellectual property portfolios increase our risk of intellectual property litigation.

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

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

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

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

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

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

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

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

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

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

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

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

The market price of our common stock is volatile.

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

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

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

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

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

Due to our recent financial performance and the risks described in this Report, in the future we may be unable to maintain adequate financial resources for capital expenditures, working capital and research and development. Our prior borrowing agreement with our banks matured on March 31, 2000, and we have signed an agreement for a new credit facility for our HDS division. 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 insure that additional financing will be available to us or available on favorable terms. An equity financing could also be dilutive to our existing stockholders.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

Disclosure About Foreign Currency Risk

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

Historically, the Company has focused on hedging its foreign currency risk related to the Singapore Dollar, the British Pound and the Malaysian Ringgit. With the establishment of currency controls and the prohibition of purchases or sales of the Malaysian Ringgit by offshore companies, the Company discontinued

hedging its Malaysian Ringgit currency risk in 1999. Future hedging of this currency will depend on currency conditions in Malaysia. The imposition of exchange controls by the Malaysian government resulted in a \$7.5 million realized loss on terminated hedging contracts in the first quarter of 1999. As a result of the closure of the Company's Singapore operations in 2000, the Company has also discontinued its hedging program related to the Singapore Dollar.

As of June 30, 2000, the Company had outstanding the following purchased foreign currency forward exchange contracts (in millions, except average contract rate):

	June 30, 2000		
	Contract Amount	Weighted Average Contract Rate	Unrealized Loss
(U.S. Dollar equivalent amounts)			
Foreign currency forward contracts:			
British Pound Sterling	13.5	1.50	—

In 1998, 1999, and 2000 total realized transaction and forward exchange contract currency gains and losses (excluding the \$7.5 million realized loss on the Malaysian Ringgits realized in 1999), were immaterial to the consolidated financial statements. Based on historical experience, the Company does not expect that a significant change in foreign exchange rates (up to approximately 25%) would materially affect the Company's consolidated financial statements.

Disclosure About Other Market Risks

Fixed Interest Rate Risk

At June 30, 2000, the market value of the Company's 5.25% zero coupon convertible subordinated debentures due in 2018 was approximately \$111.6 million, compared to the related book value of \$225.5 million. The convertible debentures will be repurchased by the Company, at the option of the holder, as of February 18, 2003, February 18, 2008, or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of redemption. The payment on those dates, with the exception of a Fundamental Change, can be in cash, stock or any combination, at the Company's option.

Between July 1, 2000 and September 26, 2000, the Company issued 6.3 million shares of common stock in exchange for Debentures with a book value of \$49.8 million and an aggregate principal amount at maturity of \$122.7 million. As of September 26, 2000, the market value of the convertible subordinated debentures was approximately \$116.9 million, compared to the related book value of \$178.7 million.

The Company has various notes receivable from other companies. All of the notes carry a fixed rate of interest. Therefore a significant change in interest rates would not cause these notes to impact the Company's consolidated financial statements.

Variable Interest Rate Risk

At the option of HDS, borrowings under the new Senior Credit Facility would bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. This is the only debt which does not have a fixed-rate of interest. A change in interest rates resulting in rates as high as 12% would not materially impact the Company's consolidated financial statements.

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

Fair Value Risk

The Company owned approximately 10.8 million shares of Komag, Inc. common stock at June 30, 2000 (See Notes 1 and 8 of Notes to Consolidated Financial Statements). The stock is restricted as to the percentage of total shares which can be sold in a given time period. The unrestricted portion of the total Komag shares acquired represents the shares which can be sold within one year. The Company determines, on a quarterly basis, the fair market value of the unrestricted Komag shares and records an unrealized gain or loss resulting from the difference in the fair market value of the unrestricted shares as of the previous quarter end and the fair market value of the unrestricted shares on the measurement date. As of June 30, 2000, a \$9.6 million total accumulated unrealized loss had been recorded in accumulated other comprehensive income (loss). If the Company sells all or a portion of this stock, any unrealized gain or loss on the date of sale will be recorded as a realized gain or loss in the Company's results of operations. As of June 30, 2000, the quoted market value of the Company's Komag common stock holdings, without regard to discounts due to sales restrictions, was \$18.9 million and the aggregate book value was \$25.3 million.

Between July 1, 2000, and September 15, 2000, the Company sold 4.9 million shares of the Komag common stock for \$15.0 million in cash. As of September 21, 2000, the quoted market value of the Company's remaining Komag common stock holdings, without regard to discounts due to sales restrictions, was \$20.0 million. Due to market fluctuations, a decline in the stock's fair market value could occur.

The Company owns approximately 1.3 million shares of Vixel common stock. The Company determines, on a quarterly basis, the fair market value of the Vixel shares and records an unrealized gain or loss resulting from the difference in the fair market value of the shares as of the previous quarter end and the fair market value of the shares on the measurement date. As of June 30, 2000, a \$11.0 million total accumulated unrealized gain has been recorded in accumulated other comprehensive income (loss). If the Company sells all or a portion of this common stock, any unrealized gain or loss on the date of sale will be recorded as a realized gain or loss in the Company's results of operations. As a result of market conditions, the market value of the shares had declined from \$11.0 million as of June 30, 2000 to \$9.9 million as of September 21, 2000. Due to market fluctuations, an additional decline in the stock's fair market value could occur.

Item 8. *Financial Statements and Supplementary Data*

Index to Financial Statements and Financial Statement Schedule

	<u>Page</u>
Consolidated Financial Statements:	
Independent Auditors' Report	32
Consolidated Statements of Operations — Three Years Ended June 30, 2000.....	33
Consolidated Balance Sheets — July 3, 1999 and June 30, 2000.....	34
Consolidated Statements of Shareholders' Equity (Deficiency) — Three Years Ended June 30, 2000.....	35
Consolidated Statements of Cash Flows — Three Years Ended June 30, 2000.....	36
Notes to Consolidated Financial Statements	37
Financial Statement Schedule:	
Schedule II — Consolidated Valuation and Qualifying Accounts — Three Years Ended June 30, 2000	61

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Western Digital Corporation:

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Western Digital Corporation and subsidiaries as of July 3, 1999 and June 30, 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended June 30, 2000, in conformity with accounting principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG LLP

Orange County, California
July 27, 2000, except as to Note 11,
which is as of September 26, 2000.

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

	Years ended		
	June 27, 1998	July 3, 1999	June 30, 2000
Revenues, net (Note 7)	\$3,541,525	\$2,767,206	\$1,957,580
Costs and expenses:			
Cost of revenues (Notes 4 and 8)	3,441,475	2,770,054	1,949,511
Research and development (Notes 4 and 8)	203,733	216,986	163,198
Selling, general and administrative	192,142	195,958	138,323
Restructuring charges (Note 8)	—	61,000	85,837
Total costs and expenses	<u>3,837,350</u>	<u>3,243,998</u>	<u>2,336,869</u>
Operating loss	(295,825)	(476,792)	(379,289)
Net interest and other income (expense) (Note 2)	3,817	(15,898)	4,874
Loss before income taxes and extraordinary item	(292,008)	(492,690)	(374,415)
Benefit for income taxes (Note 5)	(1,791)	—	(19,500)
Loss before extraordinary item	(290,217)	(492,690)	(354,915)
Extraordinary gain from redemption of debentures (Note 3) ...	—	—	166,899
Net loss	<u>\$ (290,217)</u>	<u>\$ (492,690)</u>	<u>\$ (188,016)</u>
Loss per common share (Note 9):			
Before extraordinary item	<u>\$ (3.32)</u>	<u>\$ (5.51)</u>	<u>\$ (2.89)</u>
Extraordinary item	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 1.36</u>
Basic and diluted	<u>\$ (3.32)</u>	<u>\$ (5.51)</u>	<u>\$ (1.53)</u>
Common shares used in computing per share amounts (Note 9):			
Basic and diluted	<u>87,525</u>	<u>89,478</u>	<u>122,624</u>

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands)

	<u>July 3, 1999</u>	<u>June 30, 2000</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 226,147	\$184,021
Accounts receivable, less allowance for doubtful accounts of \$18,537 in 1999 and \$13,316 in 2000.....	273,435	149,135
Inventories (Note 2)	144,093	84,546
Prepaid expenses and other assets	<u>81,853</u>	<u>33,693</u>
Total current assets	725,528	451,395
Property and equipment at cost, net (Note 2)	237,939	98,952
Other assets, net (Note 8)	<u>58,935</u>	<u>65,227</u>
Total assets	<u><u>\$1,022,402</u></u>	<u><u>\$615,574</u></u>
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current liabilities:		
Accounts payable	\$ 335,907	\$266,841
Accrued compensation	31,136	14,868
Accrued warranty	53,188	40,359
Other accrued expenses	163,877	122,998
Current portion of long-term debt (Note 3)	<u>10,000</u>	<u>—</u>
Total current liabilities	594,108	445,066
Other liabilities	47,940	44,846
Long-term debt (Note 3)	40,000	—
Convertible debentures (Note 3)	494,144	225,496
Minority interest	—	10,000
Commitments and contingent liabilities (Notes 3, 4 and 8)		
Subsequent events (Note 11)		
Shareholders' deficiency (Notes 2 and 6):		
Preferred stock, \$.01 par value; Authorized — 5,000 shares; Outstanding — None		
Common stock, \$.01 par value; Authorized — 225,000 shares; Outstanding — 101,908 shares in 1999 and 153,335 shares in 2000	1,019	1,534
Additional paid-in capital	335,197	549,932
Accumulated deficit	(294,841)	(482,857)
Accumulated other comprehensive income (loss) (Note 1)	(2,123)	1,367
Treasury stock — common shares at cost; 11,297 shares in 1999 and 9,773 shares in 2000.....	<u>(193,042)</u>	<u>(179,810)</u>
Total shareholders' deficiency	<u>(153,790)</u>	<u>(109,834)</u>
Total liabilities and shareholders' deficiency	<u><u>\$1,022,402</u></u>	<u><u>\$615,574</u></u>

See notes to consolidated financial statements.

