

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:

Name of each exchange
on which registered:

Common Stock, \$.01 Par Value
Rights to Purchase Series A Junior
Participating Preferred Stock

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.

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

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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

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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

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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

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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

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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."

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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

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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.

| Name | Age | Position |
|-----------------------|------------|---------------------------------------|
| 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:

| | First | Second | Third | Fourth |
|-------------|-----------|-----------|------------|---------|
| 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 | 108.3 | 117.2 | 119.4 |
| | — | — | — |
| Operating loss | (8.3) | (17.2) | (19.4) |
| Net interest and other income (expense) | 0.1 | (0.6) | 0.2 |
| | — | — | — |
| Loss before income taxes and extraordinary item | (8.2) | (17.8) | (19.2) |
| Benefit for income taxes | 0.1 | — | 1.0 |
| | — | — | — |
| Loss before extraordinary item | (8.1) | (17.8) | (18.2) |
| Extraordinary gain from redemption of debentures | — | — | 8.5 |
| | — | — | — |
| Net loss | (8.1)% | (17.8)% | (9.7)% |

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

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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

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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

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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

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- 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

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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.

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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

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INDEPENDENT AUDITORS' REPORT

The Board of Directors

Western Digital Corporation:

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

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Western Digital Corporation and subsidiaries as of 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 | 3,837,350 | 3,243,998 | 2,336,869 |
| 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 | \$ (290,217) | \$ (492,690) | \$ (188,016) |
| Loss per common share (Note 9): | | | |
| Before extraordinary item | \$ (3.32) | \$ (5.51) | \$ (2.89) |
| Extraordinary item | \$ — | \$ — | \$ 1.36 |
| Basic and diluted | \$ (3.32) | \$ (5.51) | \$ (1.53) |
| Common shares used in computing per share amounts (Note 9): | | | |
| Basic and diluted | 87,525 | 89,478 | 122,624 |

See notes to consolidated financial statements.

WESTERN DIGITAL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands)

| | July 3, 1999 | June 30, 2000 |
|---|-----------------|------------------|
| 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 | 81,853 | 33,693 |
| Total current assets | 725,528 | 451,395 |
| Property and equipment at cost, net (Note 2) | 237,939 | 98,952 |
| Other assets, net (Note 8) | 58,935 | 65,227 |
| Total assets | \$1,022,402 | \$ 615,574 |
| 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) | 10,000 | — |
| | <hr/> | <hr/> |
| 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. | (193,042) | (179,810) |
| | <hr/> | <hr/> |
| Total shareholders' deficiency | (153,790) | (109,834) |
| | <hr/> | <hr/> |
| Total liabilities and shareholders' deficiency | \$1,022,402 | \$ 615,574 |
| | <hr/> | <hr/> |

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) |
|---|--------------|---------|----------------|-------------|----------------------------|---|---|---|
| | 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) |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Balance at June 27, 1998 | 101,332 | \$1,013 | (13,039) | \$(207,348) | \$326,244 | \$ 197,849 | — | \$ 317,758 |
| 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) |
| Unrealized loss on investment securities | — | — | — | — | — | — | (2,123) | (2,123) |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Balance at July 3, 1999 | 101,908 | \$1,019 | (11,297) | \$(193,042) | \$335,197 | \$(294,841) | \$(2,123) | \$(153,790) |

| | | | | | | | | |
|---|----------------|----------------|----------------|--------------------|------------------|--------------------|-----------------|--------------------|
| 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) |
| Unrealized gain on investment securities | — | — | — | — | — | — | 3,490 | 3,490 |
| Balance at June 30, 2000 | 153,335 | \$1,534 | (9,773) | \$(179,810) | \$549,932 | \$(482,857) | \$ 1,367 | \$(109,834) |

[Additional columns below]

[Continued from above table, first column(s) repeated]

| | Total Comprehensive Income (Loss) |
|---|--|
| Balance at June 28, 1997 | |
| Common stock repurchase program | |
| Exercise of stock options | |
| ESPP shares issued | |
| Income tax benefit from stock options exercised | |
| Net loss | (290,217) |
| Balance at June 27, 1998 | \$(290,217) |
| ESPP shares issued | |
| Exercise of stock options | |
| Shares issued in connection with Connex acquisition | |
| Net loss | (492,690) |
| Unrealized loss on investment securities | (2,123) |
| Balance at July 3, 1999 | \$(494,813) |
| ESPP shares issued | |
| Exercise of stock options | |
| Shares issued in debenture redemption and equity facility sales | |
| Other shares issued | |
| Net loss | (188,016) |
| Unrealized gain on investment securities | 3,490 |
| Balance at June 30, 2000 | \$(184,526) |

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 | (38,973) | (139,547) | (151,964) |
| 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 | (188,883) | (106,559) | 31,845 |
| 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 | 479,410 | 12,423 | 77,993 |
| 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 | \$ 459,830 | \$ 226,147 | \$ 184,021 |

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)

| | 1998 | 1999 | 2000 |
|---|-----------------|--------------------|-----------------|
| Net Interest and Other Income (Expense) | | | |
| Interest income | \$ 15,952 | \$ 16,906 | \$ 9,260 |
| Investment gains | — | — | 14,767 |
| Interest expense | (12,135) | (32,804) | (19,153) |
| 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 | 15,958 | 4,260 |
| | <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 | 42,972 | 16,858 |
| | <u>534,262</u> | <u>389,851</u> |
| Accumulated depreciation and amortization | (296,323) | (290,899) |
| 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 | 20,600 |
| Total future minimum rental payments | \$55,785 |

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):

| | 1998 | 1999 | 2000 |
|--|--------------------|--------------------|--------------------|
| United States | \$(348,397) | \$(399,006) | \$(214,316) |
| International | 56,389 | (93,684) | 6,800 |
| 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):

| | 1998 | 1999 | 2000 |
|--------------------------------------|------------------|-------------|-------------------|
| Current | | | |
| United States | \$(6,195) | \$(3,519) | \$(15,302) |
| International | 4,905 | 3,352 | 2,623 |
| State | (501) | 167 | 179 |
| | <u>(1,791)</u> | <u>—</u> | <u>(12,500)</u> |
| Deferred, net | — | — | (7,000) |
| 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 |
| | <u>421,627</u> | <u>447,658</u> |
| Valuation allowance | (421,627) | (447,658) |
| Total deferred tax assets | <u>\$ —</u> | <u>\$ —</u> |
| 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):

Number
of Shares

Issuable in connection with:

| | |
|--|--------|
| Convertible debentures | 8,387 |
| Exercise of stock options, including options available for grant | 45,389 |
| Employee stock purchase plan | 4,133 |
| | 57,955 |

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):

| | Number of Shares | Weighted Average Exercise Price Per Share |
|---|---------------------|---|
| 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 | (502) | 20.00 |
| 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 | (3,004) | 23.63 |
| 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 | (10,022) | 9.92 |
| Options outstanding at June 30, 2000 | 20,901 | \$ 8.83 |

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 | 88 | 6.89 | 37.93 | 78 | 37.74 |
| Total | 20,901 | 7.74 | \$ 8.83 | 8,569 | \$12.19 |

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 volatility | .76 | .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

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)

| | United States | Europe | Asia | Eliminations | Total |
|------------------------------------|---------------|---------|----------|--------------|----------|
| | (in millions) | | | | |
| 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 | \$3,628 | \$1,052 | \$3,350 | \$(4,488) | \$3,542 |
| Operating income (loss) | \$ (271) | \$ 7 | \$ 66 | \$ (20) | \$ (218) |
| Identifiable assets | \$ 907 | \$ 116 | \$ 455 | \$ (35) | \$1,443 |
| 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 | \$2,747 | \$ 752 | \$2,622 | \$(3,354) | \$2,767 |
| Operating income (loss) | \$ (295) | \$ 7 | \$ (114) | \$ 8 | \$ (394) |
| Identifiable assets | \$ 550 | \$ 97 | \$ 390 | \$ (15) | \$1,022 |
| 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 | \$1,942 | \$ 488 | \$1,868 | \$(2,340) | \$1,958 |
| Operating income (loss) | \$ (317) | \$ 104 | \$ (58) | \$ (42) | \$ (313) |
| Identifiable assets | \$ 477 | \$ 154 | \$ 16 | \$ (31) | \$ 616 |

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 | 12.1 |
| | 77.1 |
| Costs: | |
| Equipment sold | 68.3 |
| Inventory sold | 18.1 |
| Prepays and other related assets sold or written off | 7.7 |
| Severance and outplacement | 3.0 |
| | 97.1 |
| Restructuring charge | \$20.0 |

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:

| | Accruals | Non-Cash Charges | Total Charges |
|---|----------|---------------------|------------------|
| 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 | 1,339 | — | 1,339 |
| | 15,610 | 25,390 | 41,000 |
| Sale of media assets to Komag: | | | |

| | | | |
|--|--------------|-----------------|-----------------|
| Assets sold or written off, net of proceeds received | — | 16,996 | 16,996 |
| Severance and outplacement | 3,004 | — | 3,004 |
| | <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 | (16,668) | | |
| Balance at July 3, 1999 | 1,946 | | |
| Changes during 2000 to 1999 restructuring actions: | | | |
| Cash payments | (170) | | |
| Accrual reversal | (1,776) | | |
| 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:

| | Accruals | Non-Cash Charges | Total Charges |
|---|-------------------|---------------------|-------------------|
| | <u> </u> | <u> </u> | <u> </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 |
| | <u>23,761</u> | <u>28,804</u> | <u>52,565</u> |
| Closure of enterprise drive business: | | | |
| Fixed asset write-offs | | 27,497 | 27,497 |
| Severance, outplacement and other | 10,651 | — | 10,651 |
| | <u>10,651</u> | <u>27,497</u> | <u>38,148</u> |
| | 34,412 | 56,301 | 90,713 |
| Cash payments: | <u>(30,529)</u> | <u>—</u> | |

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

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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 | \$(290,217) | \$(492,690) | \$(188,016) |
| 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 | — | — | — |
| Denominator for diluted loss per share | 87,525 | 89,478 | 122,624 |
| Basic and diluted loss per share | \$ (3.32) | \$ (5.51) | \$ (1.53) |

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)

| | First(1) | Second(2) | Third(3) | Fourth(4) |
|---|--|-----------|------------|------------|
| | (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 | \$ (2.20) | \$ (.93) | \$ (1.27) | \$ (1.12) |
| | ————— | ————— | ————— | ————— |
| 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 | \$ (1.11) | \$ (.13) | \$ (.53) | \$.03 |
| | ————— | ————— | ————— | ————— |

(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)

| | Allowance for Doubtful Accounts | Accrued Warranty(1) |
|---------------------------------|---------------------------------------|------------------------|
| Balance at June 28, 1997 | \$11,706 | \$ 28,898 |
| Charges to operations | 4,674 | 104,600 |
| Deductions | (454) | (86,363) |
| Balance at June 27, 1998 | 15,926 | 47,135 |
| Charges to operations | 2,632 | 153,000 |
| Deductions | (21) | (121,948) |
| | | |

| | | |
|---------------------------------|-----------------|------------------|
| Balance at July 3, 1999 | 18,537 | 78,187 |
| Charges to operations | 1,000 | 77,724 |
| Deductions | (6,221) | (85,341) |
| Balance at June 30, 2000 | \$13,316 | \$ 70,570 |

- (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.

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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.

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(3) Exhibits

**Exhibit
Number**

Description

| | |
|---------|--|
| 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) |

| Exhibit Number | Description |
|-------------------|---|
| 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) |
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| 10.41 | OEM Sales and Purchase Agreement, dated June 7, 1998, between Western Digital Corporation and IBM Corporation(15)(19) |
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| 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)* |

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| 21 | Subsidiaries of the Company† |
| 23 | Consent of Independent Auditors† |
| 27 | Financial Data Schedule† |

† New exhibit filed with this Report.

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- (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.
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- (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.

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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.

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

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EXHIBIT INDEX

| Exhibit Number | Description |
|----------------|--|
| 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) |

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| 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)* |
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| 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) |
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AMENDMENT TO RIGHTS AGREEMENT

This Amendment (this "AMENDMENT") to Rights Agreement (the "RIGHTS AGREEMENT") is effective as of _____, 1999 by and between Western Digital Corporation, a Delaware corporation (the "CORPORATION") and American Stock Transfer & Trust Company, a New York corporation (the "RIGHTS AGENT"). Capitalized terms used herein but not defined herein shall have their defined meanings set forth in the Rights Agreement.

BACKGROUND

A. The Corporation and the Rights Agent entered into the Rights Agreement effective as of October 15, 1998.

B. The Rights Agreement provides that the Continuing Directors have certain powers to the exclusion of other directors.

C. In response to a recent ruling by the Delaware Supreme Court, the parties wish to amend the terms of the Rights Agreement to eliminate the concept and powers of the Continuing Directors.

AGREEMENT

NOW, THEREFORE, the parties hereby agree as follows:

1. Section 1(j) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"[This Section intentionally left blank.]"

2. Section 1(g)(g) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"[This Section intentionally left blank.]"

3. Section 11(a)(ii) is hereby deleted in its entirety and the following is inserted in lieu thereof:

(ii) Subject to Section 23(a) and Section 24, in the event any Person (other than an Exempt Person), alone or together with its Affiliates and Associates, shall, at any time after the Rights Dividend Declaration Date, become the Beneficial Owner of 15% or more of the shares of Common Stock then outstanding, unless the event causing the 15% threshold to be crossed is a transaction set forth in Section 13(a), or is an acquisition of shares of Common Stock pursuant to a tender offer or an exchange offer for all outstanding shares of Common Stock at a price and on

terms determined by the Board of Directors of the Corporation after receiving advice from one or more investment banking firms, to be (a) at a price which is fair to stockholders of the Corporation (taking into account all factors which such members of the Board deem relevant including, without limitation, prices which could reasonably be achieved if the Corporation or its assets were sold on an orderly basis designed to realize maximum value) and (b) otherwise in the best interests of the Corporation and its stockholders, then, proper provision shall be made so that each holder of a Right (except as provided below and in Section 7(e)) shall thereafter have the right to receive, upon exercise thereof at the then current Purchase Price in accordance with the terms of this Agreement, in lieu of a number of one one-thousandths of a share of Preferred Stock, such number of shares of Common Stock of the Corporation as shall equal the result obtained by (x) multiplying the then current Purchase Price by the then number of one one-thousandths of a share of Preferred Stock for which a Right was exercisable immediately prior to the occurrence of a Section 11(a)(ii) Event, and (y) dividing that product (which, following such occurrence, shall thereafter be referred to as the "Purchase Price" for each Right and for all purposes of this Agreement) by 50% of the Current Market Price (determined pursuant to Section 11(d)) per share of Common Stock on the date of such occurrence (such number of shares is herein called the "Adjustment Shares"); provided that the Purchase Price and the number of Adjustment Shares shall be further adjusted as provided in this Agreement to reflect any events occurring after the date of such occurrence; and provided, further, that if the transaction that would otherwise give rise to the foregoing adjustment is also subject to the provisions of Section 13, then only the provisions of Section 13 shall apply and no adjustment shall be made pursuant to this Section 11(a)(ii).

4. Section 23(a) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"(a) The Board of Directors of the Corporation may, at its option, at any time prior to the earlier of (i) the Close of Business on the tenth (10th) day following the Stock Acquisition Date (or, if the Stock Acquisition Date shall have occurred prior to the Record Date, the Close of Business on the tenth (10th) day following the Record Date), subject to extension as provided in Section 27 or (ii) the Close of Business on the Final Expiration Date, redeem all but not less than all the then outstanding Rights at a redemption price of \$.001 per Right, as such amount may be appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such redemption price being hereinafter referred to as the "REDEMPTION PRICE"). Notwithstanding anything contained in this Agreement to the contrary, the Rights shall not be exercisable after the occurrence of an event described in Section 11(a)(ii) until such time as the Corporation's right of redemption hereunder has expired. The Corporation may, at its option, pay the Redemption Price in cash, shares of Common Stock (based on the Current Market Price, as defined in Section 11(d)(i), of the Common Stock at the time of redemption) or any other form of consideration deemed appropriate by the Board of Directors. Such redemption of the Rights by the Corporation may be made effective at such time, on such basis and with such conditions as the Board of Directors in its sole discretion may establish."

5. Section 24(a) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"(a) Subject to applicable laws, rules and regulations, and subject to subsection (c) below, at any time after the occurrence of a Triggering Event, the Board of Directors of the Corporation, may cause the Corporation to exchange all or part of the then outstanding and exercisable Rights (which shall not include Rights that have become void pursuant to the provisions of Section 7(e)) for Common Stock at an exchange ratio of one share of Common Stock per Right, appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such exchange ratio being hereinafter referred to as the "RATIO OF EXCHANGE"). Notwithstanding the foregoing, the Board of Directors shall not be empowered to effect such exchange at any time after any Person (other than an Exempt Person), together with all Affiliates and Associates of such Person, becomes the Beneficial Owner of 50% or more of the Common Stock then outstanding."

6. Section 24(c) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"(c) In the event that there shall not be sufficient Common Stock authorized but unissued to permit any exchange of Rights as contemplated in accordance with Section 24(a), the Corporation shall either take such action as may be necessary to authorize additional shares of Common Stock for issuance upon exchange of the Rights or alternatively, at the option of the Board of Directors, with respect to each Right (i) pay cash in an amount equal to the Current Value (as hereinafter defined), in lieu of issuing Common Stock in exchange therefor, or (ii) issue debt or equity securities or a combination thereof, having a value equal to the Current Value, in lieu of issuing Common Stock in exchange for each such Right, where the value of such securities shall be determined by a nationally recognized investment banking firm selected by the Board of Directors, or (iii) deliver any combination of cash, property, Common Stock and/or other securities having a value equal to the Current Value in exchange for each Right. For purposes of this Section 24(c) only, the "Current Value" shall mean the product of the current per share market price of Common Stock (determined pursuant to Section 11(d) on the date of the occurrence of the event described above in subparagraph (a)) multiplied by the number of shares of Common Stock for which the Right otherwise would be exchangeable if there were sufficient shares available. To the extent that the Corporation determines that some action need be taken pursuant to clauses (i), (ii), or (iii) of this Section 24(c), the Board of Directors may temporarily suspend the exercisability of the Rights for a period of up to sixty (60) days following the date on which the event described in Section 24(a) shall have occurred, in order to seek any authorization of additional Common Stock and/or to determine the appropriate form of distribution to be made pursuant to the above provision and to determine the value thereof. In the event of any such suspension, the Corporation shall issue a public announcement stating that the exercisability of the Rights has been temporarily suspended."

7. Section 24(e) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"(e) The Corporation may, at the option of the Board of Directors, at any time before any Person has become an Acquiring Person, exchange all or part of the then outstanding Rights for rights of substantially equivalent value, as determined reasonably and with good faith by the Board of Directors, based upon the advice of one or more nationally recognized investment banking firms."

8. Section 24(f) is hereby deleted in its entirety and the following is inserted in lieu thereof:

"(f) Immediately upon the action of the Board of Directors ordering the exchange of any Rights pursuant to subsection (e) of this Section 24 and without any further action and without any notice, the right to exercise such Rights shall terminate and the only right thereafter of a holder of such Rights shall be to receive that number of rights in exchange therefore as has been determined by the Board of Directors in accordance with subsection (e) above. The Corporation shall give public notice of any such exchange; provided, however, that the failure to give, or any defect in, such notice shall not affect the validity of such exchange. The Corporation shall mail a notice of any such exchange to all of the holders of such Rights at their last addresses as they appear upon the registry books of the transfer agent for the Common Stock of the Corporation. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of exchange will state the method by which the exchange of the Rights will be effected."

9. Section 27 is hereby deleted in its entirety and the following is inserted in lieu thereof:

"27. SUPPLEMENTS AND AMENDMENTS.

Prior to the Distribution Date and subject to the penultimate sentence of this Section 27, the Board of Directors of the Corporation may, in its sole and absolute discretion and the Rights Agent shall, if the Board of Directors so directs, supplement or amend any provision of this Agreement without the approval of any holders of certificates representing shares of Common Stock, whether or not such supplement or amendment is adverse to any holders of Rights. From and after the Distribution Date, and subject to the penultimate sentence of this Section 27, the Board of Directors may, and the Rights Agent shall, if the Board of Directors so directs, supplement or amend this Agreement without the approval of any holders of Rights Certificates in order to (i) cure any ambiguity, (ii) correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions hereunder, (iii) shorten or lengthen any time period hereunder, or (iv) otherwise change or supplement the provisions hereunder in any manner which the Board of Directors may deem necessary or desirable and which shall not materially and adversely affect the interests of the holders of Rights Certificates (other than an Acquiring Person or an Affiliate or Associate of any such Person); provided, however, this Agreement may not be supplemented or amended after the Distribution Date to (A) make the Rights again redeemable after the Rights have ceased to be redeemable, or (B) change any other time period unless such change is for the purpose of protecting, enhancing or clarifying the rights of, and/or the benefits to the holders of Rights (other than any Acquiring Person and its Associates or Affiliates). Upon the delivery of a certificate from an appropriate officer of the Corporation which states that the proposed supplement or amendment is in compliance with the terms of this Section 27, the Rights Agent shall execute such supplement or amendment. Notwithstanding anything contained in this Agreement to the contrary, no supplement or amendment shall be made which changes the Redemption Price. Prior to the Distribution Date, the interests of the holders of Rights shall be deemed coincident with the interests of the holders of Common Stock."

10. Section 29 is hereby deleted in its entirety and the following is inserted in lieu thereof:

"29. DETERMINATION AND ACTIONS BY THE BOARD OF DIRECTORS, ETC.

For all purposes of this Agreement, any calculation of the number of shares of Common Stock outstanding at any particular time, including for purposes of determining the particular percentage of such outstanding shares of Common Stock of which any Person is the Beneficial Owner, shall be made in accordance with the last sentence of Rule 13d-3(d)(1)(i) of the General Rules and Regulations under the Exchange Act. The Board of Directors of the Corporation shall have the exclusive power and authority to administer this Agreement and to exercise all rights and powers specifically granted to the Board of Directors of the Corporation or to the Corporation, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power to (i) interpret the provisions of this Agreement, and (ii) make all determinations deemed necessary or advisable for the administration of this Agreement (including, but not limited to, a determination to redeem or not redeem the Rights, or to amend this Agreement). All such actions, calculations, interpretations and determinations (including, for purposes of clause (y) below, all omissions with respect to the foregoing) which are done or made by the Board of Directors of the Corporation in good faith, shall (x) be final, conclusive and binding on the Corporation, the Rights Agent, the holders of the Rights and all other parties, and (y) not subject any member of the Board of Directors to any liability to the holders of the Rights or to any other Person."

11. Section 31 is hereby deleted in its entirety and the following is inserted in lieu thereof:

"31. SEVERABILITY.

If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated; provided, however, that notwithstanding anything in this Agreement to the contrary, if any such term, provision, covenant or restriction is held by such court or authority to be invalid, void or unenforceable and the Board of Directors of the Corporation determines in its good faith judgment that severing the invalid language from this Agreement would adversely affect the purpose or effect of this Agreement, the right of redemption set forth in Section 23, if lapsed, shall be reinstated and shall not expire until the Close of Business on the tenth (10th) Business Day following the date of such determination by the Board of Directors of the Corporation."

12. Exhibit C is hereby deleted in its entirety and Exhibit C attached hereto and incorporated herein by reference is inserted in lieu thereof.

13. Except as expressly set forth in this Amendment all other terms of the Rights Agreement shall remain in full force and effect.

14. This Amendment shall be governed by and construed in accordance with the laws of the State of Delaware applicable to contracts made and to be performed entirely within such State.

15. This Amendment may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument.

IN WITNESS WHEREOF, the Corporation and the Rights Agent have executed this Amendment effective as of the date first above written.

THE CORPORATION:

WESTERN DIGITAL CORPORATION
A DELAWARE CORPORATION

By:

Michael A. Cornelius
Vice President, Law and Administration
and Secretary

THE RIGHTS AGENT:

AMERICAN STOCK TRANSFER & TRUST COMPANY,
A NEW YORK CORPORATION

By:

Name: -----

Title: -----

EXHIBIT C

SUMMARY OF RIGHTS TO PURCHASE
PREFERRED STOCK
OF
WESTERN DIGITAL CORPORATION

On September 10, 1998 (the "RIGHTS DIVIDEND DECLARATION DATE") the Board of Directors of Western Digital Corporation (the "CORPORATION") declared a dividend of one Right (a "RIGHT") for each outstanding share of Corporation Common Stock to be distributed to stockholders of record at the close of business on November 30, 1998. Each Right entitles the registered holder to purchase from the Corporation one one-thousandth of a share (a "UNIT") of Series A Junior Participating Preferred Stock (the "PREFERRED STOCK") at a "PURCHASE PRICE" of \$150, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "RIGHTS AGREEMENT") between the Corporation and American Stock Transfer & Trust Company, as Rights Agent.

A copy of the Rights Agreement has been filed with the Securities and Exchange Commission as an Exhibit to a Registration Statement on Form 8-A dated November 19, 1998. A copy of the Rights Agreement is available free of charge from the Corporation. This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement, which is incorporated herein by reference. A more detailed summary is also attached to the Form 8-A and to the Corporation's current report on Form 8-K filed with the Securities and Exchange Commission in connection with the adoption of the rights plan, and can be viewed on the Securities and Exchange Commission's web site at www.sec.gov or obtained from the Corporation upon request.

Initially, the Rights will be attached to all Common Stock certificates representing shares then outstanding, and no separate Rights Certificates will be distributed.

Until the Distribution Date (as described below), (i) the Rights will be evidenced by the Common Stock certificates and will be transferred with and only with such Common Stock certificates, (ii) new Common Stock certificates issued after November 30, 1998 will contain a notation incorporating the Rights Agreement by reference and (iii) the surrender for transfer of any certificates for Common Stock outstanding will also constitute the transfer of the Rights associated with the Common Stock represented by such certificate.

The Rights are not exercisable until the Distribution Date and will expire at the close of business on October 14, 2008, unless earlier redeemed or exchanged by the Corporation as described below.

The Rights will separate from the Common Stock and a Distribution Date will occur (the "DISTRIBUTION DATE") upon the earlier of 10 days (or such longer time as may be determined by the Corporation's board) following (i) a public announcement (or determination by the Corporation's board) that a person or group of affiliated or associated persons (an "ACQUIRING PERSON") has acquired, or obtained the right to acquire, beneficial ownership of 15% or more of the outstanding shares of Common Stock (the "STOCK ACQUISITION DATE"), or (ii) the

commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 15% or more of such outstanding shares of Common Stock.

As soon as practicable after the Distribution Date, Rights Certificates will be mailed to holders of record of the Common Stock as of the close of business on the Distribution Date and, thereafter, the separate Rights Certificates alone will represent the Rights.

In the event that on or at any time following the Rights Dividend Declaration Date, a person becomes the beneficial owner of more than 15% of the then outstanding shares of Common Stock (except pursuant to an offer for all outstanding shares of Common Stock which the board of directors determines to be fair to and otherwise in the best interests of the Corporation and its stockholders), then each holder of a Right will thereafter have the right to receive, upon exercise, Common Stock (or, in certain circumstances, cash, property or other securities of the Corporation) having a value equal to two times the Purchase Price of the Right. Rights are exercisable following the occurrence of the foregoing only after such time as the Rights are no longer redeemable by the Corporation, as set forth below. Notwithstanding any of the foregoing, following the occurrence of the event set forth in this paragraph, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by any Acquiring Person will be null and void.

In the event that, at any time following the Stock Acquisition Date, (i) the Corporation is acquired in a merger or other business combination transaction in which the Corporation is not the surviving corporation or in which the Corporation's outstanding Common Stock is exchanged for cash, stock or other property (other than a merger which follows an offer for all outstanding shares described in the preceding paragraph), or (ii) 50% or more of the Corporation's assets or earning power is sold or transferred, each holder of a Right (except Rights which previously have been voided as set forth above) shall thereafter have the right to receive, upon exercise, common stock of the acquiring company having a value equal to two times the Purchase Price of the Right.

The Purchase Price payable, and the number of Units of Preferred Stock or other securities or property issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution, as set forth in the Rights Agreement. With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments amount to at least 1% of the Purchase Price. No fractional Rights, fractions of shares of Preferred Stock (other than fractions which are integral multiples of one one-thousandth of a share), or fractional shares of Common Stock will be issued and, in lieu thereof, an adjustment in cash will be made based on the market price of the Rights, Preferred Stock, or Common Stock, respectively, on the last trading date prior to the date of exercise.

In general, the Corporation may redeem the Rights in whole, but not in part, at a price of \$.001 per Right, at any time until ten days following the Stock Acquisition Date (or such later date as may be determined by the Corporation's board). Immediately upon the action of the Board of Directors ordering redemption of the Rights, the Rights will terminate and the only right of the holders of Rights will be to receive the \$.001 redemption price.

At any time after a person becomes beneficial owner of 15% or more of the Common Stock then outstanding, and prior to the first date upon which that person becomes the beneficial owner of at least 50% of the outstanding Common Stock, the Corporation may, by majority vote of the board of directors, exchange some or all of the outstanding Rights (other than those that have become void) for shares of Common Stock at an exchange ratio of one share of Common Stock per Right, appropriately adjusted for splits, dividends, and similar transactions (the "RATIO OF EXCHANGE"). Immediately upon the action of the Board of Directors ordering the exchange of the Rights, the Rights will terminate and the only right of the holders of Rights will be to receive the number of Common Shares equal to the Ratio of Exchange.

Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Corporation, including, without limitation, the right to vote or to receive dividends.

Other than those provisions relating to the redemption price of the Rights, any of the provisions of the Rights Agreement may be supplemented or amended by the Board of Directors prior to the Distribution Date, without approval of the Rights holders, whether or not a supplement or amendment is adverse to the Rights holders. After the Distribution Date, the provisions of the Rights Agreement (other than the provisions relating to the redemption price or the final expiration date of the Rights) may be amended by the Board of Directors in order to make changes which do not materially and adversely affect the interests of holders of Rights (excluding the interests of any Acquiring Person), provided, however, that the Rights Agreement may not be amended to (i) make the Rights again redeemable after the Rights have ceased to be redeemable, or (ii) change any other time period unless such change is for the benefit of the holders (excluding any Acquiring Person).

LEASE
FOR
SERRANO CREEK CENTER
BY AND BETWEEN
SERRANO JACK, L.L.C.
"LANDLORD"
AND
WESTERN DIGITAL CORPORATION
"Tenant"

LEASE

This Lease dated for reference purposes as of May___, 2000, by and between SERRANO JACK, L.L.C., a Delaware limited liability company ("Landlord") and WESTERN DIGITAL CORPORATION, a Delaware corporation ("Tenant").

ARTICLE 1. BASIC LEASE INFORMATION:

Each reference in the Lease to any of the Basic Lease Information shall mean the respective information set forth below, and such information shall be deemed incorporated as a part of the terms provided under the particular Lease Section pertaining to such information. In the event of any conflict between any Basic Lease Information and the Lease, the former shall control.

- 1.1 Buildings: Serrano Creek Center
20411, 20511 and 20521 Lake Forest Drive
Lake Forest, California
- 1.2 Landlord: Serrano Jack, L.L.C., a Delaware limited liability company
- 1.3 Landlord's Address for Giving of Notices and Payment of Rent:
- c/o Serrano Jack, L.L.C.
Birtcher Property Services
Attn: Portfolio Manager
27611 La Paz Rd
PO Box 30009
Laguna Niguel, CA 92607-0009
Fax No. (949) 643-7455
Phone No. (949) 643-7400

With a Copy of Notices only to:

Serrano Jack, L.L.C.
c/o AmberJack Ltd.
Attn: Investment Dept. - Real Estate
One State Farm Plaza, E-10
Bloomington, IL 61710
Fax No. (309) 766-0442

For overnight packages:

27611 La Paz Rd.
Laguna Niguel, CA 92677

- 1.4 Tenant: Western Digital Corporation, a Delaware corporation
- 1.5 Tenant's Address for Giving of Notices:
- Western Digital Corp.
Attn: Real Estate Specialist
8105 Irvine Center Drive
Irvine, CA 92618
Fax No. (949) 932-5633
Phone No. (949) 932-5000

After Commencement Date:

20411 Lake Forest Drive
Lake Forest, CA 92630

- 1.6 Premises: All of the land described on Exhibit A attached hereto (the "Land") including the three (3) Buildings located thereon (Buildings A, B and C), consisting of an aggregate of 187,673 square feet, with Building A comprised of 56,109 square feet, Building B comprised of 75,455 square feet and Building C comprised of 56,109 square feet, all as shown on Exhibit B attached hereto, together with all of the Park Common Areas located on the Land as depicted on Exhibit B.
- 1.7 Park Common Areas: All areas of the Land situated outside of the exterior walls of the Buildings as outlined on Exhibit B attached hereto.
- 1.8 Project: Project is synonymous with Premises as used and defined in this Lease.
- 1.9 Parking: Parking shall be within parking spaces striped on the

surface lot constructed on the Land as shown on Exhibit B and part of the Park Common Areas.

- 1.10 Use of Premises: Offices, corporate headquarters, research and development laboratories, and related uses in connection therewith, all in compliance with applicable laws and private restrictions and pursuant to all required permits and approvals pertaining to Tenant's use to be obtained by Tenant at Tenant's expense. Tenant's initial use shall be electronic laboratories for product development, quality control and testing and engineering of computer disk drives and corporate headquarters and offices in connection therewith. (Article 3)
- 1.11 Construction Information Submittal Dates: Tenant shall provide all of the construction information requested by Tenant's architect, Landlord and Landlord's architect in accordance with Exhibit D of this Lease.
- 1.12 Construction Document Approval Dates: Landlord and Tenant shall approve the Working Drawings in accordance with the terms and conditions set forth in Exhibit D of this Lease.
- 1.13 Anticipated Commencement Date: November 1, 2000. The actual Commencement Date shall be determined as set forth in Section 2.3.
- 1.14 Lease Term: One hundred twenty (120) months, commencing on the Commencement Date and expiring on the last day of the one hundred twentieth (120th) month from and after the Commencement Date (or from and after the first day of the next calendar month if the Commencement Date occurs on a date other than the first day of a calendar month). (Section 2.3)
- 1.15 Base Rent:

| Months During Term ----- | Monthly Base Rent Amount ----- |
|-----------------------------|-----------------------------------|
| 1-12 | \$253,358.55 |
| 13-24 | \$260,959.30 |
| 25-36 | \$268,788.07 |
| 37-48 | \$276,851.71 |
| 49-60 | \$285,157.26 |
| 61-72 | \$293,711.97 |
| 73-84 | \$302,523.32 |
| 85-96 | \$311,599.01 |
| 97-108 | \$320,946.98 |
| 109-120 | \$330,575.38 |

The months referred to above are the full calendar months after any first partial month of the Lease Term. The Base Rent for any such partial month shall be prorated based on the same rents as specified for the first full calendar month when Base Rent is payable. Upon Tenant's execution of this Lease, Tenant has deposited with Landlord \$253,358.55 to be applied against the first month's Rent. (Section 2.4)

- 1.16 Tenant's Percentage of Operating Expenses shall be one hundred percent (100%). (Section 6.2)
- 1.17 Letters of Credit: See Article 7.
- 1.18 Guarantor(s) Name and Address: N/A
- 1.19 Brokers: Landlord: CB Richard Ellis, Inc.

Tenant: Daum Commercial Real Estate

LANDLORD

SERRANO JACK, L.L.C.,
a Delaware limited liability company

By: AmberJack Ltd.,
an Arizona corporation,
Managing Member

By: /s/ DAVID C. GRAVES

Name (print): David C. Graves

Title: President

Date: June 1, 2000

By: /s/ EARLE B. JOHNSON

Name (print): Earle B. Johnson

Title: Vice President

Date: June 1, 2000

TENANT

WESTERN DIGITAL CORPORATION,
a Delaware corporation

By: /s/ MATTHEW E. MASSENGILL

Name (print): Matthew E. Massengill

Title: President & CEO

Date: May 30, 2000

By: /s/ TERESA A. HOPP

Name (print): Teresa A. Hopp

Title: CFO

Date: May 30, 2000

LEASE AGREEMENT
TERMS AND CONDITIONS

ARTICLE 2. DEMISE AND RENT:

2.1 DEMISE: Landlord hereby leases to Tenant, and Tenant hereby leases from Landlord, upon and subject to the terms, covenants, provisions and conditions of this Lease Agreement (herein called the "Lease"), the Premises (including all Buildings [each individually a "Building"] and Park Common Areas) located on the Land described on Exhibit A attached hereto and incorporated herein. The Buildings and Park Common Area are more particularly depicted on Exhibit B attached hereto and incorporated herein, and Landlord and Tenant hereby stipulate and agree that the square footages of the Buildings as set forth in Section 1.6 hereof shall be the square footages for all purposes of this Lease without re-measurement or adjustment of any kind. The floor plans for the Buildings are outlined on Exhibit C attached hereto and the Buildings shall be delivered to Tenant complete and in substantial conformance with the specifications outlined in Exhibit C-1 attached hereto, both of which are incorporated herein by this reference.

2.2 PREMISES: The Premises (herein called "Premises") leased to Tenant are described in Section 1.6 hereof, constituting and located in the Buildings described in Section 1.6 and Section 2.1 hereof, together with the Park Common Areas.

2.3 TERM AND COMMENCEMENT: Unless sooner terminated as provided herein, the term of this Lease (the "Lease Term") shall be for that period of years and months set forth in the Basic Lease Information, as the same may be extended in accordance with any option or options to extend the Lease Term granted herein, and shall commence (the "Commencement Date") on the earlier of (i) the date upon which the last of the Premises is "substantially completed" as defined in the Work Letter attached hereto as Exhibit D, or (ii) the date Tenant commences occupancy of the last of the Premises for the conduct of business therein; provided however, that with respect to clause (i) only, in no event shall the Commencement Date be earlier than November 1, 2000. When the actual Commencement Date has occurred, Landlord and Tenant shall execute a Commencement Date Memorandum in the form shown in Exhibit E attached hereto. Landlord and Tenant anticipate that the Lease Term will commence on the "Anticipated Commencement Date" set forth in the Basic Lease Information, but the "Anticipated Commencement Date" shall in no event affect the actual Commencement Date, which shall be determined as set forth in this Section 2.3. Tenant shall have the early possession rights as set forth in (and subject to the provisions of) Section 30.1 below. Landlord agrees to prioritize completion of the laboratories and data center portions of the Tenant Improvements, provided that (i) Tenant submits to Landlord all specifications and requirements sufficient for Landlord to be able to so prioritize such areas, and (ii) in no event shall Landlord be required to delay other portions of the Tenant Improvements as part of such prioritization. If Landlord has not delivered all of the Premises with the Tenant Improvements substantially completed by February 1, 2001 plus Tenant Delays and delays due to force majeure as defined in Section 31.5, Landlord thereafter (so long as no Event of Default by Tenant is outstanding) shall pay to Tenant an amount equal to the holdover rent on a per day basis required to be paid by Tenant to The Irvine Company under its existing lease at 8105 Irvine Center Drive pursuant to the terms and conditions of its existing lease (the "Existing Lease") at such location (exclusive of operating expenses and net of the rent in effect immediately prior to the expiration of the term of the Existing Lease), up to a maximum amount of (\$0.96 per square foot of the Buildings which Landlord has not substantially completed as defined in Exhibit D attached to this Lease) ~ 30, per day, for each day that Landlord has failed to so deliver possession of all of the Premises to Tenant from the expiration of such period until the earlier of (a) the date upon which Landlord has so delivered all of the Premises to Tenant, or (b) sixty (60) days following the commencement of such holdover rent payment obligation. Notwithstanding the preceding sentence, (i) if Landlord has not delivered the portions of the Premises containing the laboratories and data center with the Tenant Improvements substantially completed by February 1, 2001 plus Tenant Delays and delays due to force majeure as defined in Section 31.5, then the obligation of Landlord to pay holdover rent on a per day basis as hereinabove described shall be extended for the period of such failure to deliver the laboratory and data center portions of the Premises up to a maximum of an additional sixty (60) days, (ii) Landlord shall promptly notify Tenant if Landlord at any time reasonably believes that Landlord will not have all or any portion of the Premises available for occupancy by Tenant by February 1, 2001, and Tenant shall thereafter seek to mitigate damages with The Irvine Company to the extent reasonably possible, and (iii) to the extent applicable and appropriate under the circumstances, Landlord shall make available for Tenant's temporary use alternative space owned by Landlord in other properties in the general geographic area of the Premises, on the same terms as set forth in this Lease (except that Base Rent shall be at the same per square foot rate as under this Lease for the amount of temporary space occupied by Tenant, and Tenant shall have no right and Landlord shall have no obligation to alter, improve or modify

such temporary space) until such time as Landlord has made the Premises available for occupancy by Tenant. The failure of Tenant to seek to reasonably mitigate damages in accordance with clause (ii) of the preceding sentence or to accept temporary space adequate for Tenant's temporary use in accordance with clause (iii) of the preceding sentence shall render the obligations of Landlord to pay holdover rent under this Section 2.3 void and of no further force or effect.

2.4 RENT: The rents shall be and consist of a Base Rent (herein called "Base Rent") and Additional Rent (herein called "Additional Rent"). For purposes of this Lease Agreement, Base Rent and Additional Rent are referred to collectively as "Rent." Base Rent shall be the amount indicated in the Basic Lease Information. Base Rent shall be payable in equal monthly installments in advance on the first day of each and every calendar month during the term of this Lease (except to the extent otherwise specifically provided elsewhere in this Lease and except that Tenant shall pay, upon the execution and delivery of this

Lease by Tenant, the sum indicated in the Basic Lease Information, to be applied against the first installment of Base Rent becoming due under this Lease). Additional Rent shall consist of all other sums of money as shall become due from and payable by Tenant to Landlord under this Lease. All Rent shall be paid in lawful money of the United States of America to Landlord at its office or such other place as Landlord shall designate by notice to Tenant. Tenant shall pay the Base Rent and Additional Rent promptly when due without notice or demand and without any abatement (except as expressly provided in Sections 3.3.8, 15.3, 19.1 and 19.2 of this Lease), deduction or offset for any reason whatsoever. If the Commencement Date occurs on a day other than the first day of a calendar month, the Base Rent for that partial calendar month shall be prorated as provided in Section 31.8.

2.5 LATE CHARGE: Tenant agrees that if Rent from Tenant to Landlord remains unpaid five (5) days after said amount is due, the amount of such unpaid Rent or other payments shall be increased by a late charge to be paid to Landlord by Tenant in an amount equal to the greater of (i) five percent (5%) of the amount of the delinquent Rent or other payment, or (ii) an amount equal to any late charge imposed upon Landlord under any Superior Lease or Superior Mortgage (as defined in Section 8.1 below), plus two percent (2%) of the amount of the delinquent Rent or other payment, in no event however to exceed any maximum amount permitted by applicable law, and provided further that if Tenant is so delinquent more than two (2) times in any twelve (12) month period, the percentage in clause (i) hereof shall be increased to ten percent (10%) for every late payment charge after the second in a twelve-month period. The provisions of this Section in no way relieve Tenant of the obligation to pay Rent or other payments on or before the date on which they are due, nor do the terms of this Section in any way affect Landlord's remedies pursuant to Article 22 of this Lease in the event Rent is past due.

2.6 CONFIDENTIALITY: Tenant shall use reasonable good faith efforts not to disclose and shall instruct its employees and representatives not to disclose the Rent and other material terms of this Lease except to the extent disclosure is reasonably necessary in the conduct of Tenant's business or as otherwise required by applicable law.