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

	Common Stock		Treasury Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Comprehensive Income (Loss)	Total Shareholders' Equity (Deficiency)	Total Comprehensive Income (Loss)
	Shares	Amount	Shares	Amount					
Balance at June 28, 1997	101,332	\$ 1,013	(15,436)	\$(225,746)	\$356,654	\$ 488,066	—	\$ 619,987	
Common stock repurchase program ..	—	—	—	—	(35,828)	—	—	(35,828)	
Exercise of stock options	—	—	1,166	8,892	(99)	—	—	8,793	
ESPP shares issued	—	—	1,231	9,506	3,178	—	—	12,684	
Income tax benefit from stock options exercised	—	—	—	—	2,339	—	—	2,339	
Net loss						(290,217)		(290,217)	(290,217)
Balance at June 27, 1998	<u>101,332</u>	<u>\$ 1,013</u>	<u>(13,039)</u>	<u>\$(207,348)</u>	<u>\$326,244</u>	<u>\$ 197,849</u>	<u>—</u>	<u>\$ 317,758</u>	<u>\$(290,217)</u>
ESPP shares issued	—	—	1,002	8,222	1,632	—	—	9,854	
Exercise of stock options	—	—	740	6,084	(590)	—	—	5,494	
Shares issued in connection with Connex acquisition ..	576	6	—	—	7,911	—	—	7,917	
Net loss	—	—	—	—	—	(492,690)	—	(492,690)	(492,690)
Unrealized loss on investment securities	—	—	—	—	—	—	(2,123)	(2,123)	(2,123)
Balance at July 3, 1999	<u>101,908</u>	<u>\$ 1,019</u>	<u>(11,297)</u>	<u>\$(193,042)</u>	<u>\$335,197</u>	<u>\$(294,841)</u>	<u>\$(2,123)</u>	<u>\$(153,790)</u>	<u>\$(494,813)</u>
ESPP shares issued	—	—	1,236	10,660	(5,622)	—	—	5,038	
Exercise of stock options			288	2,572	(1,427)	—	—	1,145	
Shares issued in debenture redemption and equity facility sales	51,336	514	—	—	221,397	—	—	221,911	
Other shares issued	91	1	—	—	387	—	—	388	
Net loss	—	—	—	—	—	(188,016)	—	(188,016)	(188,016)
Unrealized gain on investment securities	—	—	—	—	—	—	3,490	3,490	3,490
Balance at June 30, 2000	<u>153,335</u>	<u>\$ 1,534</u>	<u>(9,773)</u>	<u>\$(179,810)</u>	<u>\$549,932</u>	<u>\$(482,857)</u>	<u>\$ 1,367</u>	<u>\$(109,834)</u>	<u>\$(184,526)</u>

See notes to consolidated financial statements.

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

	Years ended		
	June 27, 1998	July 3, 1999	June 30, 2000
Cash flows from operating activities			
Net loss	\$(290,217)	\$(492,690)	\$(188,016)
Adjustments to reconcile net loss to net cash used for operating activities:			
Depreciation and amortization	106,550	131,066	78,452
Interest on convertible debentures	9,059	24,956	15,447
Non-cash portion of restructuring charges (Note 8)	—	42,386	56,301
In-process research and development charge (Note 8)	—	7,471	—
Extraordinary gain on redemption of convertible debentures	—	—	(166,899)
Investment gains	—	—	(14,767)
Changes in assets and liabilities:			
Accounts receivable	176,539	107,693	124,430
Inventories	37,958	22,069	45,802
Prepaid expenses and other assets	2,830	(10,101)	4,680
Accrued warranty	18,110	31,052	(3,094)
Accounts payable, accrued compensation and accrued expenses	(83,236)	(3,013)	(103,156)
Other	(16,566)	(436)	(1,144)
Net cash used for operating activities	<u>(38,973)</u>	<u>(139,547)</u>	<u>(151,964)</u>
Cash flows from investing activities			
Capital expenditures, net	(198,641)	(106,559)	(22,044)
Proceeds from sales of property and equipment	—	—	66,756
Other investment activity	9,758	—	(12,867)
Net cash provided by (used for) investing activities	<u>(188,883)</u>	<u>(106,559)</u>	<u>31,845</u>
Cash flows from financing activities			
Proceeds from ESPP shares issued and stock option exercises	23,816	15,348	6,183
Debt issuance costs	(18,707)	(2,925)	—
Proceeds from bank debt (Note 3)	50,000	—	—
Repayment of bank debt (Note 3)	—	—	(50,000)
Proceeds from issuance of convertible debentures (Note 3)	460,129	—	—
Common stock issued for cash (Note 6)	—	—	111,810
Proceeds from minority investment in Sagetree (Note 1)	—	—	10,000
Common stock repurchase program	(35,828)	—	—
Net cash provided by financing activities	<u>479,410</u>	<u>12,423</u>	<u>77,993</u>
Net increase (decrease) in cash and cash equivalents	251,554	(233,683)	(42,126)
Cash and cash equivalents at beginning of year	208,276	459,830	226,147
Cash and cash equivalents at end of year	<u>\$ 459,830</u>	<u>\$ 226,147</u>	<u>\$ 184,021</u>

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

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

Fiscal Year

The Company has a 52 or 53-week fiscal year. In order to align its manufacturing and financial calendars, effective during the three months ended December 31, 1999, the Company changed its fiscal calendar so that each fiscal month ends on the Friday nearest to the last day of the calendar month. Prior to this change, the Company’s fiscal month ended on the Saturday nearest to the last day of the calendar month. The change did not have a material impact on the Company’s results of operations or financial position. The 1998, 1999 and 2000 fiscal years ended on June 27, July 3, and June 30, respectively, and consisted of 52 weeks for the fiscal years 1998 and 2000, and 53 weeks for the fiscal year 1999. All general references to years relate to fiscal years unless otherwise noted.

Basis of Presentation

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

Cash Equivalents

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

Concentration of Credit Risk

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

Inventory Valuation

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

The Company maintains a base stock of two to three weeks of current finished goods inventory for certain key original equipment manufacturer (“OEM”) customers in facilities located adjacent to their operations. Inventory at these locations usually includes minor product customizations (such as labeling) for the related

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

OEM. If subsequent to its initial order the OEM changes its requirements, inventory held at these facilities can be sold to other OEM's or distributors as is or with minor modifications (such as a change in labeling) at little or no additional cost.

Depreciation and Amortization

The cost of property and equipment is depreciated over the estimated useful lives of the respective assets. Depreciation is computed on a straight-line basis for financial reporting purposes and on an accelerated basis for income tax purposes. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the related lease terms. Goodwill and purchased technology, which are included in other assets, are capitalized at cost and amortized on a straight-line basis over their estimated lives of five to fifteen years. Other intangible assets, including intangibles acquired from IBM pursuant to a joint technology development agreement (See Note 4), are amortized over their expected useful lives or the lives of the related products.

The Company reviews identifiable intangibles, goodwill and other long-lived assets for impairment whenever events or circumstances indicate the carrying amounts may not be recoverable. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of an asset, an impairment loss is recognized.

Revenue Recognition

The Company recognizes revenue at time of shipment, net of pricing adjustments and estimated sales returns. In accordance with standard industry practice, the Company's agreements with certain resellers provide price protection for inventories held by the resellers at the time of published list price reductions and, under certain circumstances, stock rotation for slow-moving items. These agreements may be terminated upon written notice by either party. In the event of termination, the Company may be obligated to repurchase a certain portion of the resellers' inventory. The Company recognizes revenue at the time of shipment on sales to resellers who have inventory repurchase agreements due to the Company's ability to reasonably estimate future returns as well as the historically low levels of actual repurchases. Revenue recognized on sales to resellers with inventory repurchase agreements was \$1,083, \$841, and \$683 million for fiscal years 1998, 1999 and 2000, respectively. Repurchases of inventory under such agreements were not material in 1998, 1999 and 2000.

Warranty

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

The Company increased warranty accruals from 1998 to 1999 primarily due to a normal increase in units under warranty and the completion of the Company's transition in its desktop product line from thin-film to the newer magnetoresistive head technology in the June 1998 quarter. This transition and experience with thin film returns, which indicated a higher return rate, higher cost of repair and longer duration of returns within the warranty period, resulted in an increase in warranty accruals. Prior to 1999, the Company's experience with returns of older generation thin-film products was that a large percentage of the products which were going to fail, failed in the first six months after sale. However, with the advancements in thin-film recording

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

technology, the gaps between critical components (principally the recording heads and disks) within the drive became much smaller until they were almost in contact with one another. This made the thin-film drives much more susceptible to environmental factors which typically manifest themselves over longer periods of time, such as gases released from the surrounding environment that may permeate through or from other components in the drive. In early 1999, the Company began to see consistent data indicating a higher percentage of advanced thin-film drives coming back after the first six months. That, combined with the significant amount of these drives that were in the field, led to a higher lifetime return rate being applied to a larger base of products in the field and an incremental warranty provision was recorded.

Advertising Expense

Advertising costs are expensed as incurred. Selling, general and administrative expenses of the Company include advertising costs of \$17.4, \$14.3, and \$9.0 million in 1998, 1999 and 2000, respectively.

Income Taxes

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

Per Share Information

The Company computes basic loss per share using the net loss and the weighted average number of common shares outstanding during the period. Dilutive loss per share is computed using the net loss and the weighted average number of common shares and dilutive potential common shares outstanding during the period. Dilutive common shares include outstanding employee stock options, employee stock purchase plan shares and common shares issuable upon conversion of the convertible debentures. The effects of these items were not included in the computation of diluted loss per share for each period presented as their effect would have been anti-dilutive (See Note 9).