ARTICLE 3. USE:

3.1 Tenant shall use the Premises only for the use specified in Section 1.10 of the Basic Lease Information and for no other purpose without the prior written consent of Landlord. If any governmental license or permit, other than a certificate of occupancy, shall be required for the proper and lawful conduct of Tenant's business in the Premises or any part thereof, Tenant, at its expense, shall duly procure and thereafter maintain such license or permit and submit the same to Landlord for inspection. Tenant shall at all times comply with the terms and conditions of each such license or permit. Tenant shall not do or permit anything to be done in, on, or about the Project or bring or keep anything therein which will: (i) in any way obstruct or interfere with the rights of any neighboring properties to the Project, or injure or unreasonably annoy the owners or occupants of such properties; (ii) use or allow the Project to be used for any unlawful purpose; (iii) use or allow the Premises to be used for schools, government offices or other uses inconsistent with comparable Class A office, headquarters and research and development buildings; (iv) cause or maintain or permit any nuisance, nor commit or allow the commission of any waste, nor use or permit anything to be done which will in any way conflict with any law, statute, ordinance, or governmental rule or regulation applicable to Tenant now in force or which may hereafter be enacted or promulgated; and (v) in any way increase the rate of any insurance upon the Project or any of its contents or cause a cancellation of said insurance or otherwise affect said insurance in any adverse manner. Tenant shall, at its sole cost and expense, promptly comply with all laws, statutes, ordinances, and governmental rules, regulations, or requirements ("Legal Requirements") applicable to Tenant's particular use of the Premises now in force or which may hereafter be in force, and with the requirements of any board of fire underwriters or similar body now or hereafter constituted relating to or affecting Tenant's particular use, alteration, or occupancy of the Premises. Tenant shall also promptly comply with all private restrictions now or at any time hereafter encumbering the Project, including without limitation that certain Declaration, Covenant for Easement and Maintenance Agreement and that certain Grant of Trail Easement and Maintenance Agreement to be recorded against the Project, provided however, that with respect to any other future private restriction which Landlord voluntarily elects (and not mandated by any governmental authority or otherwise required due to Tenant's particular use of the Premises) to record as an encumbrance against the Project, Tenant shall have the right to review and reasonably approve any provisions of such voluntary private restrictions to the extent that the same limit any of Tenant's rights or increase any of Tenant's obligations under this Lease. Tenant shall not be required to make structural changes to the Buildings or the Park Common Areas to comply with Legal Requirements, unless related to or affected by: (i) alterations or improvements made by or for Tenant, including without limitation any structural or other changes resulting from Tenant's use of or acts at the Premises; or (ii) Tenant's use or acts, and in all other events, Landlord shall be responsible for such structural changes, subject to reimbursement to the extent reimbursable under Article 5 below. Similarly,

Tenant shall not be required to incur expenses in connection with compliance of the Buildings or Park Common Areas with Legal Requirements in effect at the time of construction of the Buildings or Park Common Areas to the extent that the Buildings or Park Common Areas are not so in compliance and were not in compliance with such Legal Requirements at the time of their construction, and Landlord shall, at Landlord's expense, be responsible for bringing the Buildings and Park Common Areas into compliance with all such Legal Requirements in effect at the time of construction of the Buildings or Park Common Areas if, as and when required by applicable governmental authorities. The judgment of any court of competent jurisdiction or the admission of Tenant in an action against Tenant, whether Landlord be a party thereto or not, that Tenant has so violated any Legal Requirements, shall be conclusive of such violation as between Landlord and Tenant. Tenant shall use its best efforts to prevent any violation of applicable Legal Requirements by its

directors, officers, agents, employees, contractors, customers, invitees, subsidiaries, affiliates, subtenants, successors and/or assigns (collectively the "Tenant Parties").

3.2 [INTENTIONALLY DELETED]

3.3 HAZARDOUS SUBSTANCES: Except for storage and use that has been expressly permitted in this Section 3.3, Tenant shall not cause or permit the release, discharge, or disposal nor the presence, use, transportation, generation, or storage of any Hazardous Material (as defined below) in, on, under, about, to, or from the Buildings, the Land or the Park Common Areas by either Tenant or any Tenant Parties. Tenant further agrees and covenants to Landlord, its employees, property managers, independent contractors, affiliates, shareholders, directors and officers (collectively the "Landlord Parties") that:

3.3.1 Tenant shall comply and shall use reasonable efforts to cause all Tenant Parties to comply (but in any event shall be responsible for non-compliance by any Tenant Parties) with all Environmental Laws (as defined below) in effect, or that may come into effect, applicable to the Tenant or Tenant's use and occupancy of the Project;

3.3.2 Tenant shall immediately notify Landlord, in writing, of any existing, pending or threatened (a) investigation, inquiry, claim or action by any governmental authority in connection with any Environmental Laws of which Tenant receives notice; (b) third party claims of which Tenant receives notice with respect to the Project; (c) regulatory actions of which Tenant receives notice with respect to the Project; and/or (d) contamination of the Project;

3.3.3 Tenant shall, at Tenant's expense, investigate, monitor, remediate, and/or clean up any Hazardous Material or other environmental condition on, about, or under the Project required as a result of Tenant's or any Tenant Parties' use or occupancy of the Project;

3.3.4 Tenant shall keep the Project free of any lien imposed pursuant to any Environmental Laws; and

3.3.5 Tenant shall indemnify, defend, and save Landlord and all Landlord Parties harmless for, from and against any and all claims (including personal injury, real, or personal property damage), actions, judgments, damages, penalties, fines, costs, liabilities, interest, or attorney fees that arise, directly or indirectly, from Tenant's or any Tenant Parties' violation of any Environmental Laws or the presence of any Hazardous Materials on, under or about the Project caused or permitted by Tenant or any Tenant Parties.

The Tenant's obligations, responsibilities, and liabilities under this Section shall survive the expiration or termination of the Lease.

For purposes of this Section the following definitions apply:

"Hazardous Materials" shall mean: (1) any "hazardous waste" and/or "hazardous substance" defined pursuant to any Environmental Laws; (2) asbestos or any substance containing asbestos; (3) polychlorinated biphenyls; (4) lead; (5) radon; (6) pesticides; (7) petroleum or any other substance containing hydrocarbons; (8) any substance which, when on the Project, is prohibited by any Environmental Laws; (9) petroleum; and (10) any other substance, material, or waste which, (i) by any Environmental Laws requires special handling or notification of any governmental authority in its collection, storage, treatment, or disposal or (ii) is defined or classified as hazardous, dangerous or toxic pursuant to any Environmental Laws.

"Environmental Laws" shall mean: any and all federal, state and local laws, statutes, codes, ordinances, regulations, rules or other requirements, relating to human health or safety or to the environment, including, but not limited to, those applicable to the storage, treatment, disposal, handling and release of any Hazardous Materials, all as amended or modified from time to time.

3.3.6 Notwithstanding the foregoing, Tenant shall have the right, without obtaining prior written consent of Landlord, to utilize within the Buildings standard office products that may contain Hazardous Materials (such as photocopy toner, "White Out", and the like), provided however, that (i) Tenant shall maintain such products in their original retail packaging, shall follow all instructions on such packaging with respect to the storage, use and disposal of such products, and shall otherwise comply with all applicable laws with respect to such products, and (ii) all of the other terms and provisions of this Section 3.3 shall apply with respect to Tenant's storage, use and disposal of all such products. In addition, subject to all of the other terms and provisions of this Section 3.3 (including without limitation as set forth in the balance of this Subsection 3.3.6), Landlord shall not withhold its consent to Tenant storing and using upon the Premises those Hazardous Materials and in the quantities listed on Exhibit G attached hereto, subject to Tenant's compliance with any conditions of approval contained therein or any reasonable conditions of approval contained in a separate writing from Landlord, and provided such storage and use is in accordance with all applicable Legal Requirements and

permits and the provisions of this Section 3.3. Landlord may, in its reasonable discretion, place such conditions as Landlord deems appropriate with respect to any of such Hazardous Materials, or any other Hazardous Materials Tenant may request to use at the Premises; and in connection therewith, Tenant understands that Landlord may utilize an environmental consultant to assist in determining conditions of approval of the storage, generation, release, disposal or use of Hazardous Materials by Tenant on or about the Premises, and/or to conduct periodic inspections of the storage, generation, use, release and/or disposal of such Hazardous Materials by Tenant on and from the Premises, and Tenant agrees that any reasonable costs incurred by Landlord in connection with (i) determining such conditions, and (ii) conducting up to one (1) inspection per calendar year (unless a release or noncompliance has occurred or is discovered, in which event additional inspection(s) with respect to such release(s) may occur at Tenant's expense) shall be reimbursed by Tenant to Landlord as Additional Rent hereunder upon demand.

Subject to the restrictions on entry set forth in Article 16 below, Landlord and its representatives shall have the right, but not the obligation, to inspect, sample and/or monitor the Premises and/or the soil or groundwater thereunder at any time upon prior notice to Tenant's corporate services department to determine whether Tenant is complying with the terms of this Section 3.3, and in connection therewith Tenant shall provide Landlord with full access to all relevant facilities, records and personnel. Any sampling and monitoring shall be at Landlord's expense unless the same reveals a noncompliance by Tenant under this Section 3.3, in which event Tenant shall reimburse to Landlord all costs reasonably incurred in connection therewith as Additional Rent upon demand. If Tenant is not in compliance with any of the provisions of this Section 3.3, or in the event of a release of any Hazardous Material on, under or about the Premises caused or permitted by Tenant, or any Tenant Parties, Landlord and its representatives shall have the right, but not the obligation, without limitation upon any of Landlord's other rights and remedies under this Lease, to immediately enter upon the Premises (subject to the restrictions on entry set forth in Article 16 below unless such entry arises out of a release of any Hazardous Material, in which event such restrictions shall not apply) and to discharge Tenant's obligations under this Section 3.3 at Tenant's expense, including without limitation the taking of emergency or long-term remedial action. Landlord and its representatives shall, except in an emergency, coordinate any such entry with Tenant following reasonable prior notice to Tenant, and shall endeavor to minimize interference with Tenant's business in connection therewith, but shall not be liable for any such interference unless such interference arises out of willful misconduct of Landlord. In addition, Landlord, at Tenant's expense, shall have the right, but not the obligation, to join and participate in any legal proceedings or actions initiated in connection with any claims arising out of the storage, generation, use, release and/or disposal by Tenant or any Tenant Parties, of Hazardous Materials on, under, from or about the Premises.

Promptly upon the expiration or sooner termination of this Lease, Tenant shall at Tenant's expense obtain a report prepared by a qualified licensed and certified environmental engineer, certifying to Landlord and Tenant that there are no Hazardous Materials on, under or about the Premises as a result of any acts or omissions of Tenant or any Tenant Parties. If Tenant or such report discloses the existence of Hazardous Materials on, under or about the Premises, or if Landlord at any time discovers that Tenant or any Tenant Parties caused or permitted the release of a Hazardous Material on, under, from or about the Premises, Tenant shall, at Landlord's request, immediately prepare and submit to Landlord within thirty (30) days after such request a comprehensive plan, subject to Landlord's approval, specifying the actions to be taken by Tenant to return the Premises to the condition existing prior to the introduction of such Hazardous Materials. Upon Landlord's approval of such clean up plan, Tenant shall, at Tenant's sole cost and expense, without limitation on any rights and remedies of Landlord under this Lease or at law or in equity, immediately implement such plan and proceed to clean up such Hazardous Materials in accordance with all Environmental Laws and as required by such plan and this Lease.

3.3.7 On each anniversary of the Commencement Date until the expiration or sooner termination of this Lease, Tenant shall disclose to Landlord in writing the names and amounts of all Hazardous Materials which were stored, generated, used, released and/or disposed of on, under or about the Premises for the twelve-month period prior thereto, and which Tenant desires to store, generate, use, release and/or dispose of on, under or about the Premises for the succeeding twelve-month period. In addition, to the extent Tenant is permitted to utilize Hazardous Materials upon the Premises, Tenant shall promptly provide Landlord upon request with complete and legible copies of all the following environmental documents relating thereto: reports filed pursuant to any self-reporting requirements; permit applications, permits, monitoring reports, work place exposure and community exposure warnings or notices and all other reports, disclosures, plans or documents (even those which may be characterized as confidential) relating to water discharges, air pollution, waste generation or disposal, and underground storage tanks for Hazardous Materials. Tenant shall promptly provide Landlord, without the need for request from Landlord, with complete and legible copies of: orders, reports, notices, listings and correspondence (even those which may be considered confidential) of or concerning the release, investigation of, compliance, cleanup, remedial and corrective actions, and abatement of Hazardous Materials; and all complaints, pleadings and other legal documents filed by or against Tenant related to Tenant's use, handling, storage, release and/or disposal of Hazardous Materials.

3.3.8 If the presence or release of Hazardous Materials caused solely by Landlord renders the Premises untenable in whole or in part or results in Tenant being required to vacate the Premises in whole or in part pursuant to an order or requirement of any governmental agency or authority, then the Rent, Taxes, insurance premiums, and other charges, if any, payable by Tenant hereunder applicable to any such Building area so untenable, if any, for the period during which such Building area remains so impaired, shall be abated in proportion to the degree to which Tenant's use of such Building area is impaired and for the period of such impairment, provided however, that to the

extent that Tenant's business interruption insurance, if any, or other insurance would cover such obligations, Tenant shall either cause such proceeds to be paid to Landlord or this abatement provision shall not apply.

3.4 ANTENNA USES: Landlord hereby grants Tenant the right to install and maintain a satellite dish and related facilities and antenna (collectively the "Antenna") on the roofs of the Buildings, at Tenant's expense, which Antenna and its location shall be reasonably approved by Landlord and shall be in compliance with the following terms, requirements and conditions:

3.4.1 The size, location and placement, as well as the manner and method of installation and removal of the Antenna and related equipment, shall be subject to the prior written approval of Landlord, which shall not be unreasonably withheld. The Antenna and related equipment shall not penetrate the roof membrane and shall be adequately screened from view. If Landlord elects to hire structural, mechanical, roofing and/or other engineers or consultants to review such plans and specifications, Tenant shall reimburse Landlord for the reasonable costs thereof, whether or not Landlord grants such approval.

3.4.2 Tenant shall pay for all utilities consumed to install, maintain, operate and remove its Antenna and equipment, as well as the reasonable costs of any engineers or consultants employed by Landlord to review the same.

3.4.3 Prior to the installation of said Antenna and equipment, Tenant shall secure and shall at all times thereafter maintain all required approvals and permits of the Federal Communications Commission and all other governmental bodies having jurisdiction over its business, including its communications, operations, and facilities. Tenant shall at all times comply with all laws and ordinances and all rules and regulations of municipal, state and federal governmental authorities relating to the installation, maintenance, height, location, use, operation, and removal of said Antenna and equipment and shall fully indemnify Landlord and all Landlord Parties against any loss, cost, or expense which may be sustained or incurred by it as a result of the installation, maintenance, operation, or removal of said Antenna and equipment. Landlord makes no representation that applicable laws, ordinances or regulations permit the installation or operation of antennas on the Project.

3.4.4 Landlord hereby grants unto Tenant the right, to be exercised as herein set forth, to enter upon the roofs of the Buildings for the sole purpose of gaining access to the Tenant's installation. In addition thereto, Landlord grants unto Tenant the right, to be exercised as herein set forth, to install such equipment, conduits, chases, utility closets and other facilities as is reasonably necessary to connect Tenant's Antenna to Tenant's other machinery and equipment in other parts of the Buildings, subject to the requirements of any permits and the codes, regulations and rules of any governmental body, agency or authority. Landlord further grants to Tenant the right of access for the purposes of maintaining, repairing, testing and replacing the connecting equipment. Tenant shall promptly reimburse Landlord for the costs of repairs of any damage to the Premises (including the roofs of the Buildings) directly or indirectly caused by Tenant's installations or the operation, maintenance or removal thereof.

3.4.5 Tenant, at its expense, shall be solely responsible for and shall maintain its Antenna and related equipment in a safe, structural, sound, clean and sightly condition and shall indemnify and save harmless Landlord against all liens and claims of mechanics and materialmen furnishing labor and materials in the construction and maintenance of same.

3.4.6 Tenant agrees to defend, indemnify and save harmless Landlord and all Landlord Parties and to assume all liability for death or injury to any persons and all liability for loss, damage or injury to any property incurred or sustained by Tenant or any other person arising from, growing out of or resulting from Tenant's installation or its use of the roofs of the Buildings or any other areas in the Premises where Tenant's antenna-related equipment is located, including costs, attorney's fees and other expenses incurred by Landlord in defending any such claim.

3.4.7 Landlord shall have the right to terminate the rights under this Section 3.4 upon written notice to Tenant, in the event that: (a) it shall be determined that such installation or use materially interferes with the operation of machinery and apparatus of the Buildings, such as the elevators; or (b) it is found by public authority having jurisdiction over the Buildings that such installation and use constitute a nuisance or hazard to the public or to the occupants of the Buildings; or (c) the expiration or earlier termination of this Lease.

3.4.8 Upon the expiration or earlier termination of this Lease or the termination of Tenant's rights under this Section 3.4, the Antenna and the related equipment installed under the terms hereof shall be removed by Tenant and the area of the Buildings where they were installed shall be restored by Tenant to as good condition as existed immediately prior to installation of such Antenna and related equipment.

ARTICLE 4. TENANT'S ACCEPTANCE AND MAINTENANCE OF PREMISES:

4.1 ACCEPTANCE OF PREMISES: Subject to the provisions of Section 4.2 below relating to latent defects and warranty items, and the punch list items identified in Exhibit C-2 attached to this Lease and as provided for in Exhibit D, and subject to all other obligations of Landlord contained in this Lease, by taking possession of each Building, Tenant accepts such Building as being in the condition in which Landlord is obligated to deliver it and otherwise in good order, condition and repair. Except as set forth in Section 4.2 below and any punchlist items, Landlord shall have no obligation to repair or maintain the Premises, and except for Landlord's work described in Exhibit D, Landlord shall have no obligation to alter, remove, improve, decorate, or paint the Premises or any part thereof. Tenant acknowledges that neither Landlord nor any of Landlord's agents or employees has made any representations or warranties as to the suitability or fitness of the Premises for the conduct of Tenant's business, including, but not limited to, any representations or warranties regarding zoning or other land use matters, or for any other purpose, and that neither Landlord nor any of Landlord's representatives or employees has agreed to

undertake any alterations or additions or construct any Tenant Improvements to the Premises except as expressly provided in Exhibit D attached to this Lease.

4.2 LANDLORD'S OBLIGATIONS: Subject to the provisions of Section 4.3 and Article 19, Landlord shall, at Landlord's expense (and not reimbursed as part of Operating Expenses) for the initial Lease Term only, repair (i) any latent defects to the foundation, footings, roof structure, underground plumbing, underground electrical lines and pipes and underground storm drains owned by Landlord within the Project, load-bearing walls of the Buildings, parking lot areas within the Park Common Areas, and light standards within such parking lot areas, which defects pose an imminent threat of injury to persons, damage to property, or inability of Tenant to occupy the Buildings; and (ii) any other defects in the construction of the Buildings, the Park Common Areas or the Tenant Improvements covered by any warranty or guaranty during the length of any warranty or guaranty period.

Landlord shall, subject to receiving Tenant's payment of Operating Expenses as defined in Article 5, and subject to Section 4.3 and Article 19, maintain in good condition and repair the Park Common Areas, including but not limited to, landscaping (including replacement thereof), sprinkler systems, walkways, parking areas, the exterior surfaces of the exterior walls of the Buildings, all exterior glass, window seals and vents of the Buildings, fencing and exterior lighting; and the electrical, mechanical, heating, ventilation and air conditioning installed by Landlord ("HVAC"), elevators, and plumbing systems of the Buildings, and fire/life safety and sprinkler systems. Such maintenance shall include restriping of the parking areas, periodic window washing of the exterior windows of the Buildings (but in no event less than 4 times per year), and painting of the exterior walls of the Buildings, as and when the same becomes necessary in Landlord's reasonable discretion or as requested by Tenant. Such maintenance shall further include the roofs of the Buildings. Landlord's regularly scheduled maintenance under this Section 4.2 shall generally conform to the specifications set forth in Exhibit I attached to this Lease. Landlord shall not be required to make any repairs unless and until Tenant has notified Landlord in writing of the need for such repair and Landlord shall have a reasonable period of time thereafter to commence and complete said repair, if warranted. The cost of any maintenance, repairs and/or replacements on the part of Landlord provided for in this Section 4.2 shall be considered part of Operating Expenses and paid by Tenant in the manner set forth in Article 5, except as provided in the first sentence hereof and except that repairs which Landlord reasonably deems arise out of any act or omission of Tenant or any Tenant Parties shall be made at the immediate expense of Tenant. Landlord's obligation to repair and maintain hereunder shall be limited to the cost of effecting such repair and maintenance and in no event shall Landlord be liable for any costs or expenses in excess of said amounts, including but not limited to any consequential damages, opportunity costs or lost profits incurred or suffered by Tenant. Upon Tenant's request, Landlord agrees to provide to Tenant copies of all guaranties and warranties applicable to any portions of the Project. Notwithstanding the foregoing, Landlord may, by written notice to Tenant, elect at any time to cease maintaining all or any portion of the Park Common Areas and/or the roofs of the Buildings, in which event Tenant shall be responsible for such maintenance as set forth in Section 4.3 below.