Stock-Based Compensation

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

Fair Value of Financial Instruments

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

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

carrying value of \$225.5 million. The carrying amounts of all other financial instruments in the consolidated balance sheets, with the exception of the Komag common stock classified as long-term (discussed below), approximate fair values.

Investments

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

The Company owned approximately 10.8 million shares of Komag common stock at June 30, 2000, which when acquired on April 8, 1999, had a fair market value of \$34.9 million. The stock is restricted as to the number of shares which can be sold in a given time period. The restrictions lapse over a three and one-half year period. As of June 30, 2000, approximately 60% of these shares could be sold within twelve months. Because the Company has identified these shares as "available for sale" under the provisions of Statement of Financial Accounting Standards No. 115, "Investments in Certain Debt and Equity Securities" ("SFAS 115"), the amount sellable within twelve months was marked to market value using published closing prices of Komag stock as of June 30, 2000. Accordingly, a total accumulated unrealized loss of \$9.6 million was included in accumulated other comprehensive income (loss). The aggregate book value of the total Komag shares was \$25.3 million (market value of approximately \$18.9 million) as of June 30, 2000, of which \$11.3 million related to shares sellable within twelve months and was classified as current. Subsequent to June 30, 2000, the Company sold some of its Komag common stock holdings (see Note 11).

The Company owns approximately 1.3 million shares of Vixel Corporation ("Vixel") common stock. The Company has identified these shares as "available for sale" under the provisions of SFAS 115. During the three months ended October 2, 1999, Vixel completed an initial public offering and the shares were marked to market value. At June 30, 2000 a total accumulated unrealized gain of \$11.0 million is included in accumulated other comprehensive income (loss). The investment in Vixel common stock is classified as current. The aggregate carrying value of the shares, which approximates market value, is \$11.0 million as of June 30, 2000.

Other Comprehensive Income (Loss)

The Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"), beginning with the Company's fourth quarter of 1999. Prior to the fourth quarter of 1999, the Company did not possess any components of other comprehensive income as defined by SFAS 130. SFAS 130 separates comprehensive income into two components: net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) refers to revenue, expenses, gains and losses that are recorded as an element of shareholders' equity (deficiency) but are excluded from net income (loss). While SFAS 130 establishes new rules for the reporting and display of comprehensive income (loss), SFAS 130 has no impact on the Company's net loss or total shareholders' deficiency. The Company's other

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

comprehensive income (loss) is comprised of unrealized gains and losses on marketable securities categorized as “available for sale” under SFAS 115.

Minority Interest in Subsidiary

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

Foreign Exchange Contracts

Although the majority of the Company’s transactions are in U.S. Dollars, some transactions are based in various foreign currencies. From time to time, the Company purchases short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses denominated in foreign currencies. The purpose of entering into these hedge transactions is to minimize the impact of foreign currency fluctuations on the results of operations. The contracts have maturity dates that do not exceed twelve months. The unrealized gains and losses on these contracts are deferred and recognized in the results of operations in the period in which the hedged transaction effects the results of operations. Costs associated with entering into such contracts are typically amortized over the life of the instrument. The Company does not purchase short-term forward exchange contracts for trading purposes.

In response to the Company’s underlying foreign currency exposures, the Company may, from time to time, adjust its foreign currency hedging position by taking out additional contracts or by terminating or offsetting existing foreign currency forward exchange contracts. Gains or losses on terminated contracts and offsetting contracts are recognized in the results of operations in the periods in which the hedged transactions effect the results of operations.

The Company had outstanding forward exchange contracts with commercial banks with nominal values of \$241.9, \$66.4 and \$13.5 million, at June 27, 1998, July 3, 1999 and June 30, 2000, respectively. The total unrealized gains and losses on outstanding forward exchange contracts and foreign currency transactions were not material to the consolidated financial statements as of and for the years ended June 27, 1998 and June 30, 2000. For the year ended July 3, 1999, the total net loss on foreign currency transactions and forward exchange contracts was \$10.3 million. Of this amount, a realized loss of \$7.5 million on terminated hedging contracts was recorded due to the imposition of exchange controls by the Malaysian government. Historically, the Company has focused on hedging its foreign currency risk related to the Singapore Dollar, the British Pound and the Malaysian Ringgit. With the establishment of currency controls and the prohibition of purchases or sales of the Malaysian Ringgit by offshore companies, the Company has discontinued hedging its Malaysian Ringgit currency risk. Future hedging of this currency will depend on currency conditions in Malaysia. As a result of the closure of the Company’s Singapore operations in 2000, the Company has also discontinued its hedging program related to the Singapore Dollar.

Use of Estimates

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

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

Reclassifications

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

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"). SFAS 133 was effective for all fiscal quarters for fiscal years beginning after June 15, 1999. In August 1999, the FASB issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133, an amendment of FASB Statement No. 133" ("SFAS 137"), which defers the effective date of SFAS 133 to all fiscal quarters for fiscal years beginning after June 15, 2000. In June 2000, the FASB issued Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an Amendment of FASB Statement No. 133". SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments embedded in other contracts and for hedging activities. The application of these statements is not expected to have a material impact on the Company's consolidated financial position, results of operations or liquidity, and the Company does not anticipate recording a significant adjustment as a result of the transition to these statements.

In December 1999, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin 101 ("SAB101") "Revenue Recognition in Financial Statements". This Staff Accounting Bulletin summarizes certain of the staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. The Company will be required to follow the guidance in SAB101 no later than its fourth quarter of 2001, with restatement of earlier quarters in 2001 required, if necessary. The SEC has recently indicated it intends to issue further guidance with respect to adoption of specific issues addressed by SAB101. Until such time as this additional guidance is issued, the Company is unable to assess the impact, if any, SAB101 may have on its consolidated financial position or results of operations.

In March 2000, the FASB issued Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation — an interpretation of APB Opinion No. 25" ("FIN 44"). This Interpretation clarifies the definition of an employee for purposes of applying Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequence of various modifications to the terms of a previously fixed stock option or award, and the accounting for an exchange of stock compensation awards in a business combination. This Interpretation is effective July 1, 2000, but certain conclusions in this Interpretation cover specific events that occur after either December 15, 1998 or January 12, 2000. The adoption of FIN 44 is not expected to have a material impact on the Company's consolidated financial position, results of operations or liquidity.

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

Note 2. Supplemental Financial Statement Data (in thousands)

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Net Interest and Other Income (Expense)			
Interest income	\$ 15,952	\$ 16,906	\$ 9,260
Investment gains	—	—	14,767
Interest expense	<u>(12,135)</u>	<u>(32,804)</u>	<u>(19,153)</u>
Net interest and other income (expense)	<u>\$ 3,817</u>	<u>\$ (15,898)</u>	<u>\$ 4,874</u>
Cash paid for interest	<u>\$ 2,073</u>	<u>\$ 4,819</u>	<u>\$ 2,100</u>
Inventories			
Finished goods		\$ 101,828	\$ 69,033
Work in process		26,307	11,253
Raw materials and component parts		<u>15,958</u>	<u>4,260</u>
		<u>\$ 144,093</u>	<u>\$ 84,546</u>
Property and Equipment			
Land and buildings		\$ 94,788	\$ 53,372
Machinery and equipment		383,095	310,342
Furniture and fixtures		13,407	9,279
Leasehold improvements		<u>42,972</u>	<u>16,858</u>
		534,262	389,851
Accumulated depreciation and amortization		<u>(296,323)</u>	<u>(290,899)</u>
Net property and equipment		<u>\$ 237,939</u>	<u>\$ 98,952</u>
Supplemental disclosure of non-cash investing and financing activities:			
Proceeds from sale of Santa Clara disk media operations		<u>\$ 77,100</u>	
Common stock issued and liabilities assumed in connection with acquisition of Connex		<u>\$ (10,000)</u>	
Common stock issued for redemption of convertible debentures			<u>\$ 110,101</u>
Redemption of convertible debentures for Company common stock, net of capitalized issuance costs			<u>\$ 277,008</u>
Settlement of accounts payable by transfer of cost method investments			<u>\$ 26,242</u>
Transfer of Service Center assets in exchange for promissory note			<u>\$ 11,655</u>

Note 3. Long-Term Debt

Line of Credit

The Company had a secured revolving credit and term loan facility that matured on March 31, 2000. Outstanding borrowings at July 3, 1999 amounted to \$50.0 million. This amount was paid in full in 2000. Subsequent to June 30, 2000, the Company's hard drive solutions division entered into a new credit facility (see Note 11).

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

Convertible Debentures

In February 1998, the Company received gross proceeds of \$460.1 million (before the Initial Purchasers' discount) from an offering of zero coupon convertible subordinated debentures due February 18, 2018 ("the Debentures"). The Debentures are subordinated to all senior debt; are redeemable at the option of the Company any time after February 18, 2003 at the issue price plus accrued original issue discount to the date of redemption; and at the holder's option, will be repurchased by the Company, as of February 18, 2003, February 18, 2008 or February 18, 2013, or if there is a Fundamental Change (as defined in the Debenture documents), at the issue price plus accrued original issue discount to the date of repurchase. The repurchase price may be paid in cash or common stock, at the Company's option. The Debentures are convertible into shares of the Company's common stock at the rate of 14.935 shares per \$1,000 principal amount at maturity. The principal amount at maturity of the Debentures when issued was \$1.3 billion. During 2000, the Company issued 26.7 million shares of common stock in exchange for Debentures with a book value of \$284.1 million, and an aggregate principal amount at maturity of \$735.6 million. These redemptions were private, individually negotiated transactions with certain institutional investors and resulted in extraordinary gains of \$166.9 million. As of June 30, 2000, the book value of the remaining outstanding Debentures was \$225.5 million and the aggregate principal amount at maturity was \$561.6 million. Included in other assets is the amount of unamortized Debenture issuance costs. The Debenture issuance costs totaled approximately \$14.5 million at origination and are being amortized over 10 years. During 2000, approximately \$7.1 million of unamortized costs were netted against the extraordinary gain in connection with the redemptions. As of June 30, 2000, the balance of unamortized Debenture issuance costs was approximately \$4.7 million and is included in other assets. Subsequent to June 30, 2000, the Company redeemed additional Debentures (see Note 11).