4.3 TENANT'S OBLIGATIONS: Except for Landlord's obligations stated in Section 4.2 above, Tenant shall, at all times during the term hereof at Tenant's sole cost and expense, keep the Premises in good order, condition and repair, which obligation shall include, without limitation, the obligation to maintain, repair and replace as necessary: (i) floor coverings; (ii) wall coverings; (iii) paint on the interior of the Buildings; (iv) casework; (v) ceiling tiles; (vi) supplemental heating, ventilating and air conditioning systems serving the Premises and installed by or at the request of Tenant ("Supplemental HVAC Systems"); (vii) window coverings; (viii) lights and ballasts; (ix) locks and hardware; (x) all of Tenant's Property (as defined in Section 14.2 herein); (xi) any and all Tenant Improvements (as defined in Exhibit D); (xii) interior window glass and door glass in the Buildings (including any replacement thereof and periodic washing of the interior surfaces); (xiii) public lobbies, stairs, corridors and rest rooms; (xiv) all required janitorial and trash removal services to the Premises; and (xv) all security systems, card key systems, and other similar systems serving the Project.

During the Lease Term, Tenant agrees to employ a contractor or qualified internal employee reasonably approved by Landlord to perform Tenant's obligations for maintenance of the Supplemental HVAC System on the Premises. Such maintenance shall include at least quarterly inspections and cleaning of said units and systems, together with such adjustments and servicings as each inspection discloses to be required. In addition, Tenant shall perform all repair, testing and servicing as shall be necessary or reasonably required by Landlord or Landlord's insurance underwriter. Upon Landlord's request, Tenant shall provide to Landlord complete, accurate and legible copies of all periodic maintenance contracts required hereunder and of the results of any periodic inspections, testing and repair.

4.4 TENANT IMPROVEMENTS: A description of the tenant improvements to be performed by Landlord ("Tenant Improvements") and the terms under which they are to be executed is attached hereto as Exhibit D. Landlord shall construct the Tenant Improvements in accordance with Exhibit D and in a good and workmanlike manner.

ARTICLE 5. OPERATING EXPENSES AND TAXES:

5.1 OPERATING EXPENSES: For the purpose of this Lease, the term "Operating Expenses" shall mean all expenses paid or incurred by Landlord (or on Landlord's behalf) as reasonably determined by Landlord to be necessary or appropriate for the efficient use, operation, maintenance, repair and replacement of the Project, including without limitation:

5.1.1 All costs and expenses to Landlord in maintaining fire and extended coverage insurance including an all risk endorsement on the property, public liability, fidelity, rent loss insurance, difference in conditions and any other insurance maintained by Landlord covering the use and operation of the

Project as set forth in Section 11.2 below, and the part of any claim required to be paid under the deductible portion of any insurance policies carried by Landlord in connection with the Project (other than the deductibles under any earthquake insurance maintained by Landlord for all or any portion of the Premises, for which Tenant shall not be liable or responsible hereunder), and subject to the limitation contained in the first sentence of Section 11.2 below.

5.1.2 Reasonable costs incurred by accountants, attorneys or other experts or consultants incurred in connection with (i) any items requested by Tenant, (ii) any matters arising out of or attributable to the acts or omissions of Tenant or any Tenant Parties, (iii) attempts to reduce Operating Expenses in other areas, or to reduce Taxes, and (iv) the operation or maintenance of the Premises, excluding however, any internal costs incurred or required by Landlord in connection with the Premises (such as, for example, audits

conducted solely for the benefit of Landlord, disputes between Landlord and its property manager or any Superior Mortgagee or Superior Lessor, and the like) or otherwise as limited under Section 5.2 below.

5.1.3 All costs and expenses incurred by Landlord in operating, managing (including a commercially reasonable market rate management fee), maintaining and repairing the Project, including without limitation: (i) all sums expended in connection with the Park Common Areas for general maintenance and repairs, resurfacing, painting, restriping, cleaning, sweeping, sidewalks, curbs, sprinkler systems, planting and landscaping; (ii) maintenance, repair and replacement of any storm drainage systems; (iii) cost of all tools, equipment and supplies and personnel specifically utilized to implement such services at the Project only and to generally monitor and maintain the Project; (iv) reasonable rental and/or depreciation of machinery and equipment used in such maintenance and services; (v) the cost of any capital improvements, repairs and replacements made by or on behalf of Landlord to the Project, net of any reserves collected therefor; (vi) the cost of any capital improvements, repairs and replacements made by or on behalf of Landlord for which no reserves were collected to the extent of the amortized cost thereof over the useful life thereof calculated at a market cost of funds at the time the expense is incurred, all as reasonably determined by Landlord; (vii) establishment of reasonable reserves for replacements and/or repairs to Park Common Areas, roofs and exterior Premises painting in accordance with the schedule attached hereto as Exhibit I or otherwise in accordance with generally acceptable accounting principals and practices; (viii) costs incurred in connection with compliance with laws (other than building codes in effect at the time of construction of the Buildings) or changes in laws applicable to the Project; (ix) commercially reasonable premiums and other commercially reasonable costs for worker's compensation insurance, salaries, wages, withholding taxes, social security taxes, medical, surgical, union and general welfare benefits (including without limitation, group life insurance), and pension or other retirement payments of employees of Landlord or Landlord's property manager engaged in the repair, maintenance and operation of the Project; (x) personal property taxes, fees for required licenses and permits, supplies and charges; (xi) all other costs incurred by Landlord under Section 4.2 above; and (xii) all other charges allocable to the operation, maintenance and repair of the Project.

5.2 EXCLUSIONS FROM OPERATING EXPENSES: Operating Expenses shall not include: (i) depreciation or amortization and other "non-cash" expense items (except as provided above in Section 5.1.3); (ii) interest on and amortization of debts; (iii) Tenant Improvements under Exhibit D; (iv) leasing commissions, attorneys' fees and other expenses incurred in connection with negotiating this Lease; (v) costs associated with defense of Landlord's title to or interests in the Project; (vi) refinancing costs; (vii) advertising and promotional expenses; (viii) repairs and other work occasioned by fire or other casualty to the extent Landlord is actually reimbursed or entitled to reimbursements by insurance proceeds; (ix) fines or penalties incurred due to violations by Landlord of governmental laws, regulations, orders and the like; (x) all overhead, costs and expenses associated with the operation of Landlord's business, as distinguished from costs and expenses associated with the operation of the Project, such as, without limitation, corporate accounting and legal fees, costs and expense of defending or prosecuting litigation not related to the Project, and costs and expense of selling, syndicating, financing or mortgaging Landlord's interest in the Project; (xi) any items of expense as to which the Landlord is reimbursed by means other than Operating Expenses such as through insurance proceeds or litigation against the party who wrongfully caused the expense; (xii) costs of correcting structural or other construction defects, including any allowances for same, in the construction of the Buildings or Park Common Areas (including latent defects) or equipment used therein (or the replacement of defective equipment) but only to the extent described as a Landlord expense in Section 4.2 above, or costs of repairs covered by any warranties or guaranties; (xiii) services, items and benefits for which Tenant specifically reimburses Landlord or for which Tenant pays third persons; (xiv) penalties for late payment, including, without limitation, with respect to taxes, equipment leases, etc., unless arising out of any late payment by Tenant; (xv) costs directly resulting from the willful misconduct of Landlord, its employees, representatives and/or contractors; (xvi) costs or expenses for sculpture, paintings or other works of art (other than on-site sculpture, paintings, or art in place as of the Commencement Date), including costs incurred with respect to the purchase, ownership, leasing, showing, promotion, repair and/or maintenance of same; (xvii) costs of restoration or repair of the Buildings as a result of total or partial destruction or condemnation thereof, such costs to be handled pursuant to Article 19 of this Lease; (xviii) contributions to charitable organizations; (xix) the costs of any initial construction "tap fees" or one-time lump sum sewer or water connection fees for the Buildings; (xx) compensation in the form of wages, salaries and such other compensation and benefits, as well as any adjustments thereto, for all employees and personnel of Landlord not providing services to the Project; (xxi) fees, costs, reimbursements and other sums paid to affiliates of Landlord for services provided to the Project to the extent that such fees, costs, reimbursements or other sums are in excess of prevailing market amounts for comparable services provided by unaffiliated third parties; (xxii) any costs, expenses, losses or liabilities relating to the public trail easement through the Park Common Areas for which Landlord is reimbursed or

indemnified by the County of Orange pursuant to any indemnity or insurance provisions benefiting Landlord under the easement agreement therefor; (xxiii) costs paid directly by the County of Orange to maintain and repair the public trail easement through the Park Common Areas; and (xxiv) costs incurred by Landlord in connection with responding to any Hazardous Materials release by a third party who is not a Tenant Party migrating onto the Land.

5.3 TAXES: The term "Taxes" shall include (i) all real property taxes and assessments and personal property taxes, charges, rates, duties and assessments charged, levied or imposed by any governmental authority with respect to the Project, and any improvements, fixtures and equipment located therein or thereon, and with respect to all other property of Landlord, real or personal, used in connection with the operation of the Project or any obligation to any governmental entity assessed upon Landlord as a result of its ownership or operation; (ii) any tax in lieu of a real property tax; (iii) any tax or excise levied or assessed by

any governmental authority on the rentals payable under this Lease or rentals accruing from the use of the Project; (iv) any tax or excise imposed or assessed against Landlord which is measured or based in whole or in part on the capital employed by Landlord to improve the Project, or to construct the Buildings; (v) any assessments, levies or charges imposed by any quasi governmental authority, association, declarant, or similar entity pursuant to any covenant, restriction or other encumbrance upon or relating to the Project, except to the extent arising out of the non-performance by Landlord of any Landlord obligations under any such covenant, restriction or other encumbrance upon or relating to the Project; and (vi) all reasonable costs and expenses incurred by Landlord in contesting or negotiating the same with governmental authority if Landlord, in its reasonable discretion, elects to contest or negotiate the same. Notwithstanding the foregoing, Taxes shall not include federal or state corporate or personal income, excess profits, estate, business, inheritance, succession, transfer or franchise taxes or assessments upon Landlord.

Tenant may contest the amount or validity of any Taxes or taxes levied on Tenant's personal property by appropriate proceedings, provided that Tenant gives Landlord prior written notice of any such contest and keeps Landlord advised as to all proceedings, and provided further that Tenant shall continue to reimburse Landlord for Tenant's Pro Rata Share of such Taxes unless such proceedings shall operate to prevent or stay such payment and the collection of the Taxes so contested. Landlord shall join in any such proceedings if any applicable laws shall so require, provided that Tenant shall indemnify, protect, hold harmless and defend Landlord from and against any liability, claim, demand, cost or expense in connection therewith, including but not limited to, attorneys' fees and costs reasonably incurred.

ARTICLE 6. PAYMENT OF OPERATING EXPENSES:

6.1 OPERATING YEAR: As used in this Article 6, the term "Operating Year" shall mean each calendar year of the Lease Term and in the event this Lease begins or ends on any date other than the first day of the calendar year, the calculations, costs and payments referred to herein shall be prorated as provided in Section 31.8.

6.2 TENANT'S PRO RATA SHARE: Throughout the entire Lease Term, Tenant shall pay, as Additional Rent, the Tenant's Pro Rata Share of the Operating Expenses and Taxes. If in any Operating Year Tenant occupies the Premises or any portion thereof for less than the full Operating Year, Tenant's Pro Rata Share of Operating Expenses and Taxes shall be pro rated accordingly. "Tenant's Percentage" shall mean a percentage, the numerator of which is the number of rentable square feet of the Premises and the denominator of which is the total number of rentable square feet of the Project, whether or not such space is actually rented. The initial Tenant's Percentage is specified in Section 1.16 of the Basic Lease Information. "Tenant's Pro Rata Share" shall mean Tenant's Percentage multiplied by the total Operating Expenses and Taxes for the applicable Operating Year.

6.3 WRITTEN STATEMENT OF ESTIMATE: Prior to each Operating Year during the Lease Term, Landlord shall furnish Tenant for Tenant's review with a written statement setting forth Tenant's Pro Rata Share of the estimated Operating Expenses and Taxes for the next Operating Year. Such statement shall (a) reasonably demonstrate that the amounts charged under each line item of expense conform to the specifications set forth in Exhibit I attached to this Lease (or, if there is a deviation from such specifications, include a brief description of the reasonable basis for such deviation), and (b) for any change in the amortization amount of any reserves included in such statement, a certification by Landlord's consultant with respect to such reserve item (or, upon Tenant's request, by a mutually acceptable third party consultant experienced with such reserve item) providing a reasonable basis for such change. Tenant shall have the right to meet with Landlord to (i) confer with Landlord regarding any such deviations, (ii) propose to Landlord alternatives or options seeking to reduce Operating Expenses including the right to require competitive bidding for major line item services (e.g., landscaping, window washing, etc.), without, however, compromising the quality of any services or compromising any of Landlord's rights or obligations under this Lease, and (iii) with respect to parking lot sweeping, steam cleaning, and window washing, Tenant shall have the right to approve the frequency of such services. It is understood and agreed that, notwithstanding Tenant's rights to confer with Landlord as set forth in the preceding sentence, other than with respect to the items under clause (iii) of said sentence, the decisions of Landlord with respect to service specifications required to properly maintain the Premises as a Class A building project shall be final and controlling. Tenant shall pay to Landlord as Additional Rent commencing on January 1 of the Operating Year, and thereafter on the first day of each calendar month, an amount equal to one-twelfth of the amount of Tenant's Pro Rata Share of such Operating Expenses and Taxes. In the event Landlord delivers the written statement late, Tenant shall continue to pay to Landlord an amount equal to one-twelfth of Tenant's Pro Rata Share of the Operating Expenses and Taxes for the immediately preceding Operating Year until Landlord furnishes the written statement, at which time Tenant shall pay the amount of any excess of the Tenant's Pro Rata Share for the expired portion of the current Operating Year over the Tenant's actual payments during such time; any excess payments by

Tenant shall be credited to the next due payment of Additional Rent from Tenant. The late delivery of any written statement by Landlord shall not constitute a waiver of Tenant's obligation to pay Tenant's Pro Rata Share of the Operating Expenses and Taxes, nor subject the Landlord to any liability, but Landlord shall use reasonable efforts to deliver such written statements of Operating Expenses and Taxes as soon as reasonably possible.

6.4 REESTIMATIONS: At any time from time to time during each Operating Year, not more frequently than once per Operating Year, Landlord may furnish Tenant with written notice of a reestimation of the annual Operating Expenses and Taxes to reflect more accurately Landlord's most recent estimate of the current Operating Expenses and Taxes. Commencing with the first day of the calendar quarter following delivery of such notice to Tenant, and continuing on the first day of each calendar month during the Lease

Term (until subsequently reestimated), Tenant shall pay to Landlord one twelfth (1/12th) of the Tenant's Pro Rata Share of the estimated Operating Expenses and Taxes, as reestimated.

6.5 ANNUAL ADJUSTMENTS: Within ninety (90) days following the end of each calendar year during the Lease Term, Landlord shall furnish to Tenant an itemized statement certified by Landlord, setting forth the total Operating Expenses and Taxes for the preceding calendar year, the amount of Tenant's Pro Rata Share of such Operating Expenses and the payments made by Tenant with respect to such calendar year. If Tenant's Pro Rata Share of the actual Operating Expenses and Taxes for such year exceeds the payment so made by Tenant, based on the Landlord's estimate, Tenant shall pay Landlord the deficiency within thirty (30) days after receipt of said statement. If said payments by Tenant, based on Landlord's estimate, exceed Tenant's Pro Rata Share of the actual Operating Expenses and Taxes, Landlord will credit the amount of such overpayment against Tenant's next Operating Expense and Tax payment due; or, if the Lease has expired or terminated, Landlord will refund such amount to Tenant within thirty (30) days after the date of such estimate, subject to set off by Landlord against any sums then due Landlord by Tenant.

6.6 TENANT EXAMINATION: In addition, Tenant or an authorized representative of Tenant may at any time during business hours, upon at least five days advance written notice to Landlord, examine any invoices, receipts, canceled checks, vouchers or other instruments used to support the figures shown on any statement of Operating Expenses and Taxes for the Project; provided, however, that Tenant shall only be entitled to such an examination once in each Operating Year, and the examination shall not be conducted by anyone who is engaged on a contingent fee basis to represent Tenant or who is a competitor of Landlord. Property managers and commercial building owners shall be deemed competitors of Landlord. The person conducting the examination on behalf of Tenant shall enter into a confidentiality agreement reasonably satisfactory to Landlord. In the event the examination discovers an overcharge in excess of 5% of the Operating Expense payments during the Operating Year covered by the examination, Landlord shall reimburse Tenant for the actual out-of-pocket costs reasonably incurred by Tenant due to the examination. In the event the examination fails to discover an overcharge in excess of 5% of the Operating Expense payments during the Operating Year covered by the examination, Tenant shall reimburse Landlord for the actual costs incurred by Landlord due to the examination.

6.7 DISPUTES: Each statement given by Landlord pursuant to this Section shall be conclusive and binding upon Tenant unless within the earlier of (i) one (1) year plus sixty (60) days after the receipt of such statement, or (ii) sixty (60) days after Tenant completes any examination under Section 6.6 above, Tenant notifies Landlord that it disputes the correctness of the statement, specifying the particular respects in which the statement is claimed to be incorrect. If such disputes shall not have been settled by agreement, either party, within sixty (60) days after receipt of such statement, may pursue its available legal remedies. Tenant hereby agrees that a dispute over the statement or any good faith error by Landlord in interpreting or applying Article 5 or in calculating the amounts in the statement shall not be a breach of this Lease by Landlord. If any legal proceeding over the statement is resolved against Landlord, this Lease shall remain in full force and effect and Landlord shall not be liable for any consequential damages, and pending the determination of such dispute, Tenant, within thirty (30) days of receipt of such statement, shall pay Additional Rent in accordance with the statement, without prejudice to Tenant's positions. If the dispute shall be determined in Tenant's favor, Landlord shall forthwith pay to Tenant the amount of Tenant's overpayment of Additional Rents resulting from compliance with the statement; or if the Lease has expired or earlier terminated pursuant to Section 30.4 below, Landlord will promptly refund such amount to Tenant.

6.8 PAYMENT: If an Operating Year ends after the expiration or termination of this Lease, the Additional Rent in respect thereof payable under this Section shall be paid by Tenant within ten (10) days of its receipt of the itemized statement for such Operating Year; or, if applicable, Landlord will deliver any excess amount paid by Tenant concurrently with such itemized statement.

ARTICLE 7. LEASE SECURITY:

7.1 Security Deposit: Concurrently with the execution of this Lease, Tenant shall deposit with Landlord in cash or by wire transfer of funds, the sum of One Million Eight Hundred Thousand Dollars (\$1,800,000.00) (the "Security Deposit"), to be held by Landlord as security for the full and faithful performance by Tenant of all of the terms, covenants and conditions of this Lease to be performed by Tenant during the Term until such time as Tenant shall deposit with Landlord the first Letter of Credit described in Section 7.2 (i) below, at which time Landlord shall return the Security Deposit to Tenant, less any amounts properly applied by Landlord by reason of any Tenant Event of Default under this Lease. The Security Deposit shall be placed in a federally insured interest bearing account reasonably acceptable to Tenant, with all interest accruing thereon to be paid to Tenant upon return of the Security

Deposit to Tenant. Prior to the substitution of the first Letter of Credit for the Security Deposit, upon the occurrence of an Event of Default, including without limitation any default by Tenant in the payment of Base Rent and Additional Rent beyond applicable cure periods under this Lease, Landlord may (but shall not be required to) without waiver of any other rights or remedies Landlord may have under this Lease or at law or in equity, use, apply or retain all or any part of the Security Deposit for the payment of any Base Rent and Additional Rent or any other sums owed to Landlord by reason of such Event of Default or for any such sums which Landlord may expend or may be required to expend by reason of such Event of Default, including, but not limited to, unamortized Tenant Improvement costs, unamortized leasing commissions, and any damages or deficiency in the reletting of the Premises, whether such damages or deficiency accrue before or after summary proceedings or other re-entry by Landlord. If any portion of the Security Deposit is so used or

applied, Tenant shall, within ten (10) days after demand therefor, deposit with Landlord in cash or by wire transfer of funds, an amount sufficient to restore the Security Deposit to its original amount.

7.2 Letters of Credit: Tenant shall deposit with Landlord two (2) unconditional, irrevocable sight draft letters of credit in the amounts and for the purposes set forth below (each hereinafter a "Letter of Credit" and collectively the "Letters of Credit"). The form and content of each Letter of Credit shall conform to International Standby Practices 1998 International Chamber of Commerce Publication No. 590, shall name Landlord as beneficiary thereunder, shall be freely transferable by Landlord, and shall otherwise be acceptable to Landlord in its reasonable discretion (including, without limitation, a provision that any termination or cancellation thereof not be effective until at least sixty (60) days after delivery of written notice to Landlord of such termination or cancellation) and shall be drawn on Bank of America, GE Capital, or another comparable commercial lender reasonably acceptable to Landlord. Each Letter of Credit shall have a term of twelve (12) months and shall be replaced or renewed by Tenant annually effective as of each anniversary of the Commencement Date for consecutive twelve (12) month terms as set forth below. Landlord shall have the right to obtain written assurances from the issuer(s) at any time that any of such Letters of Credit are still valid and enforceable. Upon the occurrence of an Event of Default, including without limitation any default by Tenant in the payment of Base Rent and Additional Rent beyond applicable cure periods under this Lease, or if Landlord has not received replacement Letters of Credit or written confirmation of renewal of any expiring Letter of Credit at least thirty (30) days prior to its expiration, Landlord may, without waiver of any other rights or remedies Landlord may have under this Lease or at law or in equity, draw upon each or all of the Letters of Credit in whole or in part, and hold same as a cash Security Deposit (if drawn on for failure to replace or renew) or (if drawn on by reason of the occurrence of an Event of Default) apply the proceeds thereof to the payment of any Base Rent and Additional Rent or any other sums owed to Landlord by reason of the occurrence of such Event of Default or for any such sums which Landlord may expend or may be required to expend by reason of such Event of Default, including, but not limited to, unamortized Tenant Improvement costs, unamortized leasing commissions, and any damages or deficiency in the reletting of the Premises, whether such damages or deficiency accrue before or after summary proceedings or other re-entry by Landlord, and Landlord may hold the cash balance as a cash Security Deposit, provided that at such time as Tenant shall have cured all such Event(s) of Default and shall have replaced and/or restored the subject Letter(s) of Credit to their then required full amount(s), and provided further that Landlord shall not have exercised its right to terminate this Lease as a result of such Event of Default, Landlord shall return all cash previously drawn by Landlord less all amounts properly applied by Landlord to any amounts hereunder and Landlord shall thereafter continue to hold the Letter(s) of Credit in accordance with the terms of this Article 7.