Note 4. Commitments, Agreements and Contingent Liabilities

Operating Leases

The Company leases certain facilities and equipment under long-term, non-cancelable operating leases which expire at various dates through 2010. Rental expense under these leases, including month-to-month rentals, was \$39.3, \$36.2 and \$17.8 million in 1998, 1999 and 2000, respectively. Leases with terms through 2003 for which the Company is contingently liable, totaling \$42.0 million, are not included in the table below. See Note 8 for further discussion.

Future minimum rental payments under non-cancelable operating leases as of June 30, 2000 are as follows (in thousands):

2001	\$11,532
2002	6,663
2003	6,065
2004	5,343
2005	5,582
Thereafter	<u>20,600</u>
Total future minimum rental payments	<u>\$55,785</u>

IBM License Agreement

In June of 1998, the Company entered into a broad based technology licensing and component supply agreement with IBM (the "Agreement") involving the design and manufacture of desktop hard disk drives

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

using IBM's giant magnetoresistive ("GMR") heads and other components. The terms of the Agreement included a \$20.0 million non-refundable initial payment in June 1998, which was fully expensed in 1998 as in-process research and development. Additional payments of \$30.0 million and \$10.0 million were made in 1999 and 2000, respectively, upon the achievement of certain product development milestones. These additional payments were capitalized and amortized to cost of sales as the related product was sold (generally within one year). As of June 30, 2000 the payments had been fully amortized. The Agreement also required the Company to make supplemental per unit payments as the related product was sold. These amounts were recorded to cost of sales as the product was sold. The Agreement also included a supply arrangement for the purchase of GMR heads at negotiated market prices.

Legal Proceedings

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

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

On October 23, 1998, Censtor Corporation ("Censtor") initiated an arbitration proceeding against the Company in California, alleging that it is owed royalties under a license agreement between Censtor and the Company. In response, the Company filed a complaint in federal court in California seeking a determination that the patents at issue are invalid. The federal court action has been stayed pending completion of the arbitration procedures. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

On June 9, 2000 a suit was brought against the Company in California State Superior Court on behalf of a class of former employees of the Company who were terminated as a result of a reduction in force in December 1999. The complaint asserts claims for unpaid wages, fraud, breach of fiduciary duty, breach of contract, and unfair business practices. The Company has removed the suit to federal court in California on the ground that all of the claims are preempted by the Employee Retirement Income Security Act of 1974. The Company denies the material allegations of the complaint and intends to vigorously defend this action. The Company does not believe that the outcome of this matter will have a material adverse effect on its consolidated financial position, results of operation or liquidity.

In the normal course of business, the Company receives and makes inquiries regarding possible intellectual property matters, including alleged patent infringement. Where deemed advisable, the Company may seek or extend licenses or negotiate settlements. Although patent holders often offer such licenses, no assurance can be given that in a particular case a license will be offered or that the offered terms will be acceptable to the Company. One such matter currently pending involves Discovision Associates, which has recently brought patents it holds to the Company's attention. The Company does not believe that the ultimate

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

resolution of these matters will have a material adverse effect on its consolidated financial position, results of operations or liquidity.

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

Note 5. Income Taxes

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

	<u>1998</u>	<u>1999</u>	<u>2000</u>
United States	\$(348,397)	\$(399,006)	\$(214,316)
International	<u>56,389</u>	<u>(93,684)</u>	<u>6,800</u>
Income (loss) before income taxes and after extraordinary item	<u>\$(292,008)</u>	<u>\$(492,690)</u>	<u>\$(207,516)</u>

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

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Current			
United States	\$ (6,195)	\$ (3,519)	\$ (15,302)
International	4,905	3,352	2,623
State	<u>(501)</u>	<u>167</u>	<u>179</u>
	(1,791)	—	(12,500)
Deferred, net	<u>—</u>	<u>—</u>	<u>(7,000)</u>
Provision (benefit) for income taxes	<u>\$(1,791)</u>	<u>\$ —</u>	<u>\$(19,500)</u>

The tax benefits associated with employee exercises of non-qualified stock options, disqualifying dispositions of stock acquired with incentive stock options, and disqualifying dispositions of stock acquired under the employee stock purchase plan reduced taxes currently payable in 1998 by \$2.3 million. Such benefits were credited to additional paid-in capital. No amounts were recorded to additional paid-in capital in 1999 and 2000 because their realization was not more likely than not to occur and, consequently, a valuation allowance was recorded against the entire benefit.

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

Income tax payments amounted to \$16.9 million, \$5.5 million and \$4.6 million in 1998, 1999 and 2000, respectively.

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Temporary differences and carryforwards which give rise to a significant portion of deferred tax assets and liabilities at July 3, 1999 and June 30, 2000 are as follows (in thousands):

	1999	2000
Deferred tax assets:		
NOL carryforward	\$ 251,009	\$ 309,315
Business credit carryforward	34,242	35,374
Reserves and accrued expenses not currently deductible	120,117	98,695
All other	16,259	4,274
	421,627	447,658
Valuation allowance	(421,627)	(447,658)
Total deferred tax assets	\$ —	\$ —
Deferred tax liabilities:		
Unremitted income of foreign subsidiaries	\$ 15,430	\$ 7,995
All other	3,640	4,146
Total deferred tax liabilities	\$ 19,070	\$ 12,141

Reserves and accrued expenses not currently deductible include the following:

	1999	2000
Sales related reserves and adjustments	\$ 50,889	\$ 49,487
Accrued compensation and benefits	17,897	10,232
Inventory reserves and adjustments	4,498	2,675
Other accrued liabilities	46,833	36,301
Total deferred tax assets	\$ 120,117	\$ 98,695

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

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

	1998	1999	2000
U.S. Federal statutory rate	(35.0)%	(35.0)%	(35.0)%
State income taxes, net	(0.2)	0.0	0.0
Tax rate differential on international income	(15.5)	0.9	8.7
Effect of valuation allowance	46.5	34.1	12.5
Other	3.6	0.0	4.5
Effective tax rate	(0.6)%	0.0%	(9.3)%

Certain income of selected subsidiaries is taxed at substantially lower income tax rates as compared to local statutory rates. The lower rates reduced income taxes and increased net earnings or reduced the net loss

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

by \$17.1 million (\$.20 per share, diluted), \$25.2 million (\$.28 per share, diluted), and by \$19 million (\$.15 per share, diluted) in 1998, 1999 and 2000, respectively. These lower rates are in effect through fiscal year 2004.

At June 30, 2000, the Company had Federal and state net operating loss carryforwards of approximately \$820 million and \$385 million, respectively. In addition, the Company had various Federal and state tax credit carryforwards of approximately \$35.3 million. The loss carryforwards expire in fiscal years 2008 through 2020 and the credit carryforwards expire in fiscal years 2001 through 2013.

Net undistributed earnings from international subsidiaries at June 30, 2000, on which no U.S. tax has been provided, amounted to approximately \$450 million. The net undistributed earnings are intended to finance local operating requirements. Accordingly, an additional United States tax provision has not been made on these earnings.

Note 6. Shareholders' Equity

Equity Facility

Under an existing shelf registration ("equity facility"), the Company may issue for cash, shares of common stock to institutional investors. The equity facility provides for up to \$190.0 million in cash proceeds of which \$111.8 million had been utilized during 2000. Shares sold under the equity facility are at the market price of the Company's common stock less a discount ranging from 2.75% to 4.25%. During 2000, the Company issued 24.6 million shares of common stock under the equity facility for net cash proceeds of approximately \$111.8 million. Subsequent to June 30, 2000, the Company sold additional shares under the equity facility (see Note 11).

Stock Reserved for Issuance

The following table summarizes all shares of common stock reserved for issuance at June 30, 2000 (in thousands):

	<u>Number of Shares</u>
Issuable in connection with:	
Convertible debentures	8,387
Exercise of stock options, including options available for grant	45,389
Employee stock purchase plan	<u>4,133</u>
	<u>57,955</u>

Employee Stock Purchase Plan

The Company has an employee stock purchase plan ("ESPP") that operates in accordance with Section 423 of the Internal Revenue Code whereby eligible employees may authorize payroll deductions of up to 10% of their salary to purchase shares of the Company's common stock at 85% of the fair market value of common stock on the date of grant or the exercise date, whichever is less. Approximately 4.1 million shares of common stock have been reserved for issuance under this plan. Approximately 1,231,000, 1,002,000 and 1,236,556 shares were issued under this plan during 1998, 1999 and 2000, respectively.

Stock Option Plans

Western Digital's Employee Stock Option Plan ("Employee Plan") is administered by the Compensation Committee of the Board of Directors ("Compensation Committee"), which determines the vesting provisions, the form of payment for the shares and all other terms of the options. Terms of the Employee Plan require that the exercise price of options be not less than the fair market value of the common stock on the

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

date of grant. Options granted generally vest 25% one year from the date of grant and in twelve quarterly increments thereafter and have a ten-year term. As of June 30, 2000, options to purchase 7,533,074 and 11,734,723 shares of common stock were exercisable and available for grant, respectively, under this plan. Pursuant to the terms of the Employee Plan, participants are permitted to utilize previously purchased common stock as consideration to purchase additional common stock upon exercise of options or to exercise on a cashless basis.

On September 30, 1999, the Company's Board of Directors approved the Broad-Based Stock Incentive Plan (the "Broad-Based Plan") under which options to purchase shares of common stock may be granted to employees of the Company and others. This plan is intended to qualify as "broadly-based" under the New York Stock Exchange shareholder approval policy. The Compensation Committee determines the vesting provisions and other terms of the options. To date, the options granted vest either 100% one year from the date of grant or 25% every six months beginning six months from the date of grant. As of June 30, 2000, options to purchase 792,648 and 12,515,448 shares of common stock were exercisable and available for grant, respectively, under this plan.

The Company has a Stock Option Plan for Non-Employee Directors ("Director Plan") and has reserved 1.6 million shares for issuance thereunder. The Director Plan provides for initial option grants to new directors of 75,000 shares per director and additional grants of options to purchase 10,000 shares of common stock per director each year upon their reelection as a director at the annual shareholders' meeting. Terms of the Director Plan require that options have a ten-year term and that the exercise price of options be not less than the fair market value at the date of grant. Options granted generally vest 25% one year from the date of grant and in twelve quarterly increments thereafter and have a ten-year term. As of June 30, 2000, options to purchase 243,131 shares of common stock were exercisable and options to purchase 237,839 shares of common stock were available for grant.

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

	<u>Number of Shares</u>	<u>Weighted Average Exercise Price Per Share</u>
Options outstanding at June 28, 1997	9,586	\$11.20
Granted	4,433	27.17
Exercised, net of value of redeemed shares	(1,166)	7.54
Canceled or expired	<u>(502)</u>	<u>20.00</u>
Options outstanding at June 27, 1998	12,351	16.92
Granted	9,119	11.10
Exercised, net of value of redeemed shares	(740)	7.30
Canceled or expired	<u>(3,004)</u>	<u>23.63</u>
Options outstanding at July 3, 1999	17,726	13.19
Granted	13,485	3.82
Exercised, net of value of redeemed shares	(288)	4.10
Canceled or expired	<u>(10,022)</u>	<u>9.92</u>
Options outstanding at June 30, 2000	<u>20,901</u>	<u>\$ 8.83</u>

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

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following tables summarize information about options outstanding and exercisable under the Employee, Broad-Based and Director Plans at June 30, 2000 (in thousand, except per share amounts):

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Shares	Weighted Average Contractual Life (in years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$ 1.44	12	1.37	\$ 1.44	12	\$ 1.44
1.62 – 2.81	3,285	8.71	2.77	1,079	2.69
3.31 – 4.37	2,459	6.64	3.67	73	3.74
4.43 – 4.44	2,197	9.67	4.44	—	—
4.50 – 6.50	2,774	8.87	5.29	595	5.91
6.56 – 8.81	2,931	5.91	7.84	2,237	7.94
8.87 – 11.87	2,611	6.90	11.22	1,935	11.37
12.25 – 17.19	2,371	8.17	12.99	930	13.09
17.25 – 34.19	2,173	7.22	25.59	1,630	26.25
34.50 – 48.50	<u>88</u>	<u>6.89</u>	<u>37.93</u>	<u>78</u>	<u>37.74</u>
Total	<u>20,901</u>	<u>7.74</u>	<u>\$ 8.83</u>	<u>8,569</u>	<u>\$12.19</u>

Some of the Company's new venture subsidiaries maintain stock option plans for their own employees and directors. The terms of these plans are similar to those of the Company's Employee Plan. These new ventures have reserved up to approximately 30% of their stock for existing and future option grants to their employees and directors.

Pro Forma Information

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

The fair value of options granted in 1998, 1999 and 2000 reported below has been estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions:

	Stock Option Plans			ESPP Plan		
	1998	1999	2000	1998	1999	2000
Option life (in years)	4.5	5.0	4.0	2.0	2.0	2.0
Risk-free interest rate	5.50%	5.75%	6.15%	5.50%	5.75%	6.15%
Stock price volatility76	.82	.83	.76	.82	.83
Dividend yield	—	—	—	—	—	—

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

	1998	1999	2000
Options granted under the Stock Option Plans	\$17.10	\$7.74	\$2.44
Shares granted under the ESPP Plan	\$ 7.39	\$9.92	\$8.77

The Company applies APB Opinion No. 25 in accounting for its stock option and ESPP plans and, accordingly, no compensation expense has been recognized for the options in the consolidated financial statements. Had the Company determined compensation expense based on the fair value at the grant date for

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

its options under SFAS 123, the Company's net loss and net loss per share would have been increased to the amounts indicated below:

	Year Ended		
	June 27, 1998	July 3, 1999	June 30, 2000
Pro forma net loss (in thousands)	\$(324,178)	\$(538,637)	\$(227,799)
Pro forma net loss per share:			
Basic and diluted.....	\$ (3.70)	\$ (6.02)	\$ (1.86)

Pro forma net loss and net loss per share reflects only options granted after 1995. Therefore, the full impact of calculating compensation expense for options under SFAS 123 is not reflected in the pro forma net loss amounts presented above because compensation expense is reflected over the options' vesting period and compensation expense for options granted before 1996 is not considered. The pro forma net loss information appearing above excludes the effects on pro forma compensation expense of options granted under the new venture plans, as the amounts are not material.

Stock Purchase Rights

In 1989, the Company implemented a plan to protect shareholders' rights in the event of a proposed takeover of the Company. Under the plan, each share of the Company's outstanding common stock carries one Right to Purchase Series A Junior Participating Preferred Stock (the "Right"). The Right enables the holder, under certain circumstances, to purchase common stock of Western Digital or of the acquiring company at a substantially discounted price ten days after a person or group publicly announces it has acquired or has tendered an offer for 15% or more of the Company's outstanding common stock. On September 10, 1998 the Company's Board of Directors approved the adoption of a new Rights plan to replace the previous plan, which expired in September of 1998. The Rights under the new plan are similar to the rights under the 1989 plan except they are redeemable by the Company at \$.01 per Right and expire in 2008.

Note 7. Business Segment, International Operations and Major Customer

Segment Information

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

In 1998, the Company operated in one industry segment, the hard drive industry (hard drive solutions, "HDS"), and in accordance with SFAS 131, has provided enterprise-wide disclosures. During 1999, the Company acquired Connex, which is a separate operating segment as defined under SFAS 131. Connex is an early-stage business which did not meet the separate disclosure requirements under SFAS 131 in 1999 and in 2000. The Company also has other new venture businesses which it began developing in 2000 and which did not meet the separate disclosure requirements under SFAS 131. In accordance with SFAS 131, the Company has combined the results of Connex and other new ventures in an "all other" category in order to report the HDS segment results separately which is consistent with the segment information used by the chief operating decision maker in 2000 to assess performance and evaluate how to allocate resources. General and corporate expenses of the Company are included in the HDS segment.

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

	HDS	All Other	Total
	(in thousands)		
Year ended June 30, 2000			
Revenues	\$1,956,671	\$ 909	\$1,957,580
Restructuring charges	\$ 85,837	\$ —	\$ 85,837
Operating loss	\$ (340,348)	\$ (38,941)	\$ (379,289)
Total assets	\$ 609,522	\$ 6,052	\$ 615,574
Depreciation and amortization	\$ 77,518	\$ 934	\$ 78,452
Additions to property and equipment	\$ 20,477	\$ 1,567	\$ 22,044

International Operations

The Company's operations outside the United States include a manufacturing facility in Malaysia as well as sales offices throughout Europe and Asia. During 1998, 1999 and the first half of 2000, the Company also had manufacturing facilities in Singapore. The following table summarizes operations by geographic areas for the past three years. United States revenues to unaffiliated customers include export sales to various countries in Europe and Asia of \$606.7, \$482.5, and \$546.5 million in 1998, 1999 and 2000, respectively.

Transfers between geographic areas are accounted for at prices comparable to normal sales through outside distributors. General and corporate expenses of \$77.6, \$82.7 and \$66.3 million in 1998, 1999, and 2000 respectively, have been excluded in determining operating income (loss) by geographic region.

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

	<u>United States</u>	<u>Europe</u>	<u>Asia</u> (in millions)	<u>Eliminations</u>	<u>Total</u>
Year ended June 27, 1998					
Sales to unaffiliated customers	\$2,630	\$ 886	\$ 26	\$ —	\$3,542
Transfers between geographic areas	998	166	3,324	(4,488)	—
Revenues, net	<u>\$3,628</u>	<u>\$1,052</u>	<u>\$3,350</u>	<u>\$(4,488)</u>	<u>\$3,542</u>
Operating income (loss)	<u>\$(271)</u>	<u>\$ 7</u>	<u>\$ 66</u>	<u>\$ (20)</u>	<u>\$(218)</u>
Identifiable assets	<u>\$ 907</u>	<u>\$ 116</u>	<u>\$ 455</u>	<u>\$ (35)</u>	<u>\$1,443</u>
Year ended July 3, 1999					
Sales to unaffiliated customers	\$2,001	\$ 751	\$ 15	\$ —	\$2,767
Transfers between geographic areas	746	1	2,607	(3,354)	—
Revenues, net	<u>\$2,747</u>	<u>\$ 752</u>	<u>\$2,622</u>	<u>\$(3,354)</u>	<u>\$2,767</u>
Operating income (loss)	<u>\$(295)</u>	<u>\$ 7</u>	<u>\$(114)</u>	<u>\$ 8</u>	<u>\$(394)</u>
Identifiable assets	<u>\$ 550</u>	<u>\$ 97</u>	<u>\$ 390</u>	<u>\$ (15)</u>	<u>\$1,022</u>
Year ended June 30, 2000					
Sales to unaffiliated customers	\$1,463	\$ 485	\$ 10	\$ —	\$1,958
Transfers between geographic areas	479	3	1,858	(2,340)	—
Revenues, net	<u>\$1,942</u>	<u>\$ 488</u>	<u>\$1,868</u>	<u>\$(2,340)</u>	<u>\$1,958</u>
Operating income (loss)	<u>\$(317)</u>	<u>\$ 104</u>	<u>\$(58)</u>	<u>\$ (42)</u>	<u>\$(313)</u>
Identifiable assets	<u>\$ 477</u>	<u>\$ 154</u>	<u>\$ 16</u>	<u>\$ (31)</u>	<u>\$ 616</u>

Major Customer

During 1998, 1999, and 2000 sales to Compaq accounted for 14%, 21% and 21% of the Company's revenues, respectively.