The terms of the Letters of Credit shall be as follows:

(i) One Letter of Credit shall be for the amount of Three Million Five Hundred Thousand and 00/100 Dollars (\$3,500,000.00). Such Letter of Credit shall be delivered by Tenant to Landlord at or before the Commencement Date and have a term of twelve (12) months and shall be replaced or renewed by Tenant annually at least thirty (30) days prior to expiration (i.e., at least thirty (30) days prior to each anniversary of the Commencement Date) throughout the first seven (7) years of the Lease Term as provided herein, in each instance for a consecutive term of twelve (12) months. At each annual replacement or renewal during the first seven (7) years of the Lease Term, provided the issuer has received written authorization from Landlord as set forth below, the face amount of the renewal or replacement Letter of Credit available for drawing by Landlord shall be reduced, by the amount of Five Hundred Thousand Dollars (\$500,000.00) until the final replacement or renewal Letter of Credit shall expire and Tenant shall have no further obligation to renew or replace the Letter of Credit; provided, however, that if as of any anniversary of the Commencement Date, Landlord shall have drawn upon the Letter of Credit as a result of an Event of Default under this Lease, or if there shall be outstanding any of the matters set forth in Section 3.3.2 above, then Tenant shall restore or replace the Letter of Credit as of such anniversary of the Commencement Date to the full amount of the prior Letter of Credit in effect immediately prior to such Event of Default or the commencement of such matter under Section 3.3.2, as applicable (i.e., without regard to such scheduled reduction), and such replacement Letter of Credit shall not reduce again until the next succeeding anniversary of the Commencement Date and then shall reduce only if Landlord has not exercised its right to terminate this Lease as a result of such Event of Default and if such matter under Section 3.3.2 is not still outstanding. At least forty-five (45) days prior to each annual anniversary of the Commencement Date, Tenant shall send to Landlord a written notice certifying to Landlord (in the same manner as set forth in Section 28.1 below) that there is no outstanding Event of Default by Tenant under this Lease and that there are no matters outstanding under Section 3.3.2 of this Lease, and requesting that Landlord therefor authorize the reduction of this Letter of Credit; and unless Landlord disagrees with Tenant's notice, Landlord shall authorize the issuer of the Letter of Credit to so reduce the same. If Landlord disputes Tenant's

certification, Landlord shall promptly notify Tenant in writing, which writing shall set forth in reasonable detail the basis of Landlord's dispute.

(ii) The second Letter of Credit shall be in the amount of One Million Five Hundred Thousand and 00/100 Dollars (\$1,500,000.00). Such Letter of Credit shall be delivered by Tenant to Landlord at or before the Commencement Date and have a term of twelve (12) months and shall be replaced or renewed by Tenant annually at least thirty (30) days prior to expiration (i.e., at least thirty (30) days prior to each anniversary of the Commencement Date) for a period through and including ninety (90) days beyond the initial Lease Term, in each instance for a consecutive term of twelve (12) months.

7.3 Uses and Disposition of Letters of Credit: If Landlord shall draw upon the whole or any part of the Letters of Credit as provided in Section 7.2, Tenant shall upon demand immediately cause the Letters of Credit to be fully restored to their original amounts (or, if drawn in full, deliver to Landlord replacement Letters of Credit), and upon such restoration or replacement, provided all Events of Default have been cured and Landlord has not exercised its right to terminate this Lease as a result of such Event of Default, Landlord shall immediately return to Tenant all Letter of Credit proceeds previously drawn by Landlord and not

applied by Landlord in accordance with Section 7.2. In the event of any sale of Landlord's interest in the Buildings or any master lease of the Buildings by Landlord to a third party, whether or not in connection with a sale or leasing of the Land, Landlord shall either transfer the Letters of Credit to the vendee or master lessee, or the vendee or master lessee shall assume Landlord's obligations under this Lease in respect of the Letters of Credit, and upon written request by Landlord or such vendee or master lessee, Tenant shall cause the issuer of the Letters of Credit to certify or reissue such Letters of Credit to the vendee or master lessee. Notice to Tenant of any such transfer shall not be a condition to the validity of such transfer, but Landlord agrees to notify Tenant of any such transfer. Upon transfer of the Letters of Credit to the vendee or master lessee, and provided Landlord also transfers to such vendee or master lessee all proceeds from any Letter(s) of Credit held at that time by Landlord which have not been applied by Landlord to an Event of Default, Landlord shall thereupon be released by Tenant from all liability for the return or payment thereof; and if the vendee or master lessee expressly assumes Landlord's obligations in respect of the Letters of Credit, Tenant shall look solely to the new landlord for the return or payment of the same. Further, the provisions hereof shall apply to every transfer or assignment made of the same to a new landlord. Tenant shall not assign or encumber or attempt to assign or encumber the Letters of Credit and neither Landlord nor its successors or assigns shall be bound by any such assignment, encumbrance, attempted assignment or attempted encumbrance.

ARTICLE 8. SUBORDINATION, NOTICE TO SUPERIOR LESSORS AND MORTGAGEES:

8.1 SUBORDINATION: Any lease to which this Lease is, at the time referred to, subject and subordinate is herein called "Superior Lease" and the lessor of a Superior Lease or its successor in interest, at the time referred to, is herein called "Superior Lessor," and any mortgage to which this Lease is, at the time referred to, subject and subordinate is herein called "Superior Mortgage" and the holder of a Superior Mortgage, or its successor in interest, at the time referred to, is herein called "Superior Mortgagee." This Lease, and all rights of Tenant hereunder, are and shall be subject and subordinate to any ground leases covering the Land and/or the Project now or hereafter existing, and to all mortgages which may now or hereafter affect the Land and/or the Project and/or any of such leases, whether or not such mortgages shall also cover other lands and/or buildings and/or leases, to each and every advance made or hereafter to be made under such mortgages, and to all renewals, modifications, replacements and extensions of such leases and such mortgages, subject however to Tenant's rights under Section 8.3 below. In confirmation of such subordination, Tenant shall execute, acknowledge or deliver any instrument that Landlord, any Superior Lessor or any Superior Mortgagee may reasonably request to evidence such subordination within fifteen (15) days after written demand from Landlord, provided that such subordination further confirms the attornment and nondisturbance protections set forth in Section 8.3 below.

8.2 NOTICE: If any act or omission of Landlord would give Tenant the right, immediately or after lapse of a period of time, to cancel or terminate this Lease, or to claim a partial or total eviction, Tenant shall not exercise such right: (i) until it has given written notice of such act or omission to Landlord and each Superior Mortgagee and each Superior Lessor whose name and address shall previously have been furnished to Tenant; and (ii) until a reasonable period of time for such parties to cure the condition has passed.

8.3 NONDISTURBANCE AND ATTORNMENT: For the purposes of this Section, the term "Successor Landlord" shall mean the Superior Lessor or Superior Mortgagee if the same succeeds to the rights of Landlord under this Lease, whether through possession or foreclosure action or delivery of a new lease or deed, or any third party that succeeds to the rights of Landlord under this Lease by virtue of having purchased the Land, one or more of the Buildings, or the Park Common Areas at a foreclosure sale. So long as Tenant is not in default of this Lease beyond any notice and/or cure period at the time of succession, the Successor Landlord shall accept Tenant's attornment and shall not disturb Tenant's quiet possession of the Premises in accordance with the terms of this Lease. Tenant shall attorn to and recognize such Successor Landlord as Tenant's Landlord under this Lease and shall promptly execute and deliver any instrument that such Successor Landlord may reasonably request to evidence such attornment provided such instrument also evidences the non-disturbance protection for Tenant described in this Section 8.3.

8.4 MODIFICATIONS FOR SUPERIOR MORTGAGEE: If any Superior Mortgagee shall require any modification(s) of this Lease, Tenant upon ten (10) days prior written notice of Landlord's request, shall execute and deliver to Landlord such instruments effecting such modification(s) as Landlord shall require, provided that such modification(s) do not increase any of Tenant's obligations or diminish any of Tenant's rights under this Lease and Landlord pays Tenant's reasonable out-of-pocket attorneys' fees and costs in connection with such request and evaluation of such modifications.

ARTICLE 9. QUIET ENJOYMENT:

So long as Tenant pays all of the Base Rent and Additional Rent and performs all of Tenant's other obligations hereunder, Tenant shall peaceably and quietly have, hold and enjoy the Premises and its nonexclusive rights in the Park Common Areas without hindrance, ejection or molestation by Landlord or any person lawfully claiming through or under Landlord, subject nevertheless, to the provisions of this Lease.

ARTICLE 10. ASSIGNMENT AND SUBLETTING:

10.1 GENERALLY: Except as set forth in Section 10.3 below, Tenant shall not sell, assign, sublet, or otherwise transfer by operation of law or otherwise this Lease or any interest herein, or the Premises, its rights in the Park Common Areas, or any portion of any of them, without the prior written consent of Landlord (which Landlord shall not unreasonably withhold, condition or delay), nor shall Tenant encumber any of the same, nor

shall Tenant permit any lien to be placed on the Tenant's interest by operation of law or otherwise. Notwithstanding the foregoing, Landlord agrees not to unreasonably withhold or delay its consent to any personal property financing by Tenant at the Premises and agrees to confirm any granted consent in writing, upon written request therefor, so long as (i) such consent is on Landlord's standard form or includes Landlord's required protections, (ii) in no event shall Landlord be required to amend or modify this Lease or waive any of Landlord's rights under this Lease other than subordinating lien rights with respect to personal property collateral, and (iii) the provisions of Section 31.14.3 shall apply to any such consent. Any change in effective control of a corporation, partnership, limited liability company, or other entity which is Tenant shall be deemed a transfer of this Lease except as permitted in Section 10.3 below. Regardless of Landlord's consent, no transfer hereunder by Tenant shall release or discharge Tenant from its obligations or liability under this Lease. This Lease shall bind any assignee, transferee or sublessee. Any sale, assignment, encumbrance, subletting, occupation, lien or other transfer of this Lease which does not comply with the provisions of this Article 10 shall be void. Consent to one transfer, assignment or sublease shall not be deemed consent to a subsequent transfer, assignment or sublease. Any listing on Building directories or other signage using a name other than Tenant's in conjunction with the Premises will not be deemed and it will not substitute for, Landlord's consent, as required by this Lease, to any sublease, assignment or other occupancy of the Premises or any portion thereof.

10.1.1 Tenant shall, by written notice, advise Landlord of its desire from and after a stated date (which shall not be less than thirty (30) days after the date of Tenant's notice), to transfer its interest in the Premises or any portion thereof for any part of the term hereof; and such notice by Tenant shall state the name and address and business of the proposed transferee, include a true, complete counterpart of the proposed transfer instrument with said notice, financial statements of the proposed transferee, the intended use of the Premises and such other information as the Landlord may reasonably request.

10.1.2 Upon any request by Tenant to transfer all or any part of the Premises, Landlord shall have the right to either: (i) permit the transfer on the conditions referred to in Section 10.2 and any other reasonable conditions Landlord may impose; (ii) reasonably deny Tenant's request, in which event this Lease shall continue in full force and effect and unmodified; or (iii) for an assignment of this Lease or subletting of the Premises or any Building in its entirety for the remainder of the Term only, terminate this Lease with respect to the entire Premises or such Building within thirty (30) days unless Tenant withdraws its proposed transfer within ten (10) days after the date of Landlord's written notice of its intent to terminate. If Tenant fails to timely withdraw its proposed transfer, Landlord may then terminate this Lease with respect to the entire Premises or the portion of the Premises described in Tenant's notice and if Landlord desires, Landlord may then lease such space to any party, including the transferee identified in Tenant's notice, at whatever terms Landlord establishes. Any such termination with respect to less than all of the Premises shall result in a reduction in Rent equal to the percentage of the Premises as to which the Lease is terminated. With respect to option (iii) of this section only, Tenant shall have the right to offer the Premises (or any portion thereof) to Landlord prior to seeking a specific transfer, and if Landlord fails to exercise its rights under such option, then provided Tenant engages a broker to seek a transferee within 30 days after Landlord's rejection (or deemed rejection) of such offer and completes such transfer with a transferee consented to by Landlord pursuant to this Article 10 within 12 months after Landlord's rejection (or deemed rejection) of such offer, Landlord shall not have the right to option (iii) for any subsequent transfer of such portion of the Premises so offered.

10.2 CONDITIONS OF LANDLORD'S CONSENT: As a condition to Landlord's prior written consent as provided for in this Article 10, (i) Tenant shall pay to Landlord a nonrefundable review fee of \$500.00 plus Landlord's reasonable legal fees and costs incurred due to the request to transfer; (ii) the transferee(s) shall agree in writing to comply with and be bound by all of the terms, covenants, conditions, provisions and agreements of this Lease; and (iii) Tenant shall deliver to Landlord, promptly after execution, an executed original of each transfer instrument and an agreement of said compliance by each transferee. Tenant agrees, by way of example and without limitation, that it shall not be unreasonable for Landlord to withhold its consent to a proposed assignment or subletting if (a) Landlord determines in Landlord's reasonable discretion that the proposed assignee's or sublessee's use of the Premises conflicts with Article 3 or conflicts with any other provision under this Lease; (b) Landlord determines in Landlord's reasonable discretion that the proposed assignment or subletting would breach a covenant, condition or restriction in any encumbrance, financing agreement or other agreement relating to the Project or this Lease; (c) if the proposed assignee or sublessee proposes to use Hazardous Materials, the proposed assignee or sublessee has not been required by any prior landlord, lender or governmental authority to take remedial action in connection with Hazardous Materials contaminating a property arising out of the proposed assignee's or sublessee's actions or use of the property in question constituting a facility or for a use comparable to the Premises; or (d) an Event

of Default under Article 21 has occurred and Tenant does not provide Landlord with reasonable assurances that the Event of Default will be cured as part of the assignment or subletting. Tenant acknowledges that if Tenant has any exterior sign rights under this Lease, such rights are personal to Tenant and may not be transferred to any sublessee of all or any portion of the Premises without Landlord's prior written consent, which consent may be withheld in Landlord's sole and absolute discretion. Landlord may further require as a condition of granting consent to a transfer that Tenant pay to Landlord 50% of profits from the transfer determined by deducting from the total consideration paid directly or indirectly to or for the benefit of Tenant or its designee for the transferred interest, the reasonable costs of the transfer incurred by the Tenant and subtracting the remaining rent obligation of the Tenant at such time under this Lease. For purposes of determining all profits from the transfer, substance shall control over form such that Landlord may ignore any attempt by Tenant to inflate the purchase price of any other assets transferred in an attempt to conceal the profit on the transfer of the Tenant's interest in this Lease. Sums payable hereunder shall be paid to Landlord as and when paid by the transferee to Tenant.

10.3 PERMITTED TRANSFERS: Notwithstanding the foregoing provisions of this Article 10, Landlord's consent shall not be required for (a) the subleasing of all or any portion of the Premises to an entity owned and controlled by Tenant or which owns or controls Tenant, so long as (i) Tenant shall provide to Landlord, prior to such sublease, written notice of such sublease and such sublease documentation and other information as Landlord may request in connection therewith, and (ii) all of the other terms and requirements of this Article 10 (other than the sharing of profits) shall apply with respect to such sublease, or (b) the assignment or effective transfer of this Lease as a result of a sale of a controlling interest in the stock of Tenant, a sale of substantially all of the assets of Tenant, or a merger by Tenant with or into another entity, including without limitation a reorganization pursuant to Delaware Corporations Code Section 251(g), so long as (i) the financial statements of the successor entity of such sale or merger immediately following the sale or merger is at least equal to the amounts set forth in Exhibit J attached hereto and incorporated herein, evidence of which, satisfactory to Landlord, shall be presented to Landlord prior to such merger, (ii) Tenant shall provide to Landlord, prior to such sale or merger, written notice of such sale or merger and such assignment documentation and other information as Landlord may reasonably request in connection therewith, and (iii) all of the other terms and requirements of this Article 10 (other than the sharing of profits) shall apply with respect to such assignment.

ARTICLE 11. INSURANCE:

11.1 PUBLIC LIABILITY INSURANCE: Tenant at its expense, shall maintain at all times during the term of this Lease, commercial public liability insurance, contractual liability insurance and property damage liability insurance in respect of the Premises and the conduct or operation of business therein, with Landlord, its asset manager and property manager, if any, and any Superior Lessor or Superior Mortgagee whose name and address shall previously have been furnished to Tenant by written notice, as additional insureds, with Five Million and No/100 Dollars (\$5,000,000.00) minimum combined single limit coverage, or its equivalent. Tenant shall have the right to satisfy such minimum insurance coverage requirements through umbrella or excess coverage policies. The limits of such insurance shall not limit the liability of Tenant. All such insurance shall insure the performance by Tenant of the indemnity provisions of Article 18 as to liability for injury to, illness of, or death of persons and damage to property. In addition, all such insurance shall be primary and shall provide that any insurance of Landlord shall be noncontributing, except with respect to sole active negligence, gross negligence or willful misconduct of Landlord, or Landlord's property manager. For insurance required to be maintained by Tenant pursuant to Sections 11.1 and 11.2, Tenant shall deliver to Landlord and any additional insured ACORD Form 27 evidence of insurance, or any other form reasonably requested by Landlord, issued by the insurance company or its authorized agent, at least ten (10) days before Tenant commences occupancy of any portion of the Premises. Tenant shall procure and pay for renewals of such insurance from time to time before the expiration thereof, and Tenant shall deliver to Landlord and any additional insured such renewal certificate at least thirty (30) days before the expiration of any existing policy. For insurance required to be maintained by Tenant pursuant to Sections 11.1 and 11.2, all such policies shall provide that they shall not be amended in any way that would effect the interests of Landlord or any such additional insureds, or cancelled, without at least thirty (30) days prior written notice to Landlord and such additional insureds.

11.2 PROPERTY INSURANCE: Landlord shall maintain fire and extended coverage insurance on the Project, including without limitation all Tenant Improvements constructed in accordance with Exhibit D, subject to such reasonable deductibles as Landlord may establish, but which shall not exceed \$25,000 per occurrence per policy year so long as the same is commercially reasonably available. Landlord shall have the right to place on all or any portion of the Project any other insurance Landlord deems necessary, including without limitation earthquake, flood, and loss of rent insurance not exceeding two (2) years. Tenant shall obtain and bear the expense of casualty insurance insuring (i) the property of Tenant on the Premises, and (ii) any Alterations constructed by Tenant under Article 13 below, against such risks. As Additional Rent for the Premises covered under Operating Expenses, Tenant shall reimburse Landlord for the cost of all insurance maintained by Landlord with respect to the Project as set forth in Section 5.1.1.

11.3 ACCEPTABLE INSURANCE COMPANIES: All insurance policies required to be carried by Tenant hereunder shall be issued by responsible insurance companies authorized to issue insurance in the State of California rated A-X or higher by Best's Insurance Rating Service.

11.4 INCREASE IN COVERAGE: Landlord may from time to time, but not more frequently than once every five (5) years, require that the amount of commercial public liability insurance to be maintained by Tenant under Section 11.1 be increased so that the amount thereof adequately protects the Landlord's interest based on amounts of coverage required of comparable tenants in comparable buildings.

11.5 WAIVER OF SUBROGATION: The insurance coverage required by this Article 11 shall contain a clause pursuant to which the insurance carriers waive all rights of subrogation against Landlord or Tenant, as the case may be, with respect to losses payable under such policies. Tenant and Landlord each waives any and all right of recovery against the other, or against the officers, directors, shareholders, employees, agents and representatives of the other, for loss of or damage to property or the property of others under its control, if and to the extent that such loss or damage is insured against under any insurance policy in force at the time of such loss or damage, or which is to be insured against under the terms of this Lease. Any applicable deductible amount or self-insured amount shall be treated as though it were recoverable under such policies. The provisions of this Section shall not limit the indemnification provisions elsewhere contained in this Lease.

ARTICLE 12. RULES AND REGULATIONS:

Tenant shall faithfully observe and comply and shall cause all Tenant Parties to faithfully observe and comply with the rules and regulations printed on or annexed to this Lease as Exhibit F and all reasonable and

non-discriminatory modifications thereof and additions thereto from time to time established by Landlord by written notice to Tenant.

ARTICLE 13. ALTERATIONS:

13.1 REQUIREMENTS: Tenant shall not make or suffer to be made any alterations, additions, or improvements ("Alterations") in, on, or to the Project or any part thereof without the prior written consent of Landlord. Subject to the remaining provisions of this Article 13, Tenant shall have the right, without the need of written consent from (but with prior written notice to) Landlord, to make Alterations provided (i) the Alterations are nonstructural, do not impair the strength of any Building or any part thereof and are not visible from the exterior of the Premises; (ii) the Alterations do not affect the proper functioning of the HVAC System, mechanical, electrical, sanitary or other utilities, systems and services of any Building; (iii) materials used are consistent with the existing materials in the Premises and comply with Building standards as established by Landlord, and do not include any Hazardous Materials; and (iv) the cost of any such individual Alteration does not exceed \$25,000.00.

Whether or not Landlord's consent is required for any Alterations, (i) Tenant shall provide to Landlord final plans and specifications for the Alterations and (with respect to Alterations for which Landlord has the right of consent) Landlord shall have approved in writing such plans and specifications and all contractors who will perform the Alterations (and, to the extent that such contractors are licensed and bondable, such consent shall not be unreasonably withheld); (ii) Tenant pays to Landlord a fee for Landlord's indirect costs, field supervision or coordination in connection with the Alterations equal to a reasonable hourly fee for the time spent on such matters; and (iii) for Alterations requiring Landlord's consent only and for which Landlord reasonably determines that the cost to repair and restore the Premises (1) with respect to removal of such Alteration alone will exceed \$500,000.00, or (2) with respect to removal of such Alteration together with costs for removal of all prior Alterations made by Tenant will exceed \$500,000.00 in the aggregate, then, if requested by Landlord, Tenant shall provide for added security (including without limitation providing an additional Letter of Credit or depositing with Landlord cash security) as Landlord may reasonably require for any obligations of Tenant to remove such Alterations and repair any damage and accomplish any restoration caused thereby at the expiration or earlier termination of the Lease Term. Unless all of the foregoing conditions are satisfied, Tenant shall not have the right to make such Alterations, and Landlord shall have the right to withhold its consent to the Alterations in Landlord's sole and absolute discretion.

13.2 REMOVAL AND RESTORATION: After the expiration or sooner termination of the Lease Term and upon demand by Landlord, Tenant shall remove any or all Alterations made by or for the account of Tenant, and Tenant shall repair and restore the Premises to their original condition, subject to ordinary wear and tear. Such removal, repair and restoration work shall be done promptly and with all due diligence at Tenant's sole cost and expense. The provisions of this Article 13 shall not apply to the initial Tenant Improvements described in this Lease, unless such improvements have been designated by Landlord to be removed in Exhibit D attached to this Lease.

13.3 COMPLIANCE: All Alterations shall comply with applicable laws in effect at the time they are made, the other terms of this Lease, and plans and specifications approved by Landlord. Landlord shall have no duty to Tenant with respect to the safety, adequacy, construction, efficiency or compliance with laws, with regard to the design of the Alterations, the plans or specifications therefore, or any other matter related to the Alterations, nor shall the approval by Landlord of any such Alterations be deemed to be a representation as to the safety, adequacy, construction, efficiency or compliance of said Alterations.

13.4 NO LIENS: Except to the extent of any initial Tenant Improvements described in Exhibit D which are to be performed by or on behalf of Landlord, Tenant, at its expense, and with diligence and dispatch, shall procure the cancellation or discharge of all notices of violation arising from or otherwise connected with Alterations, or any other work, labor, services, equipment, or materials done for or supplied to Tenant, or any other person claiming through or under Tenant, which shall be issued by any public authority having or asserting jurisdiction. Tenant shall notify Landlord of, and shall defend, indemnify and save harmless Landlord and any Superior Lessor or Superior Mortgagee from and against any and all construction and other liens and encumbrances filed in connection with Alterations, or any other work, labor, services or materials done for or supplied to Tenant, or any person claiming through or under Tenant, including, without limitation, security interests in any materials, fixtures, equipment, or articles so installed in and constituting part of the Premises and against all costs, expenses and liabilities incurred in connection with any such lien or encumbrance or any action or proceeding brought thereon. Tenant, at its expense, shall procure the satisfaction or discharge of record of all such liens and encumbrances within thirty (30) days after the filing thereof. Nothing herein contained shall prevent Tenant from contesting,

in good faith and at its own expense, any notice of violation, or lien provided Tenant posts for the protection of Landlord security acceptable to Landlord.

ARTICLE 14. LANDLORD'S AND TENANT'S PROPERTY:

14.1 LANDLORD'S PROPERTY: All fixtures and equipment (other than those described in 14.2 below), carpeting, improvements and appurtenances attached to or built into the Premises at the commencement of or during the Lease Term, whether or not by or at the expense of Tenant, shall upon the expiration or earlier termination of the Lease be and remain a part of the Premises, shall be deemed the property of Landlord and shall not be removed by Tenant, except as provided in Section 13.2 and 14.2 of this Lease or in Exhibit D; provided, that at Landlord's written request, Tenant shall, at its sole expense and upon the expiration or earlier termination of the Lease, remove those items specified by Landlord in writing during the Lease Term, including any or all fixtures, equipment, improvements, appurtenances and other personal property, which are deemed

herein the property of Landlord, but not including the initial Tenant Improvements provided by Landlord pursuant to Exhibit D of this Lease except as may be otherwise expressly set forth in Exhibit D. Tenant's covenant to remove property specified by Landlord shall survive the expiration or earlier termination of this Lease.

14.2 TENANT'S PROPERTY: All business and trade fixtures, machinery and equipment, computer and communications equipment and office equipment which are installed in the Premises or other portions of the Project by or for the account of Tenant without expense to Landlord and which can be removed without structural damage to the Buildings and all furniture, furnishings (excluding window coverings) and other articles of movable personal property owned by Tenant and located in the Premises (herein collectively called "Tenant's Property") shall be and remain the property of Tenant and may be removed by Tenant at any time during the term of this Lease; provided, that if any of Tenant's Property is removed, Tenant shall repair or pay the cost of repairing any damage to the Premises or any other portion of the Project resulting from the installation and/or removal thereof. Any equipment or other property for which Landlord shall have granted any allowance, credit or other type of accommodation to Tenant shall be deemed not to have been installed by or for the account of Tenant without expense to Landlord, shall not be considered Tenant's Property, and shall be deemed the property of Landlord. Tenant shall also remove prior to the expiration or earliest termination of the Lease Term, at Tenant's sole cost and expense, all telephone, computer and other electronic wiring and cabling installed for the benefit of Tenant within the Premises and within the common ducts and shafts of the Building. Tenant shall use all necessary care in removing such wires and cables in order to avoid any damage to or any disruption of services and Tenant agrees to be solely liable for any such damage or disruption of service caused by its removal. If Tenant fails to remove such wiring and cabling prior to the expiration or earlier termination of the Lease Term, Landlord may remove such wires and cables and Tenant shall pay the cost of such removal within ten (10) days after delivery of a bill thereof.

14.3 ABANDONMENT: Any items of Tenant's Property may be deemed, at the option of Landlord, to have been abandoned if left in the Premises or at the Project after the Abandonment Deadline, and in such case such items may be retained by Landlord, without accountability, in such a commercially reasonable manner as Landlord shall determine at Tenant's expense. The "Abandonment Deadline" means the earlier of the expiration date of this Lease and delivery to Tenant of written notice that such property remains at the Premises, or five (5) days following an earlier termination date and delivery to Tenant of written notice that such property remains at the Premises, or three (3) business days following entry of an order of possession for restoration of the Premises to Landlord; subject however, to the provisions and requirements of any applicable California laws relating to abandoned property in a leasehold.

ARTICLE 15. SERVICES AND UTILITIES:

15.1 UTILITIES: Tenant shall be responsible for and shall directly contract with and pay promptly directly to the appropriate supplier, all charges for gas, electricity, heat, light, power, telephone, refuse pickup, janitorial service, interior landscape maintenance and all other utilities, materials and services furnished directly to Tenant or the Premises or used by Tenant in, or about the Premises during the Lease Term, together with any taxes thereon. Landlord shall contract for water service to the Project and bill the cost thereof to Tenant as part of Operating Expenses. Tenant also agrees at all times to cooperate fully with Landlord and to abide by all the non-discriminatory regulations and requirements which Landlord may prescribe for the proper functioning and protection of the HVAC System. Any sums payable under this Article 15 shall be considered Additional Rent and may be added to any installment of Base Rent thereafter becoming due, and Landlord shall have the same remedies for a default in payment of such sum as for a default in the payment of Base Rent.

15.2 [INTENTIONALLY DELETED]

15.3 DISCLAIMER: Landlord shall not be in default hereunder or be liable for any damages directly or indirectly resulting from, or by reason of (i) the installation, use or interruption of use of any equipment in connection with the furnishing of the foregoing utilities and services, (ii) failure to furnish or delay in furnishing any such utilities or services when such failure or delay is caused by acts of God or the elements, labor disturbances of any character, any other accidents or other condition beyond the reasonable control of Landlord, or by the making of regular maintenance repairs or improvements to the Premises, or (iii) the limitation, curtailment, rationing or restriction on use of water or electricity, gas or any other form of energy or any other service or utility whatsoever serving the Premises or the Project. Nothing contained hereunder shall abrogate Landlord's obligations under Section 4.2 above. Notwithstanding the foregoing, if any failure or interruption of electrical service to any Building is due to the sole active negligence, gross negligence or willful misconduct of Landlord or its property manager or any of their employees, and such failure or interruption prevents Tenant from carrying on its business within such Building for a period of more than two (2) consecutive business days

following written notice to Landlord, then Tenant's Base Rent shall thereafter be abated in the proportion that and in the degree to which Tenant's use of such Building area is prevented, provided however, that to the extent that Tenant's business interruption insurance, if any, would cover such obligations, Tenant shall either cause such proceeds to be paid to Landlord or this abatement provision shall not apply, and provided further, that if Landlord is diligently pursuing the repair necessary to reinstate such service and Landlord provides substitute electrical service reasonably suitable for Tenant's purposes, then this abatement provision also shall not apply. Furthermore, Landlord shall be entitled to cooperate voluntarily in a reasonable manner with the efforts of national, state or local governmental agencies or utilities suppliers in reducing energy or other resource consumption. Tenant hereby further acknowledges that Landlord shall have no obligation whatsoever to provide guard service or other security measures for the benefit of the Premises or

the Project. Tenant waives and releases all claims of responsibility by Landlord for the protection of Tenant, all Tenant Parties and the property of Tenant and of all Tenant Parties from acts of third parties.

15.4 USE OF PARK COMMON AREAS AND FACILITIES: Landlord shall have the right to temporarily close from time to time all or any portion of the Park Common Areas to such extent as, in the reasonable opinion of Landlord's legal counsel, may be legally sufficient to prevent a dedication thereof or the accrual of any rights to any person (other than Tenant) or the public therein; provided at all times Tenant shall be provided with reasonable access to the Premises, the Buildings and Tenant's parking to be provided herein. If the amount of such Park Common Areas is diminished, Landlord shall not be subject to any liability nor shall Tenant be entitled to any compensation or diminution or abatement of Rent, nor shall such diminution of such Park Common Areas be deemed constructive or actual eviction.

15.5 PARKING FACILITIES: Tenant shall have the right throughout the Lease Term to use all parking spaces located within the Project, on a non-exclusive basis with other occupants, if any, of the Project, subject to the Rules and Regulations attached hereto as Exhibit F and any amendments thereto from time to time in accordance with said Exhibit F. All parking spaces shall be used only for parking by vehicles no larger than full size passenger automobiles, vans, sport utility vehicles or pick-up trucks. No parking shall be permitted in any driveways, accessways or in any area which would prohibit or impede the free flow of traffic within the Park Common Areas. Tenant shall have the right to mark parking spaces as reserved for Tenant's customers or employees. Subject to the other provisions and requirements of this Lease, washing, waxing and cleaning of the automobiles of Tenant's employees shall be permitted in the paved parking areas. Servicing of vehicles is prohibited in the Park Common Areas.

15.6 SIGNAGE: Tenant shall not install or keep any signs in, on or about the Project or Premises, which are visible from any public areas, without the prior written consent of Landlord which Landlord shall not unreasonably withhold. Any such sign request shall be made in accordance with the application process in place at the time of the request, and all such signs shall be in compliance with Landlord's signage program for the Project set forth in Exhibit H attached hereto and incorporated herein by this reference (the "Signage Program"), any covenants and restrictions encumbering the Project, and all conditions and requirements of the City. Notwithstanding the foregoing, Landlord hereby grants Tenant the exclusive right to install and maintain its business identification signage ("Signage") in an area approved by Landlord, at Tenant's expense, in accordance with Landlord's Signage Program, all covenants and restrictions encumbering the Project, and all requirements of the City, and subject to Landlord's written approval which shall not be unreasonably withheld. Tenant shall submit to Landlord all plans and specifications for the installation of the Signage. Tenant covenants and agrees to indemnify, defend and hold harmless Landlord against any loss, cost or expense (including reasonable attorney fees) which may be sustained or incurred by it, and assume all liability for any property damage or bodily injuries in any manner related to Tenant's installation, maintenance, operation or removal of the Signage. Tenant agrees to pay all taxes, permit fees, insurance premiums, and repairs to the area where the Signage has been installed resulting from the installation of the Signage. If any sign is placed on or about the Premises or Project without the consent of Landlord, Landlord may remove any such signs and Tenant shall pay Landlord the cost of removal together with interest as set forth in Section 22.3 from date of expenditure until payment is made in full. Tenant shall pay promptly after Landlord invoices Tenant for such costs. Tenant shall pay all costs of permitted signs (including the Signage) and all costs and expenses of installation and maintenance of such signs. Tenant shall repair any damage which alteration, renovation or removal of its signs may cause during the Lease Term. Tenant, at its expense, shall remove its signs (including the Signage) from the Premises or Project at the termination or expiration of this Lease and repair any damage and restore the Premises or Project to the same condition as existed prior to the installation of such signs, reasonable wear and tear excepted.

ARTICLE 16. ACCESS:

Landlord reserves, and shall at all times have, the right to re-enter the Premises (other than Tenant's Secured Areas as designated in writing by Tenant to Landlord unless accompanied by a representative of Tenant), upon 72 hours' prior notice to Tenant (except for regularly scheduled maintenance personnel, in an emergency, and following an Event of Default, in which cases, no notice shall be necessary) to inspect the same, to perform any service or repair obligation to be provided by Landlord to Tenant under this Lease, to show the Premises to prospective purchasers, mortgagees or tenants (provided, Landlord shall only show the Premises to prospective tenants during the last one hundred eighty (180) days of the Lease Term), to post notices of non-responsibility, and to alter, improve or repair the Premises and any other portion of the Project, without abatement of Rent. For such purpose, Landlord may erect, use and maintain scaffolding, pipes, conduits and other necessary structures in and through the Premises and the Project where reasonably required by the character of the work to be performed, provided that such work is

performed in compliance with all health and safety requirements, the entrance to the Premises shall not be blocked thereby, and further provided that the business of Tenant shall not be interfered with unreasonably. Tenant hereby waives any claim for damages for any injury or inconvenience to or interference with Tenant's business, any loss of occupancy or quiet enjoyment of the Premises and any other loss occasioned by Landlord's conduct pursuant to and in compliance with this Section. Landlord shall have the right to use all reasonable means under the circumstances to open all doors in an emergency, in order to obtain entry to any portion of the Premises, and any entry to any portion of the Premises obtained by Landlord by any such means, or otherwise shall not under any circumstances be construed or deemed to be forcible or unlawful entry into, or a detainer of, the Premises, or an eviction, actual or constructive, of Tenant from all or part of the Premises. Landlord shall have the right to change the name, number or designation by which any Building is commonly known provided Tenant is given written notice of such change. Nothing in this Article 16 shall be deemed to relieve Landlord from any liability for the willful misconduct of Landlord or its employees. Tenant may designate certain areas of the Premises as

"Secured Areas" should Tenant require such areas for the purpose of securing certain valuable property or confidential information. Landlord may not enter such Secured Areas except in the case of emergency or in the event of a Landlord inspection.

ARTICLE 17. NOTICE OF OCCURRENCES:

Tenant shall give prompt notice to Landlord of: (i) any known occurrence in or about the Project for which Landlord might be held liable; (ii) any known fire or other casualty in the Project; (iii) any known damage to or defect in the Project, the repair of which Landlord might be responsible; and (iv) known damage to or defect in any part or appurtenances of the sanitary, electrical, heating, ventilating, air-conditioning, elevator or other systems located in or passing through the Project or any part thereof.

ARTICLE 18. NONLIABILITY AND INDEMNIFICATION:

18.1 WAIVER: Neither Landlord nor any Landlord Parties shall be liable to Tenant for any loss, injury or damage to Tenant or to any other person, or to its or their property, irrespective of the cause of such injury, damage or loss except for Landlord to the extent caused by or resulting from the sole gross active negligence, intentional torts or willful misconduct of Landlord and Landlord's employees, it being the intent of the parties that it be Tenant's obligation to carry and look to its own insurance policies for coverage of any such item resulting from an accident even if caused by the passive, simple or comparative negligence of Landlord or any Landlord Parties. Further, neither Landlord nor any Landlord Parties shall be liable: (i) for any such injury, damage or loss in, upon or about the Project, or caused by operations in construction of any private, public or quasi-public work; or (ii) in any event for consequential damages, including lost profits, of Tenant or any person claiming through or under Tenant or any Tenant Parties.

18.2 INDEMNIFICATION: Tenant shall defend, indemnify and hold harmless Landlord and all Landlord Parties, Superior Lessors and/or Superior Mortgagees for, from and against any and all (i) third party claims for bodily injury and/or property damage arising from or in connection with any accident, injury or damage whatever (except as caused by the sole active negligence, gross negligence, willful misconduct or intentional torts of Landlord or any Landlord Parties) occurring in, at or upon the Project, and (ii) claims arising from Tenant's or any Tenant Parties' acts, omissions or breach of this Lease; together with all reasonable costs, reasonable expenses and liabilities incurred or in connection with each such claim or action or proceeding brought thereon, including, without limitation, all reasonable attorneys' fees and expenses at trial and upon appeal. The foregoing indemnity obligation of Tenant shall not apply to any claims relating to the public trail easement through the Park Common Areas to the extent that any indemnity or insurance of the County of Orange pursuant to the easement agreement relating to such public trail easement provides coverage, defense and indemnity to Landlord and the Landlord Parties.

18.3 DUTY TO DEFEND: In case any action or proceeding is brought against Landlord and/or any Landlord Parties, Superior Lessor and/or Superior Mortgagee and such claim is a claim from which Tenant is obligated to indemnify Landlord pursuant to Section 18.2, Tenant, upon notice from Landlord or such Superior Lessor or Superior Mortgagee, shall resist and defend such action or proceeding (by counsel reasonably satisfactory to Landlord). The obligation of Tenant under this Article 18 shall survive termination of this Lease.

ARTICLE 19. DAMAGE OR DESTRUCTION:

19.1 CASUALTY: If the Premises or the Park Common Areas are damaged by fire or other casualty, Landlord shall forthwith repair the same unless this Lease is terminated as permitted herein. If (i) Landlord reasonably determines that the cost of repair is not covered by Landlord's fire and extended coverage insurance or any other applicable insurance coverage of Landlord maintained under Section 11.2 above, plus such additional amounts Tenant elects, at its option, to contribute, excluding however the standard fire and casualty insurance deductible (for which Tenant shall be responsible); (ii) Landlord reasonably determines that the Premises cannot, with reasonable diligence, be fully repaired by Landlord (or cannot be safely repaired because of the presence of hazardous factors, including without limitation Hazardous Materials, earthquake faults, and other similar dangers) within three hundred sixty (360) days after the date of the damage; (iii) an Event of Default by Tenant has occurred and is continuing at the time of such damage; or (iv) the damage occurs during the final twelve (12) months of the Term and Tenant has not previously exercised any available option to extend the Lease Term pursuant to Section 30.3 below, then Landlord may elect to terminate this Lease. Should Landlord elect not to repair the damage for one of the preceding reasons, Landlord shall so notify Tenant in writing within sixty (60) days after the damage occurs and this Lease shall terminate sixty (60) days after the date of that notice. Notwithstanding the foregoing, if Landlord elects to terminate this Lease pursuant to clause (i) above, Tenant shall have the right, by written notice to Landlord within ten (10) days after delivery of Landlord's termination notice, that Tenant desires to reinstate this Lease. Within ten (10) days of Landlord's

receipt of such notice, Landlord shall deliver written notice to Tenant of Landlord's reasonable good faith estimate of the shortfall between the amount to repair and the amount of insurance proceeds available therefor (the "Estimated Shortfall"); and within ten (10) days after Landlord's delivery of its written notice of the Estimated Shortfall, Tenant shall deposit with Landlord the full amount thereof. Upon Landlord's receipt of the Estimated Shortfall, this Lease shall be deemed reinstated, and Landlord shall repair the Premises pursuant to the terms and requirements of this Section 19.1. Upon completion of the repairs, Landlord shall deliver to Tenant a reconciliation of the actual costs of repairs against the actual insurance proceeds received therefor and the Estimated Shortfall paid by Tenant, and if the actual cost is less than the amount so paid to Landlord, then Landlord shall reimburse such overage to Tenant or the insurance carrier, as applicable, within thirty (30) days, or if the actual cost is greater than the amount so paid to Landlord, then Tenant shall pay to Landlord the shortfall balance within thirty (30) days. The failure of Tenant to timely

deliver to Landlord its reinstatement notice, or to timely and fully pay to Landlord the Estimated Shortfall, shall automatically terminate any rights of Tenant to reinstate this Lease as hereinabove provided. If Landlord does not have the right, or has the right but does not elect, to terminate this Lease as hereinabove provided, this Lease shall remain in full force and effect, except the Rent shall be reasonably abated during the period of repair based on that portion of the rentable square feet of the Buildings not reasonably useable by Tenant. Landlord shall not be required to repair any damage by fire or other cause to the property of Tenant, any Tenant alterations or any specialized improvements of Tenant.

Unless Landlord elects to terminate this Lease in accordance with the preceding paragraph, this Lease shall continue in effect for the remainder of the Lease Term; provided that so long as no Event of Default by Tenant has occurred and is continuing under this Lease, if more than one (1) Building is damaged by fire or other casualty and (i) such damage is so extensive that Landlord reasonably determines that the Buildings cannot, with reasonable diligence, be repaired by Landlord (or cannot be safely repaired because of the presence of hazardous factors, earthquake faults, and other similar dangers) so as to allow Tenant's substantial use and enjoyment of the Buildings within three hundred sixty (360) days after the date of the damage, or (ii) the damage occurs during the final twelve (12) months of the Lease Term, Tenant has not previously exercised the options to extend the Lease Term under Section 30.3 below, and Landlord reasonably determines that the Buildings cannot, with reasonable diligence, be repaired by Landlord so as to allow Tenant's substantial use and enjoyment of the Buildings within ninety (90) days after the date of the damage, then Tenant may elect to terminate this Lease by written notice to Landlord within thirty (30) days after delivery of Landlord's estimate of the time to repair hereunder, and this Lease shall automatically terminate thirty (30) days after the date of such notice. Notwithstanding the foregoing, Tenant shall not be entitled to the termination rights set forth herein if the damage giving rise to such termination right is due to the fault or neglect of Tenant or any Tenant Parties.