Note 8. Restructurings, Acquisitions and Dispositions

1999 Restructuring Actions

In January 1999, the Company initiated a restructuring program which resulted in the combination of its personal storage and enterprise storage divisions into a single hard drive operating unit. Accordingly, design, manufacturing, materials, business and product marketing resources to address both the desktop and enterprise markets were combined. In connection with the combination, the Company's Tuas, Singapore facility was closed and production of enterprise drives was moved to the Company's facility in Chai-Chee, Singapore. This restructuring program, which was substantially completed by the end of the third quarter of 1999, resulted in a reduction of worldwide employee headcount of 934 employees, approximately 250 of which were direct and indirect labor and the remainder were management, professional and administrative personnel. A \$41.0 million restructuring charge was recorded consisting of \$19.6 million for the write-down of the Tuas building and equipment to its estimated fair value of \$7.8 million, based on a valuation done by an independent party, \$14.3 million for severance and other incremental costs related to the closure of the facility, \$5.7 million for the write-off of duplicate warranty repair and engineering supplies and \$1.4 million for renovation related costs of the Tuas facility. Of the severance and other related charges, approximately \$11.0 million was paid in 1999, and the remainder was paid in 2000. The write-off of duplicate warranty repair and engineering supplies, including base replacement stock for warranty repairs and engineering materials, was

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

necessary due to the reduced requirements of a single combined repair facility. Tuas facility renovation and related costs consisted of costs incurred to ready the facility for sale.

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

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

The Company received, as a component of the total consideration, an unsecured note (the "Note") in the amount of \$30.1 million, which is included in other assets. The Note matures in April 2002 and has an annual interest rate of 4.9%, compounded quarterly. The outstanding principal balance and accrued interest is due and payable in full upon maturity. The Note contains a principal and accrued interest reduction provision which is based on the excess, if any, of proceeds received upon sale of Komag stock over a predetermined floor.

In conjunction with the sale of Company assets, Komag assumed certain liabilities, mainly leases related to production equipment and facilities. The Company is contingently liable for these leases. If Komag were unable to meet its payment obligations on the remaining leases, totaling approximately \$42.0 million as of June 30, 2000, the Company would be ultimately liable to make the payments.

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

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

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

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

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

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

2000 Restructuring Actions

During the first half of 2000, the Company initiated restructuring actions to improve operational effectiveness and efficiency and reduce operational expenses worldwide. Charges related to these restructuring actions were accrued in the periods in which executive management committed to execute such actions. Actions taken in 2000 included reorganization of operational and management responsibilities, transfer of hard drive production from Singapore to the Company's manufacturing facility in Malaysia, closure of the Company's Singapore operations, and removal of property and equipment from service. These actions resulted in a net reduction of worldwide headcount of approximately 1,600, of which approximately 140 were management, professional and administrative personnel and the remainder were manufacturing employees. In Asia, approximately 3,800 employees were reduced from the Company's Singapore operation, while employees were added in Malaysia in connection with the transfer of production. Restructuring charges recorded in connection with these actions totaled \$52.6 million and consisted of severance and outplacement costs of \$18.0 million, the write-off of manufacturing equipment and information systems assets of \$28.8 million (taken out of service and held for disposal), and net lease cancellation and other costs of \$5.7 million.

In January 2000, the Company announced plans to exit the enterprise hard drive market and shift its strategic focus and resources in the enterprise storage market to Internet-related data content management systems and management software. In connection with this decision, the Company closed its Rochester, Minnesota enterprise hard drive design center, and approximately 402 employees in the design center were laid off and given legally required notification and outplacement services. The Company sold its Rochester,

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Minnesota facility for cash proceeds of approximately \$29.7 million. The exit from the enterprise market resulted in a restructuring charge of \$38.1 million. The restructuring charge consisted of \$27.5 million for equipment write-offs (equipment taken out of service and held for disposal), including a loss recognized on the sale of the Rochester facility of \$1.9 million, and \$10.7 million for severance, outplacement and other incremental costs associated with the closure. Reducing these charges was the favorable settlement of lease commitments in Singapore of \$5.3 million, favorable settlement of 1999 restructuring accruals of \$1.8 million and a gain realized on the sale of the Tuas facility of \$3.1. The restructuring effort was substantially completed by June 30, 2000.

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

	<u>Accruals</u>	<u>Non-Cash Charges</u>	<u>Total Charges</u>
Consolidation of Asian operations:			
Fixed asset write-offs	\$ —	\$28,804	\$28,804
Severance and outplacement	18,028	—	18,028
Lease cancellation and other (net of favorable lease settlement of \$5,252)	5,733	—	5,733
	23,761	28,804	52,565
Closure of enterprise drive business:			
Fixed asset write-offs		27,497	27,497
Severance, outplacement and other	10,651	—	10,651
	10,651	27,497	38,148
	34,412	56,301	90,713
Cash payments:	(30,529)	—	
Balance at June 30, 2000	\$ 3,883	\$56,301	
Changes to 1999 restructuring estimates:			
Gain on sale of Tuas building			(3,100)
Favorable settlement of 1999 restructuring accruals			(1,776)
			\$85,837

The Company expects that the remaining restructuring accrual balance will be paid during the first six months of 2001.

Acquisition of Connex

On February 1, 1999, the Company acquired Connex, a San Jose-based startup company formed to develop storage solutions for the Windows NT and Unix server environments, at a cost of approximately \$12.0 million. The purchase price included 575,662 shares of Western Digital common stock valued at \$7.9 million, forgiveness of amounts advanced to Connex prior to the acquisition totaling \$2.0 million and the assumption of certain liabilities of approximately \$2.1 million. The acquisition was accounted for as a purchase. At the time of the acquisition, Connex was a development stage operation with no commercial products yet available for sale. Connex had, at the time of acquisition, several in-process research and development projects which were approximately 40% complete. The major projects acquired include: industry standard storage systems and storage management software solutions for both Windows NT and UNIX server environments. The Company's primary purpose for the acquisition was to acquire these in-process projects and complete the development efforts as the Company believed they had economic value but had not yet reached technological feasibility and had no alternative future uses. Therefore, the Company allocated substantially all

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

of the purchase price as a one-time charge for in-process research and development of \$12.0 million to the Company's results of operations in 1999. Approximately \$0.4 million of assets were acquired in the acquisition. The Company continued the development efforts of Connex after the acquisition and the Consolidated Statements of Operations for 1999 and 2000 include development and administrative expenses in the results of operations associated with these efforts. Connex began shipping products during the third quarter of 2000.

Service Center Operations

During the quarter ended June 30, 2000, the Company entered into an agreement with Magnetic Data Technologies Pte Ltd., a Singapore private limited company ("MDTPL"), for the outsourcing of the Company's customer service center. As a result of the agreement, the Company transferred to MDTPL, fixed assets, inventory and other assets totaling \$11.7 million in exchange for notes receivable of \$11.7 million due over 3 years, bearing interest at 9%. The agreement contains certain cancellation provisions. No gain or loss was recorded on the transaction. The note receivable is classified in other assets on the consolidated balance sheets. As of June 30, 2000, the outstanding balance on the note was \$7.8 million.

Note 9. Loss Per Share

The following table illustrates the computation of basic and diluted loss per share:

	Years Ended		
	June 27, 1998	July 3, 1999	June 30, 2000
	(in thousands, except per share amounts)		
Numerator:			
Numerator for basic and diluted loss per share — net loss	<u>\$ (290,217)</u>	<u>\$ (492,690)</u>	<u>\$ (188,016)</u>
Denominator:			
Denominator for basic loss per share — weighted average number of common shares outstanding during the period	87,525	89,478	122,624
Incremental common shares attributable to exercise of outstanding options and ESPP contributions ...	<u>—</u>	<u>—</u>	<u>—</u>
Denominator for diluted loss per share	<u>87,525</u>	<u>89,478</u>	<u>122,624</u>
Basic and diluted loss per share	<u>\$ (3.32)</u>	<u>\$ (5.51)</u>	<u>\$ (1.53)</u>

As of June 27, 1998, July 3, 1999 and June 30, 2000, 12.4 million, 17.8 million and 20.9 million shares, respectively, relating to the possible exercise of outstanding stock options were not included in the computation of diluted loss per share. Also, for the same periods, an additional 19.4, 19.4 and 8.4 million shares, respectively, issuable upon conversion of the Debentures were excluded from the computation of diluted loss per share. The effects of these items were not included in the computation of diluted loss per share as their effect would have been anti-dilutive.

Note 10. Savings and Profit Sharing Plan

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

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

For 1998, 1999 and 2000 the Company made contributions to the 401(k) plan of \$2.9, \$3.3 and \$2.3 million, respectively.

Note 11. Subsequent Events

Investments

During the period July 1, 2000 through September 15, 2000, the Company sold 4.9 million shares of its Komag common stock holdings for \$15.0 million.

Line of Credit

On September 20, 2000, the Company's hard drive solutions division ("HDS") entered into a new three-year Senior Credit Facility replacing a previous facility that had matured on March 31, 2000. The new Senior Credit Facility provides up to \$125 million in revolving credit (subject to a borrowing base calculation), is secured by HDS's accounts receivable, inventory, 65% of its stock in its foreign subsidiaries and other assets. At the option of HDS, borrowings bear interest at either LIBOR (with option periods of one to three months) or a base rate, plus a margin determined by the borrowing base. The new Senior Credit Facility requires HDS to maintain certain amounts of tangible net worth, prohibits the payment of cash dividends on common stock and contains a number of other covenants.