19.2 CONDEMNATION: If more than twenty-five percent (25%) of the Land and/or Premises shall be taken or appropriated under the power of eminent domain or conveyed in lieu thereof, Landlord shall have the right to terminate this Lease. If this Lease is terminated, Landlord shall receive (and Tenant shall assign to Landlord upon demand from Landlord) any and all income, rent, award or any interest thereon which may be paid or owned in connection with the exercise of such power of eminent domain or conveyance in lieu thereof, and Tenant shall have no claim against the agency exercising such power or receiving such conveyance, for any part of such sum paid by virtue of such proceedings, whether or not attributable to the value of the unexpired term of this Lease. So long as Tenant is entitled to a separate award and Landlord's award is not diminished thereby, nothing contained herein shall be deemed to prevent Tenant from seeking any award against the taking authority for the taking of personal property and fixtures belonging to Tenant, for relocation or business interruption expenses recoverable by Tenant directly from the taking authority, or for loss of Tenant's goodwill. If a part of the Land and/or Premises shall be so taken or appropriated or conveyed and Landlord hereto shall elect not to terminate this Lease, Landlord shall nonetheless receive (and Tenant shall assign to Landlord upon demand from Landlord) any and all income, rent, award or any interest thereon paid or owed in connection with such taking, appropriation or conveyance; and if the Premises have been damaged as a consequence of such partial taking or appropriation or conveyance, Landlord shall restore the Premises and this Lease shall remain in full force and effect except that the Rent shall be equitably adjusted according to the remaining rentable area of the Buildings while such restoration is being made by Landlord. Notwithstanding the foregoing, Landlord's obligation to restore the Premises if this Lease is not terminated, shall be limited to the extent of available condemnation proceeds. Such proportionate reduction shall be based upon the extent to which the restoration being made by Landlord shall interfere with the business carried on by Tenant in the Buildings. Landlord will not be required to repair or restore any injury or damage to the property of Tenant.

ARTICLE 20. SURRENDER AND HOLDING OVER:

20.1 GENERAL: On the last day of the term of this Lease, or upon re-entry by Landlord upon the Premises, Tenant shall quit and surrender the Premises to Landlord "broom-clean" and in good order, condition and repair, except for ordinary wear and tear, and in accordance with the restoration provisions of Articles 13 and 14, Sections 3.3, 3.4 and 15.6, and Exhibit D of this Lease.

20.2 SURRENDER: No agreement relating to the surrender of the Premises by Tenant shall be valid unless in writing and signed by Landlord.

20.3 HOLDING OVER: If Tenant shall retain possession of the Premises or any part thereof or of the Project with Landlord's consent (express or implied) following the expiration or sooner termination of this Lease for any reason, then, for the first ninety (90) days of any such holdover Tenant shall pay to Landlord for each day of such retention one hundred ten percent (110%) of the

daily prorated amount of the Rent for the last period prior to the date of such expiration or termination, subject to adjustment as provided in Article 5. After the expiration of any such ninety (90) day holdover period, Tenant shall pay to Landlord for each day of such retention one hundred fifty percent (150%) of the daily prorated amount of the Rent for the last period prior to the date of such expiration or termination. Tenant shall also defend, indemnify and hold harmless Landlord from any loss or liability resulting from delay by Tenant in surrendering the Premises and the Project, including, without limitation, any claims made by any succeeding tenant founded on such delay, provided Landlord provides to Tenant written notice of the existence of any such succeeding tenant and Landlord's potential loss and/or liability resulting from any continued holdover by Tenant. Holding over with Landlord's consent shall constitute renewal of this Lease from month to month. Acceptance of Rent by Landlord following expiration or termination shall not constitute a renewal of this Lease, and nothing contained in this Section shall waive Landlord's right of re-entry or any other right. Tenant shall be only a tenant at sufferance, whether or not Landlord accepts any Rent from Tenant while Tenant is holding over.

ARTICLE 21. EVENTS OF DEFAULT:

21.1 EVENTS OF DEFAULT: The occurrence of any one or more of the following events of default ("Events of Default") shall constitute a breach of this Lease by Tenant:

21.1.1 If Tenant shall default in the payment of any Security Deposit, Base Rent or Additional Rent, and such default shall continue for five (5) days after written notice from Landlord to Tenant;

21.1.2 If Tenant shall fail to comply with the provisions of Section 8.1 regarding execution and delivery of subordination agreements, Section 8.4 regarding modifications for Superior Mortgagees, Section 11.1 regarding delivery of insurance certificates, or Section 28 regarding completion and delivery of executed estoppel certificates, within the time periods required in each respective Section therefor;

21.1.3 If Tenant shall, whether by action or inaction, be in default of any of its obligations under this Lease (other than under Sections 21.1.1 or 21.1.2 hereof) and such default shall continue and not be remedied within thirty (30) days after Landlord shall have given to Tenant a notice specifying the same, or, in the case of a default which cannot with due diligence be cured within such time period and the continuance of which for the period required for cure will not subject Landlord or any Superior Lessor to prosecution for a crime or termination of any Superior Lease or foreclosure of any Superior Mortgage, if Tenant shall not, (i) within such time period advise Landlord of Tenant's intention to take all steps necessary to remedy such default; (ii) duly commence within such time period, and thereafter diligently prosecute to completion all steps necessary to remedy the default; and (iii) complete such remedy within a reasonable time after the date of said notice of Landlord not exceeding ninety (90) days from the date of Landlord's notice;

21.1.4 If any event shall occur whereby this Lease or the estate hereby granted or the unexpired balance of the term hereof would, by operation of law or otherwise, be transferred to any person, firm or corporation, except as expressly permitted by Article 10;

21.1.5 If Tenant or any guarantor of Tenant's obligations shall make a general assignment for the benefit of creditors, or shall be unable to pay its debts as they become due, or shall file a petition in bankruptcy, or shall be adjudicated as bankrupt or insolvent or have entered an order for relief under any insolvency or bankruptcy laws, or shall file a petition seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or shall fail timely to contest the material allegations of a petition filed against it in any such proceeding, or shall seek or consent to or acquiesce in the appointment of any trustee, receiver or liquidator of Tenant or any material part of its properties;

21.1.6 If within sixty (60) days after the commencement of any proceeding against Tenant seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any present or future statute, law or regulation, such proceeding shall not have been dismissed or if, within sixty (60) days after the appointment without the consent or acquiescence of Tenant of any trustee, receiver or liquidator of Tenant or of any material part of its properties, such appointment shall not have been vacated; or

21.1.7 If this Lease or any estate of Tenant hereunder shall be levied upon under any attachment or execution and such attachment or execution is not vacated within ten (10) days.

Any written notice given under this Section 21.1 shall be in lieu of, and not in addition to, the notice requirements of Section 1161 et seq. of the California Code of Civil Procedure, any amendment or restatement thereof, or any other or similar statute or law.

21.2 LANDLORD'S BREACH OF LEASE: Landlord shall not be in default unless Landlord fails to perform obligations required of Landlord under this Lease within thirty (30) calendar days after written notice by Tenant to Landlord specifying wherein Landlord has failed to perform such obligations; provided, however, that if the nature of Landlord's obligation is such that more than thirty (30) calendar days are required for performance, then Landlord shall not be in default if Landlord commences performance within such thirty (30) calendar day period and thereafter diligently prosecutes the same to completion. If Landlord shall default in the performance of any of its obligations under the Lease (after notice and an opportunity to cure as provided herein), Tenant shall have the right to pursue any and all remedies available to it as set forth in this Lease, at law, or in equity, including, without limitation, the remedies provided for in Section 25.2 to the extent applicable, all subject however to the limitation contained in Section 31.4.

ARTICLE 22. REMEDIES UPON DEFAULT:

22.1 REMEDIES: Upon the occurrence of an Event of Default constituting a breach of this Lease under Article 21, Landlord may exercise any one or more of the remedies set forth in this Article 22 or in Article 25, or any other remedy available under applicable law or contained in this Lease.

22.1.1 Landlord or any authorized Landlord Parties may immediately or at any time thereafter re-enter the Premises, or any part thereof or of the Project, either by summary eviction proceedings or by any suitable action or proceeding at law, and may repossess the same, and may remove any person therefrom, to the end that Landlord may have, hold and enjoy the Premises and the Project.

22.1.2 Landlord at its option may relet the whole or any part of the Premises and/or the Project from time to time, either in the name of the Landlord or otherwise, to such tenants, for such terms

ending before, on or after the expiration date of the Lease Term, at such rentals and upon such other conditions (including concessions, tenant improvements, and free rent periods) as Landlord may determine to be appropriate. Landlord at its option may make such physical changes to the Premises and/or the Project as Landlord considers advisable or necessary in connection with any such reletting or proposed reletting, without relieving Tenant of any liability under this Lease or otherwise affecting Tenant's liability.

22.1.3 Whether or not Landlord retakes possession or relets the Premises, Landlord shall have the right to recover unpaid rent and all damages caused by the default as well as all costs and expenses incurred in the connection with the enforcement of this Lease, including reasonable attorney fees and court costs. Damages shall include, without limitation: (i) all rentals lost; (ii) all legal expenses and other related costs incurred by Landlord following Tenant's default; (iii) all costs incurred by Landlord in restoring the Premises to good order and condition, or in remodeling, renovating or otherwise preparing the Premises for reletting; (iv) all unamortized tenant improvement allowance and lease commissions; and (v) all costs incurred by Landlord in reletting the Premises, including, without limitation, any brokerage commissions and the value of Landlord's time.

22.1.4 To the extent permitted under applicable law, Landlord may sue periodically for damages as they accrue without barring a later action for further damages. Landlord may in one action recover accrued damages plus damages attributable to the remaining Lease Term equal to the difference between the Rent reserved in this Lease (including an estimated amount of Additional Rent as determined by Landlord) for the balance of the Lease Term after the time of award, and the fair rental value of the Premises for the same discounted to the time of award at the rate of the discount rate of the Federal Reserve Bank of San Francisco at the time of the award plus one percent (1%). If Landlord has relet the Premises for the period which otherwise would have constituted the unexpired portion of the Lease Term or any part, the amount of rent reserved upon such reletting shall be deemed, prima facie, to be the fair and reasonable rental value for the part or the whole of the Premises so relet during the term of the reletting.

22.1.5 To seize and dispose of Tenant's Property (as that term is defined in Section 14.2) in any manner permitted by law.

22.2 TERMINATION: Upon occurrence of an Event of Default, this Lease may be terminated at the option of Landlord by Landlord giving written notice to Tenant. If this Lease is not terminated by election of Landlord or otherwise, Landlord shall be entitled to recover damages from Tenant for the default. If this Lease is terminated, Tenant's liability to Landlord for damages shall survive such termination, and Landlord may re-enter, take possession of the Premises, and remove any persons or property by appropriate legal action and without liability for damages to Tenant, its property, any other persons, and/or their property. Acts of maintenance or preservation or efforts to relet the Premises or the appointment of a receiver upon initiative of Landlord to protect Landlord's interest under this Lease shall not constitute a termination of Tenant's contractual liability under this Lease unless written release of liability is given by Landlord to Tenant.

22.3 INTEREST ON DAMAGES: In addition to any other remedies Landlord may have under this Lease, and without reducing or adversely affecting any of Landlord's rights and remedies under this Article 22, if any Base Rent, Additional Rent or other amounts payable hereunder by Tenant to Landlord are not paid within ten (10) days after Tenant's receipt of Landlord's written demand therefor, the same shall bear interest at the annual rate of eleven percent (11%) or the maximum rate permitted by law, whichever is less, calculated monthly from the due date thereof until paid, and the amount of such interest shall be included as Additional Rent.

22.4 CUMULATIVE REMEDIES: The remedies provided for in this Lease are cumulative and are not intended to be exclusive of any other remedies to which Landlord may lawfully be entitled at any time.

ARTICLE 23. [INTENTIONALLY DELETED]

ARTICLE 24. NO WAIVERS OF PERFORMANCE:

The failure of either party to insist in any one or more instances upon the strict performance of any one or more of the obligations of the other party under this Lease, or to exercise any election herein contained, shall not be construed as a waiver or relinquishment for the future of the performance of such one or more obligations or any other obligations of such other party under this Lease or of the right to exercise such election, but the same shall continue and remain in full force and effect with respect to any subsequent breach, act or omission. The receipt by Landlord of Rent with knowledge of a breach by Tenant of any obligation of this Lease shall not be deemed a waiver of such breach.

ARTICLE 25. CURING DEFAULTS:

25.1 TENANT DEFAULTS: All covenants and agreements to be performed by Tenant under any of the terms of this Lease shall be performed by Tenant at Tenant's sole cost and expense and without any abatement of Rent except as otherwise provided in this Lease. If Tenant shall fail to pay any sum of money, other than Rent, required to be paid by it hereunder or shall fail to perform any other act on its part to be performed hereunder, and such failure shall continue beyond the periods referred to in Article 21 hereof, Landlord may make any such payment or perform any such act on Tenant's part to be made or performed as in this Lease provided but shall not be obligated so to do. Any such payment or performance shall not be a waiver or release of Tenant's obligations. All sums so paid by Landlord and all necessary incidental costs together with interest thereon at the rate specified in Section 22.3 from the date of such payment by Landlord

until paid shall be payable as Additional Rent to Landlord on demand, and Tenant covenants to pay any such sums, and Landlord shall have, in addition to any other right or remedy of Landlord, the same rights and remedies in the event of the nonpayment thereof by Tenant as in the case of default by Tenant in the payment of Rent. Except in an emergency or to prevent imminent threat of injury to persons or damage to the Premises, as reasonably determined by Landlord, Landlord shall provide Tenant with written notice and the appropriate cure period provided in the Lease before performing any act on behalf of Tenant, and will in all events provide Tenant with written request for any reimbursement payable under this Article 25.

25.2 LANDLORD DEFAULTS: If Landlord defaults in accordance with Section 21.2 above by failing to commence any repairs which Landlord is obligated to make under Section 4.2 above within thirty (30) days following Tenant's written request for such repairs, and the failure to make such repairs will result in an imminent threat of injury to persons or damage to personal property upon the Premises, or the inability of Tenant to occupy the Buildings, then provided no Event of Default by Tenant has occurred and is continuing, Tenant may elect to make such repairs strictly in accordance with the following: (i) before making any such repair, Tenant shall deliver to Landlord a second notice of the need for such repair, which notice shall specifically advise Landlord that Tenant intends to exercise its self-help right hereunder ("Self-Help Notice"); (ii) should Landlord further fail, within ten (10) days following its receipt of the Self-Help Notice, to commence the necessary repairs or to make other arrangements reasonable under the circumstances, then Tenant shall have the right to make only such repairs as are necessary to secure the Premises from the imminent threat of injury to persons or damage to personal property, or to permit Tenant to occupy the Buildings; (iii) any such repairs undertaken by Tenant shall be performed and completed in accordance with the Tenant's obligations for its own repairs and alterations under Section 4.3 above and Article 12 above, and only using contractors and materials reasonably approved by Landlord; and (iv) Tenant shall be responsible for obtaining any necessary governmental permits before commencing the repair work, and Tenant shall assume the risk of any damage, loss or injury resulting from such work. All costs of any repairs on the part of Landlord provided hereunder shall be considered part of Operating Expenses unless Landlord is obligated to make such repairs at Landlord's expense pursuant to the first sentence of Section 4.2 above, in which event, unless Landlord reasonably disputes the need for such repairs or the costs thereof, Landlord shall reimburse Tenant for its actual costs reasonably incurred in making such repairs upon written demand from Tenant accompanied by copies of paid invoices to unaffiliated third parties for such repairs and copies of lien release waivers in connection therewith. If Landlord disputes the need for such repairs or the costs thereof, the parties will meet and confer in good faith to seek to resolve Landlord's objection. If the parties are unable to resolve Landlord's objection, then either party may, by written notice to the other, submit such dispute to a reference pursuant to Section 638 et seq. of the California Code of Civil Procedure. The parties shall seek to agree upon a single referee (as contemplated in California Code of Civil Procedure Section 640) within fifteen (15) business days after delivery of such notice; if they are unable to agree, then they shall petition the Superior Court of Orange County to appoint a single referee in accordance with Section 640 of the California Code of Civil Procedure. The decision of the referee as to such dispute shall be binding and controlling on the parties. In no event shall Tenant have the right to offset the cost of any such repairs against Rent or other sums due under this Lease.

ARTICLE 26. BROKERS:

Tenant and Landlord covenant, warrant and represent that no Brokers except as provided in the Basic Lease Information (the "Brokers") was instrumental in bringing about or consummating this Lease and that neither party has had conversations or negotiations with any brokers except the Brokers concerning the leasing of the Premises. Tenant and Landlord agree to indemnify and hold harmless each other against and from any claims for any brokerage commissions and all reasonable costs, expenses and liabilities in connection therewith, including without limitation, reasonable attorneys' fees and expenses, arising out of any conversations or negotiations had by Tenant or Landlord, as applicable, with any Brokers other than the Brokers. Landlord shall pay any brokerage commissions due the Brokers as per a separate agreement between Landlord and the Brokers.

ARTICLE 27. NOTICES:

Any notice, statement, demand, consent, approval or other communication required or permitted to be given, rendered or made by either party to the other, pursuant to this Lease or pursuant to any applicable law or requirement of public authority, shall be in writing (whether or not so stated elsewhere in this Lease). Notices shall be deemed to have been properly given, rendered or made: upon delivery if delivered in person or by a recognized reputable overnight delivery service to the Landlord or Tenant or by confirmed facsimile; or, if sent postage prepaid by registered or certified mail, return receipt requested, effective on that date actually received or refused as indicated by the attached return receipt, addressed to the other party at the address

designated by the party (except that after the Commencement Date, Tenant's address, unless Tenant shall give notice to the contrary, shall be the Tenant's address at the Premises). Either party may, by notice as aforesaid, designate a different address or addresses for notices, statements, demands, consents, approvals or other communications intended for it.

ARTICLE 28. ESTOPPEL CERTIFICATES:

28.1 TENANT ESTOPPEL CERTIFICATES. Tenant agrees, at any time and from time to time, as requested by Landlord with not less than ten (10) business days prior notice, to execute and deliver to Landlord a statement certifying that this Lease is unmodified and in full force and effect (or if there have been modifications, that the same is in full force and effect as modified and stating the modifications), certifying the dates to which the Base Rent and Additional Rent have been paid, stating whether or not, to the best knowledge of the Tenant, the Landlord is in default in performance of any of its obligations under this Lease, and, if so, specifying each such default of which the Tenant shall have knowledge, and stating whether or not, to the best knowledge of Tenant, any event has occurred which with the giving of notice or passage of time, or both, would constitute such a default, and, if so, specifying each such event, it being intended that any such statement delivered pursuant hereto shall be deemed a representation and warranty to be relied upon by the

Landlord and by others with whom Landlord may be dealing, regardless of independent investigation. Tenant also shall include in any such statement such other information concerning this Lease as Landlord may reasonably request. If Tenant fails to respond within ten (10) business days of receipt by Tenant of a written request for such a statement, such failure shall constitute an Event of Default and Tenant shall be deemed to have given such statement and shall be deemed to have admitted the accuracy of any information contained in the request for such statement and that the Lease is unmodified and in full force and effect, that there are not uncured defaults in Landlord's performance, and that not more than one (1) month's Rent has been paid in advance.

28.2 LANDLORD ESTOPPEL CERTIFICATES. Landlord agrees, not more than once in each calendar year, as requested by Tenant with not less than fifteen (15) business days prior notice, to execute and deliver to Tenant a statement certifying that this Lease is unmodified and in full force and effect (or if there have been modifications, that the same is in full force and effect as modified and stating the modifications), certifying the dates to which the Base Rent and Additional Rent have been paid, stating whether or not, to the actual knowledge of the Landlord, the Tenant is in default in performance of any of its obligations under this Lease, and, if so, specifying each such default of which the Landlord shall have knowledge, and stating whether or not, to the actual knowledge of Landlord, any event has occurred which with the giving of notice or passage of time, or both, would constitute such a default, and, if so, specifying each such event, it being intended that any such statement delivered pursuant hereto shall be deemed a representation and warranty to be relied upon by the Tenant and by others with whom Tenant may be dealing, regardless of independent investigation. Landlord also shall include in any such statement such other information concerning this Lease as Tenant may reasonably request.

ARTICLE 29. MEMORANDUM OF LEASE:

Tenant shall not record this Lease. Upon execution of this Lease, however, Landlord shall execute, acknowledge and deliver to Tenant a memorandum of lease in respect of this Lease sufficient for recording, which Tenant may record in the Official Records of Orange County, California at any time, and Tenant shall (at the time of obtaining of the memorandum from Landlord and at any time thereafter upon request of Landlord) execute, acknowledge and deliver to Landlord a quitclaim deed of this Lease, which Landlord shall hold and may record at any time after the expiration or earlier termination of the Lease Term. Such memorandum shall not be deemed to change or otherwise affect any of the obligations or provisions of this Lease.