Convertible Debentures

During the period July 1, 2000 through September 26, 2000, the Company issued 6.3 million shares of common stock in exchange for Debentures with a book value of \$49.8 million and an aggregate principal amount at maturity of \$122.7 million. As of September 26, 2000, the aggregate principal amount at maturity of the remaining Debentures was \$438.9 million.

Equity Facility

During the period July 1, 2000 through September 5, 2000, the Company issued 6.1 million shares of common stock for net cash proceeds of \$27.6 million under its existing equity facility.

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

Note 12. Quarterly Results of Operations (unaudited)

	<u>First(1)</u>	<u>Second(2)</u>	<u>Third(3)</u>	<u>Fourth(4)</u>
	(in thousands, except per share amounts)			
1999				
Revenues, net	\$ 650,858	\$738,590	\$ 668,456	\$ 709,302
Gross profit (loss)	(82,752)	19,167	39,864	20,873
Operating loss	(192,005)	(79,015)	(110,045)	(95,727)
Net loss	(194,658)	(82,253)	(114,293)	(101,486)
Basic and diluted loss per share	<u>\$ (2.20)</u>	<u>\$ (.93)</u>	<u>\$ (1.27)</u>	<u>\$ (1.12)</u>
2000				
Revenues, net	\$ 406,957	\$560,174	\$ 516,587	\$ 473,862
Gross profit (loss)	(65,343)	20,242	11,584	41,586
Operating loss	(191,608)	(88,446)	(84,158)	(15,077)
Net income (loss)	(106,315)	(15,197)	(70,669)	4,165
Basic and diluted earnings (loss) per share	<u>\$ (1.11)</u>	<u>\$ (.13)</u>	<u>\$ (.53)</u>	<u>\$.03</u>

(1) First quarter 1999 includes a \$7.5 million charge to general and administrative expenses for losses on terminated hedging contracts and a \$77.0 million special charge to costs of revenues to increase warranty accruals associated with the Company's last generations of thin-film desktop products.

During the first quarter of 2000, the Company announced a recall of its 6.8GB per platter series of WD Caviar® desktop hard drives because of a reliability problem resulting from a faulty power driver chip manufactured by a third-party supplier. Approximately 1.2 million units were manufactured with the faulty chip. Replacement of the chips involved rework of the printed circuit board assembly. Revenues of approximately \$100 million, which related to products shipped during the first quarter and that were recalled, were reversed in the first quarter of 2000. In addition, the Caviar product line was shut down for approximately two weeks, eliminating approximately \$70 million of forecasted revenue during the quarter. Cost of revenues for the first quarter of 2000 included charges totaling \$37.7 million for estimated costs to recall and repair the affected drives, consisting of \$23.1 million for repair and retrieval, \$4.5 million for freight and other, and \$10.1 million for write-downs of related inventory. By June 30, 2000, the Company had completed rework on approximately 86% of the 1.2 million units and had resolved its claims against third parties resulting from the recall. The remaining drives have not yet been returned by end users, but the Company maintains a warranty accrual for potential repair or replacement.

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

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

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

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

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

- (3) The third quarter of 1999 includes a \$41.0 restructuring charge for the combination of the Company's desktop and enterprise hard drive divisions and the resulting consolidation of its Singapore facilities and a \$12.0 million charge for in-process research and development related to the acquisition of Connex.

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

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

- (4) The fourth quarter of 1999 includes a restructuring charge of \$20.0 million, for the sale of the Company's media operation to Komag.

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

WESTERN DIGITAL CORPORATION
SCHEDULE II — CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS
Three years ended June 30, 2000
(in thousands)

	<u>Allowance for Doubtful Accounts</u>	<u>Accrued Warranty(1)</u>
Balance at June 28, 1997	\$11,706	\$ 28,898
Charges to operations	4,674	104,600
Deductions	<u>(454)</u>	<u>(86,363)</u>
Balance at June 27, 1998	15,926	47,135
Charges to operations	2,632	153,000
Deductions	<u>(21)</u>	<u>(121,948)</u>
Balance at July 3, 1999	18,537	78,187
Charges to operations	1,000	77,724
Deductions	<u>(6,221)</u>	<u>(85,341)</u>
Balance at June 30, 2000	<u>\$13,316</u>	<u>\$ 70,570</u>

(1) Accrued warranty includes amounts classified in long-term liabilities of \$25.0 million at July 3, 1999 and \$30.2 million at June 30, 2000.

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

None.

PART III

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

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2000 Annual Meeting of Shareholders under the captions "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 30, 2000.

Item 11. *Executive Compensation*

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2000 Annual Meeting of Shareholders under the captions "Executive Compensation," "Compensation Committee Interlocks and Insider Participation" and "Stock Performance Graph," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 30, 2000.

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

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2000 Annual Meeting of Shareholders under the caption "Security Ownership of Beneficial Owners," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 30, 2000.

Item 13. *Certain Relationships and Related Transactions*

There is incorporated herein by reference the information required by this Item included in the Company's Proxy Statement for the 2000 Annual Meeting of Shareholders under the caption "Certain Relationships and Related Transactions," which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 30, 2000.

PART IV

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

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

(1) Index to Financial Statements

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

(2) Financial Statement Schedules

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

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

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

(3) Exhibits

<u>Exhibit Number</u>	<u>Description</u>
3.2.2	By-laws of the Company, as amended October 15, 1999(21)
3.3	Certificate of Agreement of Merger(4)
3.4.1	Certificate of Amendment and Restatement of Certificate of Incorporation dated March 27, 1997(11)
4.1.1	Rights Agreement between the Company and American Stock Transfer and Trust Company, as Rights Agent, dated as of October 15, 1998, which includes as Exhibit B thereto the Form of Rights Certificate to be distributed to holders of Rights after the Distribution Date (as that term is defined in the Rights Agreement)(17)
4.1.2	Amendment to Rights Agreement between the Company and American Stock Transfer and Trust Company dated , 1999†
4.2	Form of Common Stock Certificate(1)
4.3	Amended Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Stock of the Company(20)
4.4	Purchase Agreement dated February 12, 1998, by and between the Company and the Initial Purchasers named therein(14)
4.5	Indenture, dated as of February 18, 1998, between the Company and State Street Bank and Trust Company of California, N.A.(14)
4.6	Registration Rights Agreement, dated as of February 18, 1998, by and between the Company and the Initial Purchasers named therein(14)
4.7	The Company's Zero Coupon Convertible Subordinated Debenture due 2018 and the Global Form of the Company's Zero Coupon Convertible Subordinated Debenture due 2018 (which is identical to the Company's Zero Coupon Convertible Subordinated Debenture due 2018, except for certain provisions as marked)(14)
10.1.4	Western Digital Corporation Amended and Restated Employee Stock Option Plan, as amended on November 5, 1998(18)*
10.3	Western Digital Corporation 1993 Employee Stock Purchase Plan, as amended on November 18, 1999(25)*
10.10.1	Western Digital Corporation Deferred Compensation Plan, as amended and restated effective January 1, 1998(13)*
10.11	The Western Digital Corporation Executive Bonus Plan(6)*
10.11.1	Amendment No. 1 to the Western Digital Corporation Executive Bonus Plan(15)*
10.12	The Extended Severance Plan of the Registrant(6)*
10.12.1	Amendment No. 1 to the Company's Extended Severance Plan(9)*
10.13	Manufacturing Building Lease between Wan Tien Realty Pte Ltd and Western Digital (Singapore) Pte Ltd dated as of November 9, 1993(5)
10.16.1	Western Digital Long-Term Retention Plan, as amended July 10, 1997(12)*
10.16.2	Western Digital Corporation Executive Retention Plan(16)*
10.17	Subleases between Wan Tien Realty Pte Ltd and Western Digital (Singapore) Pte Ltd dated as of September 1, 1991(3)
10.18	Sublease between Wan Tien Realty Pte Ltd and Western Digital (Singapore) Pte Ltd dated as of October 12, 1992(3)
10.19	Retention Agreement effective September 21, 1998 between the Company and Teresa A. Hopp(23)*
10.21.1	The Company's Non-Employee Directors Stock-For-Fees Plan, Amended and Restated as of January 9, 1997(11)*
10.22	Office Building Lease between The Irvine Company and the Company dated as of January 13, 1988(2)

<u>Exhibit Number</u>	<u>Description</u>
10.22.1	Second Amendment to Lease, dated January 6, 1999, by and between The Irvine Company and Western Digital Corporation(22)
10.22.2	Letter Agreement dated December 21, 1999, by and between The Irvine Company and Western Digital Corporation(22)
10.23	Lease by and between Serrano Jack, L.L.C., and Western Digital Corporation, dated May 30, 1999.†
10.30	The Company's Savings and Profit Sharing Plan(7)*
10.31	First Amendment to the Company's Savings and Profit Sharing Plan(7)*
10.32	Second Amendment to the Company's Savings and Profit Sharing Plan(8)*
10.32.1	Third Amendment to the Company's Retirement Savings and Profit Sharing Plan(10)*
10.32.2	Fourth Amendment to the Company's Retirement Savings and Profit Sharing Plan(11)*
10.32.3	Fifth Amendment to the Company's Retirement Savings and Profit Sharing Plan(15)*
10.32.4	Sixth Amendment to the Company's Retirement Savings and Profit Sharing Plan(23)*
10.32.5	Seventh Amendment to the Company's Retirement Savings and Profit Sharing Plan(23)*
10.33	The Company's Amended and Restated Stock Option Plan for Non-Employee Directors, amended as of May 25, 2000(12)†*
10.34	Broad-Based Stock Incentive Plan(23)*
10.35	Fiscal Year 1999-2000 Western Digital Bridge Incentive Plan(20)*
10.37	Separation and Consulting Agreement dated October 1, 1999, by and between the Company and Charles A. Haggerty(21)*
10.38	Revolving Credit and Term Loan Agreement, dated as of November 4, 1998, among Western Digital Corporation, BankBoston, N.A. and other lending institutions listed therein(18)
10.38.1	First Amendment to Revolving Credit and Term Loan Agreement, dated as of April 8, 1999, among Western Digital Corporation, BankBoston, N.A. and other lending institutions named therein(20)
10.38.2	Second Amendment to Revolving Credit and Term Loan Agreement, dated as of May 7, 1999, among Western Digital Corporation, BankBoston, N.A. and other lending institutions named therein(20)
10.38.3	Third Amendment to Revolving Credit and Term Loan Agreement, dated as of July 30, 1999, among Western Digital Corporation, BankBoston, N.A. and other lending institutions named therein(20)
10.38.4	Fourth Amendment to Revolving Credit and Term Loan Agreement, dated as of August 27, 1999, among Western Digital Corporation, BankBoston N.A. and other lending institutions named therein(20)
10.38.5	Fifth Amendment to Revolving Credit and Term Loan Agreement, dated as of January 14, 2000, among Western Digital Corporation, BankBoston N.A., and other lending institutions named therein(22)
10.39	Agreement dated July 6, 1999, by and between the Company and David W. Schafer(21)*
10.40	OEM Component Supply and Technology License Agreement, dated June 7, 1998, between Western Digital Corporation and IBM Corporation(15)(19)
10.41	OEM Sales and Purchase Agreement, dated June 7, 1998, between Western Digital Corporation and IBM Corporation(15)(19)
10.42	Asset Purchase Agreement, dated April 8, 1999, by and between Western Digital Corporation and Komag, Incorporated(20)(24)
10.43	Volume Purchase Agreement, dated April 8, 1999, by and between Western Digital Corporation and Komag, Incorporated(20)(24)
10.44	Agreement dated October 7, 1999, by and between the Company and Russell R. Stern(22)*
10.45	Western Digital Corporation 1999 Employee Severance Plan for U.S. Employees(22)*

<u>Exhibit Number</u>	<u>Description</u>
10.46	Amended and Restated Purchase Agreement dated February 23, 2000, by and between Western Digital Corporation and Mayo Foundation(23)
21	Subsidiaries of the Company†
23	Consent of Independent Auditors†
27	Financial Data Schedule†

† New exhibit filed with this Report.

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

- (1) Incorporated by reference to the Company's Registration Statement on Form 8-B, filed April 13, 1987.
- (2) Incorporated by reference to Amendment No. 2 to the Company's Annual Report on Form 10-K as filed on Form 8 with the Securities and Exchange Commission on November 18, 1988, and subject to confidentiality order dated November 21, 1988.
- (3) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 28, 1992.
- (4) Incorporated by reference to Amendment No. 2 to the Company's Registration Statement on Form S-1 (No. 33-54968) as filed with the Securities and Exchange Commission on January 26, 1993.
- (5) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on January 25, 1994.
- (6) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 23, 1994.
- (7) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 27, 1995.
- (8) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 16, 1996.
- (9) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 11, 1996.
- (10) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on February 10, 1997.
- (11) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on May 9, 1997.
- (12) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 12, 1997.
- (13) Incorporated by reference to the Company's Registration Statement on Form S-8 (No. 333-41423) as filed with the Securities and Exchange Commission on December 3, 1997.
- (14) Incorporated by reference to the Company's Registration Statement on Form S-3 (No. 333-52463) as filed with the Securities and Exchange Commission on May 12, 1998.
- (15) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on September 1, 1998.
- (16) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 10, 1998.
- (17) Incorporated by reference to the Company's Form 8A (No. 001-08703) as filed with the Securities and Exchange Commission on November 19, 1998.
- (18) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on February 8, 1999.
- (19) Subject to confidentiality order dated October 2, 1998.

- (20) Incorporated by reference to the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission on October 1, 1999.
- (21) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on November 16, 1999.
- (22) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on February 14, 2000.
- (23) Incorporated by reference to the Company's Quarterly Report on Form 10-Q as filed with the Securities and Exchange Commission on May 15, 2000.
- (24) Subject to confidentiality order dated June 27, 2000.
- (25) Incorporated by reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (No. 333-95499) as filed with the Securities and Exchange Commission on January 27, 2000.

(b) Reports on Form 8-K:

On May 4, 2000, The Company filed a current report on Form 8-K to file its press release dated April 27, 2000, announcing third quarter earnings.

SIGNATURES

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

WESTERN DIGITAL CORPORATION

By: /s/ TERESA HOPP

Teresa Hopp
*Senior Vice President
and Chief Financial Officer*

Dated: September 28, 2000

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on September 28, 2000.

<u>Signature</u>	<u>Title</u>
<u>/s/ THOMAS E. PARDUN</u> Thomas E. Pardun	Chairman of the Board
<u>/s/ MATTHEW E. MASSENGILL</u> Matthew E. Massengill	President and Chief Executive Officer
<u>/s/ TERESA HOPP</u> Teresa Hopp	Senior Vice President and Chief Financial Officer
<u>/s/ JAMES A. ABRAHAMSON</u> James A. Abrahamson	Director
<u>/s/ PETER D. BEHRENDT</u> Peter D. Behrendt	Director
<u>/s/ I. M. BOOTH</u> I. M. Booth	Director
<u>/s/ HENRY T. DENERO</u> Henry T. DeNero	Director
<u>/s/ ANDRÉ R. HORN</u> André R. Horn	Director
<u>/s/ ANNE O. KRUEGER</u> Anne O. Krueger	Director
<u>/s/ ROGER H. MOORE</u> Roger H. Moore	Director

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**WESTERN DIGITAL CORPORATION
SUBSIDIARIES OF THE COMPANY**

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

Except for Connex, Inc. (“Connex”) and SageTree, Inc. (“SageTree”), all of the above-named subsidiaries are 100% owned by Western Digital. Connex and SageTree are each majority owned by Western Digital.

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CONSENT OF INDEPENDENT AUDITORS

The Board of Directors
Western Digital Corporation:

We consent to the incorporation by reference in the Registration Statements (Nos. 2-76179, 2-97365, 33-57953, 33-9853, 33-15771, 33-60166, 33-60168, 33-51725, 333-20359, 333-31487, 333-41423, 333-42991, 333-70413, 333-95499 and 333-36332) on Form S-8 of Western Digital Corporation and in Registration Statements (Nos. 333-52463, 333-70785 and 333-36350) on Form S-3 of Western Digital Corporation of our report dated July 27, 2000, except as to Note 11 which is as of September 26, 2000, relating to the consolidated balance sheets of Western Digital Corporation and subsidiaries as of July 3, 1999 and June 30, 2000 and the related consolidated statements of operations, shareholders' equity (deficiency) and cash flows for each of the years in the three-year period ended June 30, 2000, and the related financial statement schedule, which report appears in the June 30, 2000, Annual Report on Form 10-K of Western Digital Corporation.

KPMG LLP

Orange County, California
September 27, 2000

I N F O R M A T I O N

Board of Directors

Thomas E. Pardun
Chairman

Matthew E. Massengill
President and Chief Executive Officer

James A. Abrahamson
President and Chief Executive Officer
International Air Safety, L.L.C.
Air traffic control products and services

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

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

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

André R. Horn
Chairman Emeritus, Needham & Co.
Investment Banking
Former Chairman of the Board
Joy Manufacturing Company
Capital equipment for the energy industry

Dr. Anne O. Krueger
Professor of Economics
Department of Economics
Stanford University

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

Corporate Officers

Matthew E. Massengill
President and Chief Executive Officer

Arif Shakeel
Executive Vice President
General Manager of Desktop Products

Teresa A. Hopp
Senior Vice President and
Chief Financial Officer

W. Michael Williams
Senior Vice President and
General Manager
Connex

Michael A. Cornelius
Vice President
Law & Administration
and Secretary

David C. Fetah
Vice President
Human Resources

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

Steven M. Slavin
Vice President
Taxes and Treasurer

Research and Development Centers

Irvine, California
San Jose, California
Connex
San Jose, California

Manufacturing Facility

Malaysia

Domestic Sales Offices

Irvine, California
San Jose, California
Boca Raton, Florida
Burlington, Massachusetts
Waterford, Michigan
Princeton, New Jersey
Durham, North Carolina
North Sioux City, South Dakota
Austin, Texas
Carrollton, Texas
Houston, Texas

International Sales Offices

Western Digital Canada Corporation
Mississauga, Ontario, Canada

Western Digital Deutschland GmbH
Gaerbringen, Germany
Muenster, Germany
Munich, Germany

Western Digital (France) Sarl
Orsay, France

Western Digital Hong Kong Limited
Tsimshatsui, Kowloon, Hong Kong

Western Digital Japan Ltd.
Tokyo, Japan

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

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

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

Transfer Agent and Registrar

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10009
Telephone: 800.937.5449

Certified Public Accountants

KPMG LLP

Certain Forward-Looking Statements

This Annual Report contains forward-looking statements, including statements relating to growth in the non-traditional markets for hard drives and segments within those markets, management of working capital, the Company's profit outlook in its conventional business for fiscal 2001, and the financial prospects for the Company's new operations. The forward-looking statements are based on current management expectations, and actual results may differ materially as a result of several factors, including: the pace of development of new or emerging markets; successful product development by the Company and its new ventures; market acceptance of their products; pricing trends and other competitive factors; development or acquisition of the intellectual property necessary for the Company's new ventures to expand their products and services; business conditions and growth in the PC market; and other factors listed in the Company's Form 10-K for the fiscal year ended 2000 and in its other recent SEC filings. The Company undertakes no obligation to update forward-looking statements to reflect events or circumstances after the date hereof.

Stock Exchange Listing

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

Worldwide Web Site

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

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