ARTICLE 30. ADJUSTMENT OF COMMENCEMENT DATE AND LEASE TERM:

30.1 EARLY POSSESSION: From and after November 1, 2000, Tenant shall have the right and obligation to accept each Building and to begin paying Base Rent and Additional Rent therefore as the Tenant Improvements as described in Exhibit D are "substantially completed" for each Building as provided in Exhibit D, and the provisions of this Lease shall begin to apply with respect to each Building immediately upon the substantial completion of the Tenant Improvements in each Building and notwithstanding that the Commencement Date may not yet have occurred; however, before Tenant shall be permitted occupancy of each such Building, (i) Tenant shall pay for and provide evidence of the insurance to be provided by Tenant pursuant to the provisions of Section 11, (ii) Tenant shall contract for direct payment of all utility, service and maintenance charges for such Building, and (iii) Tenant shall not unreasonably interfere, delay or hinder Landlord, its representatives, contractors or subcontractors in the construction of the Tenant Improvements in the balance of the Premises in accordance with the provisions of this Lease. Prior to November 1, 2000, Tenant shall have the right to enter into each Building on the Premises up to thirty (30) days prior to the substantial completion of the Tenant Improvements for each Building to install phone systems, computer systems, furniture, fixtures and equipment, etc., within each Building on a phased basis during such thirty (30) day period prior to substantial completion (except that with respect to cabling, Tenant and Landlord shall coordinate in good faith for Tenant to be permitted to install its cabling prior to Landlord's installing drop ceilings), which early entry shall be subject to all terms of this Lease, but shall not constitute occupancy for operation of Tenant's business and shall not trigger the Commencement Date or Tenant's obligation to pay Rent or any other amounts due under this Lease; provided, however, (i) Tenant shall pay for and provide evidence of the insurance to be provided by Tenant pursuant to the provisions of Section 11, (ii) Tenant shall contract for direct payment of all utility, service and maintenance charges for such Building, and (iii) Tenant shall not unreasonably interfere, delay or hinder Landlord, its agents, contractors or subcontractors in the construction of the Tenant Improvements in the balance of the Premises in accordance with the provisions of this Lease. Early possession by Tenant in accordance with this Section 30.1 shall not constitute occupancy of the Premises for purposes of establishing the Commencement Date.

30.2 DELAY IN COMMENCEMENT: If Landlord fails to deliver the last of the Premises with the last of the Tenant Improvements described in Exhibit D substantially complete by the "Anticipated Commencement Date" due to the fault of the Landlord or due to the occurrence of an event of force majeure, Landlord

shall not be considered in default of this Lease, but the Commencement Date shall be deferred until the last of the Premises are so delivered, subject however to Tenant's rights under Section 2.3 above. Tenant shall be considered to have caused any delay in the preparation of the Premises resulting from Tenant's failure to sign this Lease on or before the Construction Information Submittal Date specified in Exhibit D or, in the alternative, to provide Landlord by such date a written agreement in form and content satisfactory to Landlord guarantying Tenant will pay Landlord for any and all costs incurred in connection with the work done prior to execution of this Lease to prepare the Premises for Tenant. If the last of the Tenant Improvements are not completed on the "Anticipated Commencement Date" due to (i) the failure of Tenant to fulfill any obligation pursuant to the terms of this Lease or any exhibit hereto, including without limitation, Tenant's failure to comply with the Construction Information Submittal Dates and Construction Approval Dates specified in Exhibit D, or (ii) any changes in the Tenant Improvements requested by Tenant after Landlord's approval of the plans, or (iii) any

other Tenant Delay as described in Exhibit D, then the Commencement Date shall be the later of the Anticipated Commencement Date specified in the Basic Lease Information or such earlier date that the last of the Tenant Improvements would have been substantially completed but for such Tenant delay. For purposes hereof, "substantial completion" shall be as described in Exhibit D attached to this Lease.

30.3 OPTION TO EXTEND LEASE TERM: Tenant shall have the right to extend the term of this Lease for two (2) additional consecutive periods of five (5) years each (each hereinafter an "Extension Term"), such rights to be exercised by written notice from Tenant to Landlord given not less than three hundred sixty-five (365) days prior to the applicable expiration date of the Lease Term. Each extension right may only be exercised if no Event of Default by Tenant under the Lease has occurred and is continuing, either at the time of the exercise of the extension right or at the commencement of such extension. In the event this Lease is terminated for any reason, the rights granted to Tenant in this paragraph shall also terminate at the same time. In the event Tenant exercises the right to extend the term of this Lease as provided herein and subsequently an Event of Default by Tenant occurs prior to commencement of an Extension Term, Landlord may elect, by written notice to Tenant, to terminate Tenant's prior election to exercise its right to extend the term hereof, in which event Tenant shall have no rights with respect to the Extension Term or any subsequent Extension Term. Tenant's failure or inability to timely and properly exercise its right to the first Extension Term shall automatically terminate the second Extension Term. The right to extend the term of this Lease may only be exercised by Tenant and any permitted assignee under Article 10 above, and may not be transferred outside of this Lease or exercised by any other person or entity.

The leasing of the Premises during any Extension Term shall be upon the same terms and conditions as are contained herein with respect to the initial term, and the Lease Term shall be deemed to include such Extension Term, except that (1) there shall be no further options to extend the term hereof after the Extension Term unless expressly granted by the Landlord in writing, (2) the provisions of this Lease shall not apply that are in the nature of concessions to induce Tenant to enter into this Lease such as rent abatement, tenant allowances, tenant improvements and the like, and (3) the monthly Base Rent rate per rentable square foot during each Extension Term shall be the then fair market rent as reasonably determined by Landlord (including periodic increases to Base Rent during each Extension Term), but in no event less than the Base Rent rate payable during the final month of the previous Lease Term. The fair market rent determined by Landlord shall be based on rents for comparable space of comparable size with a comparable level of tenant improvements for a similar term and commencement date for tenants of similar credit to that of Tenant, by reference to first-class space in other buildings comparable to the Buildings in age, quality and location (south Orange County office buildings in office/business centers or parks as defined by CB Richard Ellis as of the date of this Lease).

Upon notification from Tenant of the exercise of each extension option, Landlord shall, at least one hundred fifty (150) days prior to the commencement of the Extension Term, notify Tenant in writing of the proposed rental for the extension term; Tenant shall within fifteen (15) business days following receipt of same notify Landlord in writing of the acceptance or rejection of the proposed rental. TENANT'S FAILURE TO TIMELY PROVIDE SUCH NOTICE SHALL CONSTITUTE ACCEPTANCE OF THE PROPOSED RENTAL. In the event of rejection by Tenant, the extension rental shall be determined as follows:

Within fifteen (15) days following notification of rejection, Landlord and Tenant shall each appoint a disinterested and qualified real estate professional (but not an appraiser). If these two real estate professionals cannot agree upon an extension rental within fifteen (15) days following their appointment, the two appointees shall forthwith select a third disinterested and qualified real estate professional, and the decision of any two of the three real estate professionals shall be binding. Notification in writing of this decision shall be made by the real estate professionals to Landlord and Tenant within thirty (30) days following the selection of the third real estate professional. Landlord and Tenant shall bear the expense of the real estate professional appointed by each, and the expense of the third real estate professional shall be shared equally by both parties. During such process for establishing rent, Tenant shall pay rent for the Extension Term at Landlord's rate, with retroactive adjustment made if a different rate is established as provided above.

Within fifteen (15) days after the rental has been finally determined, the parties shall execute a written confirmation of the Extension Term and extension Base Rent. Failure or refusal of Tenant to execute the confirming memorandum shall be an Event of Default.

30.4 EARLY TERMINATION OPTION: Tenant shall have the option to terminate this Lease effective as of the end of the sixtieth (60th) month of the Lease Term or effective as of the end of the eighty-fourth (84th) month of the Lease

Term only. To exercise this option, Tenant must give Landlord not less than twelve (12) months written notice prior to the elected termination date of exercise and pay (with the notice) the Termination Fee to Landlord. The "Termination Fee" shall be equal to the sum of (i) the unamortized cost of all Tenant Improvements paid for by Landlord under Paragraphs 5 and 6 of Exhibit D of this Lease (determined by amortizing in equal payments over the first ten (10) years of the Lease Term with respect to Paragraph 5 costs and over the first seven (7) years of the Lease Term with respect to Paragraph 6 costs and all calculated at an interest rate of eleven percent (11%) per annum), plus (ii) thirty (30) months of monthly Base Rent and Operating Expenses and Taxes for the first termination right (i.e., effective as of the end of the 60th month of the Lease Term), or six (6) months of monthly Base Rent and Operating Expenses and Taxes for the second termination right. As a condition to any such early termination, Tenant shall also pay all amounts owing to Landlord through to the date of such early termination. The right to exercise the terms of this Section 30.4 shall be personal to Tenant only and shall automatically expire upon any transfer, assignment or subletting of Tenant's interest in this Lease including such transfer as may be permitted pursuant to Article 10 of this Lease.

ARTICLE 31. MISCELLANEOUS:

31.1 MERGER: All understandings and agreements heretofore had between the parties are merged in this Lease, which alone fully and completely expresses the agreement of the parties and which is entered into after full investigation, neither party relying upon any statement or representation not embodied in this Lease.

31.2 MODIFICATIONS: No agreement shall be effective to change, modify, waive, release, discharge, terminate or effect an abandonment of this Lease, in whole or in part, unless such agreement is in writing, refers expressly to this Lease and is signed by the party against whom enforcement is sought.

31.3 SUCCESSORS AND ASSIGNS: Except as otherwise expressly provided in this Lease, the obligations of this Lease shall bind and benefit the successors and permitted assigns of the parties hereto.

31.4 NONRECOURSE LEASE: Tenant shall look only to Landlord's estate and property in the Land and the Premises (including the rents, issues, profits and proceeds thereof) for the satisfaction of Tenant's remedies for the collection of a judgment (or other judicial process) requiring the payment of money by Landlord in the event of any default by Landlord hereunder, and no other property or assets of Landlord or any Landlord Parties, disclosed or undisclosed, shall be subject to levy, execution or other enforcement procedure for the satisfaction of Tenant's remedies under or with respect to this Lease, the relationship of Landlord and Tenant hereunder or Tenant's use or occupancy of the Premises or Project.

31.5 FORCE MAJEURE: The non-monetary obligations of Tenant and Landlord shall be subject to, and neither Landlord nor Tenant shall have any liability whatsoever to the other, because:

31.5.1 Such party is unable to fulfill, or is delayed in fulfilling, any of its non-monetary obligations under this Lease by reason of strike, other labor trouble, governmental pre-emption of priorities or other controls in connection with a national or other public emergency or shortages of fuel, supplies or labor resulting therefrom, delays in governmental processing, approvals, and issuance of permits and/or inspections, or any other cause, whether similar or dissimilar, beyond such party's reasonable control; or

31.5.2 of any failure or defect in the supply, quantity or character of electricity, water or other utilities furnished to the Project, by reason of any requirement, act or omission of the public utility or others serving the Project with electric energy, steam, oil, gas or water, or for any other reason whether similar or dissimilar, beyond such party's reasonable control;

provided however, that to avail oneself of a "force majeure" excuse for delay, the party claiming such delay must notify the other party in writing within ten (10) business days of the occurrence of such delay and describe in reasonable detail the scope and anticipated extent of such delay. If a party timely and properly gives such notice, the "force majeure" delay shall relate back to the date of initial delay. If such notice is not given within the ten (10) business day period, then any "force majeure" delay claim shall only be effective commencing from and after the date of delivery of such notice.

Nothing contained in this Section 31.5 shall affect, impair or excuse the obligations of Tenant to pay all Base Rent and Additional Rent in full and when due under this Lease.

31.6 DEFINITIONS: For the purpose of this Lease, the following terms have the meanings indicated:

31.6.1 The term "mortgage" shall include a mortgage and/or deed of trust, and the term "holder of a mortgage" or "mortgagee" or words of similar import shall include a mortgagee of a mortgage or a beneficiary of a deed of trust.

31.6.2 The term "laws" and "requirements of any public authorities" and words of similar import shall mean laws and ordinances of any or all of the federal, state, regional, city, and county governments and rules, regulations, orders and directives of any and all departments, subdivisions, bureaus, agencies or offices thereof, and of any other governmental, public or quasi-public authorities having jurisdiction over the Land, Park Common Areas and/or the Premises, and the direction of any public officer pursuant to law, whether now or hereinafter in force.

31.6.3 The term "requirements of insurance bodies" and words of similar import shall mean rules, regulations, orders, and other requirements of the California Surveying and Rating Bureau and/or any other similar body performing the same or similar functions and having jurisdiction or cognizance over the Land, Park Common Areas and/or the Premises, whether now or hereafter in force.

31.6.4 The term "Tenant" shall mean the Tenant herein named or any assignee or other successor in interest (immediate or remote) of Tenant herein named, which at the time in question is the owner of Tenant's estate and interest granted by this Lease; but the foregoing provisions of this subsection shall not be construed to permit any assignment of this Lease or to relieve Tenant herein named or any assignee or other successor in interest (whether immediate or remote) of Tenant herein named from the full and prompt payment, performance and observance of the covenants, obligations and conditions to be paid, performed and observed by Tenant under this Lease.

31.6.5 The term "Land" shall mean the real property, lot or parcel upon which the Project is located including without limitation Buildings, parking areas, landscaped areas, walkways, driveways, sidewalks and curbs.

31.6.6 The term "Landlord" shall mean only the owner at the time in question of a Building or of a lease of a Building, so that in the event of any transfer or transfers of title to a Building or of Landlord's interest in a lease of a Building, the transferor shall be and hereby is relieved and freed of all obligations of Landlord under this Lease accruing after such transfer with respect to such Building, provided that such transferee has assumed and agreed in writing to perform and observe all obligations of Landlord herein with respect to such Building during the period it is the holder of the Landlord's interest under this Lease with respect to such Building.

31.6.7 The term "herein," "hereof" and "hereunder," and words of similar import, shall be construed to refer to this Lease as a whole, and not to any particular Article, Section or subsection, unless expressly so stated.

31.6.8 The term "and/or" when applied to two or more matters or things shall be construed to apply to any one or more or all thereof as the circumstances warrant at the time in question.

31.6.9 The term "person" shall mean natural person or persons, a partnership, a corporation and any other form of business or legal association or entity.

31.7 EFFECT OF EXPIRATION: Upon the expiration or other termination of this Lease, neither party shall have any further obligation or liability to the other except as otherwise expressly provided in this Lease (including without limitation any indemnity obligations which shall expressly survive such expiration or termination) and except for such obligations as by their nature or under the circumstances can only be, or by the provisions of this Lease, may be, performed after such expiration or other termination; and, in any event, unless otherwise expressly provided in this Lease, any liability for a payment (including, without limitation, Additional Rent, herein) which shall have accrued to or with respect to any period ending at the time of expiration or other termination of this Lease shall survive the expiration or other termination of this Lease.

31.8 PRORATIONS: Any appointments or prorations of Base Rent or Additional Rent to be made under this Lease shall be computed on the basis of a three hundred sixty (360) day year, with twelve (12) months of thirty (30) days each.

31.9 GOVERNING LAW: Regardless of the place of execution or performance, this Lease shall be governed by and construed in accordance with the laws of the State of California. If any provision of this Lease or the application thereof to any person or circumstances shall, for any reason and to any extent, be invalid or unenforceable, the remainder of this Lease and the application of that provision to other persons or circumstances shall not be affected but rather shall be enforced to the extent permitted by law. The table of contents, captions, heading and titles in this Lease are solely for convenience or reference and shall not affect its interpretation. Each covenant, agreement, obligation or other provision of this Lease on Tenant's part to be performed, shall be deemed and construed as a separate and independent covenant of Tenant, not dependent on any other provision of this Lease. All terms and words used in this Lease, regardless of the number or gender in which they are used, shall be deemed to include any other number and any other gender as the context may require. Time is of the essence of this Lease and all of its provisions.

31.10 LIGHT, AIR AND VIEW: Any diminution or shutting off of light, air or view by any structure which may be erected on lands adjacent to or near the Premises shall in no way affect this Lease or impose any liability on Landlord.

31.11 REPRESENTATIONS RE: AUTHORITY: Tenant does hereby covenant and warrant that:

31.11.1 Tenant is duly organized and validly existing under the laws of its state of formation, and, if such entity is existing under the laws of a jurisdiction other than California, qualified to transact business in California;

31.11.2 Tenant has full right and authority to enter into this Lease and to perform all Tenant's obligations hereunder; and

31.11.3 Each person signing this Lease on behalf of Tenant is duly and validly authorized to do so.

Landlord does hereby covenant and warrant that:

31.11.4 Landlord is duly organized and validly existing under the laws of its state of formation, and, if such entity is existing under the laws of a jurisdiction other than California, is qualified to transact business in

California to the extent required by California law;

31.11.5 Landlord has full right and authority to enter into this Lease and to perform all Landlord's obligations hereunder; and

31.11.6 Each person signing this Lease on behalf of Landlord is duly and validly authorized to do so.

31.12 DEFINED TERMS: Words capitalized other than as the first word of a sentence are defined terms and have the meaning, throughout this Lease, given to them when they are first used with an initial capital or when used in quotation marks.

31.13 COUNTERPARTS: This Lease may be executed in one or more counterparts by separate signature, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument, binding on all parties hereto, even though all parties are not signatories to the original or to the same counterpart. Any counterpart of this Lease that has attached to it separate signature pages, which together contain the signatures of all parties, shall for all purposes be deemed a fully-executed instrument, and in making proof of this Lease, it shall not be necessary to produce or account for more than one such counterpart.

31.14 COSTS AND ATTORNEY FEES:

31.14.1 NO SUIT OR ACTION FILED: If this Lease is placed in the hands of an attorney due to a default in the payment or performance of any of its terms, the defaulting party shall pay, immediately upon demand, all of the other party's costs and expenses associated with enforcing the Lease, including reasonable attorney fees and collection costs even though no suit or action is filed thereon, and any other fees or expenses incurred by the nondefaulting party.

31.14.2 LITIGATION OR ARBITRATION: If legal action is instituted to enforce or interpret any of the terms of this Lease or if legal action is instituted in a Bankruptcy Court for a United States District Court to enforce or interpret any of the terms of this Lease, to seek relief from an automatic stay, to obtain adequate protection, or to otherwise assert the interest of Landlord in a bankruptcy proceeding, the party not prevailing shall pay the prevailing party's reasonable and actual costs and disbursements, the reasonable and actual fees and expenses of expert witnesses in determining reasonable attorney fees, and such sums as the court may determine to be reasonable for the prevailing party's attorney fees connected with the trial and any appeal and by petition for review thereof.

31.14.3 LANDLORD'S CONSENTS: Wherever in this Lease or otherwise the consent of Landlord is required or requested, Tenant shall pay to Landlord its actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' or other consultants' fees) incurred in consideration of, or response to, the granting or withholding of such consent, including without limitation, consents to an assignment or subletting, waivers or approvals to Tenant equipment or other financing, and the like. Tenant shall pay such costs and expenses to Landlord immediately upon demand; provided, however, that as a condition to considering any request for consent, Landlord may require that Tenant deposit with Landlord an amount reasonably calculated by Landlord to represent the estimated costs and expenses Landlord will incur in considering and responding to such request, and in such event any unused portion of such deposit shall be refunded to Tenant without interest. The foregoing payment of costs and expenses shall be in addition to, and not in lieu of, any other fees or amounts which Landlord may be entitled to under this Lease or at law with respect to its response to or consideration of any request for consent.

31.14.4 DEFINITIONS: For purposes of this Lease, the term "attorney fees" includes all charges of the prevailing party's attorneys and their staff (including without limitation legal assistants, paralegals, word processing, and other support personnel) and any postpetition fees in a bankruptcy court. For purposes of this Lease, the term fees and expenses includes but is not limited to long-distance telephone charges; expenses of facsimile transmission; expenses for postage (including costs of registered or certified mail and return receipts), express mail, or parcel delivery; mileage and all deposition charges, including but not limited to court reporters' charges, appearance fees, and all costs of transcription; costs incurred in searching records.

31.15 EFFECT OF FAILURE TO CONSENT: Except where a different standard is expressly provided in this Lease, the Landlord may grant or refuse to consent or approve any item in its sole discretion. Where this Lease states that a consent or approval may not be unreasonably withheld, and a party unreasonably withholds or conditions such consent, the other party shall not be entitled to any damages or termination of this Lease for such withholding, it being intended that the sole remedy shall be to obtain an injunction compelling such consent or approval.

IN WITNESS WHEREOF, Landlord and Tenant have duly executed this Lease Agreement as of the date and year first above written.

LANDLORD

TENANT

SERRANO JACK, L.L.C.,
a Delaware limited liability company

WESTERN DIGITAL CORPORATION,
a Delaware corporation

By: AmberJack Ltd.,
an Arizona corporation,
Managing Member

By: /s/ MATTHEW E. MASSENGILL

By: /s/ DAVID C. GRAVES

Name (print): Matthew E. Massengill

Name (print): David C. Graves

Title: President & CEO

Title: President

Date: May 30, 2000

Date: June 1, 2000

By: /s/ TERESA A. HOPP

By: /s/ EARLE B. JOHNSON

Name (print): Teresa A. Hopp

Name (print): Earle B. Johnson

Title: CFO

Title: Vice President

Date: May 30, 2000

Date: June 1, 2000

EXHIBIT A

LEASE

LEGAL DESCRIPTION FOR LAND

PARCELS 1, 2, 3 AND LETTERED LOT A OF PARCEL MAP NO. 97-230 AS SHOWN ON
A MAP FILED IN BOOK 313, PAGES 22 TO 26 INCLUSIVE OF PARCEL MAPS,
RECORDS OF ORANGE COUNTY, CALIFORNIA.

EXHIBIT B
LEASE
BUILDINGS AND PARK COMMON AREAS

EXHIBIT C
LEASE
FLOOR PLAN FOR EACH BUILDING

[SEE ATTACHED]

EXHIBIT C-1

OUTLINE SPECIFICATIONS OF BUILDINGS

[SEE ATTACHED]

OUTLINE SPECIFICATIONS
FOR SERRANO CREEK CENTER
REVISED 05/04/2000

SHELL BUILDING CONSTRUCTION:

GENERAL:

| | | | |
|----|---------------------|----------------|--------------|
| 1. | Gross Building Area | Building A & C | 56,109 S.F. |
| | | Building B | 75,455 S.F. |
| | | | ----- |
| | | TOTAL: | 187,673 S.F. |

STANDARD SITE:

1. CONSTRUCTION
Asphalt with concrete curbs, concrete curb and gutter wherever storm water will collect and flow adjacent to curb - also, storm drain on site.
2. DESIGN
In accordance with site planning and design criteria of City of Lake Forest Off-Street Parking Guidelines.
Buildings to meet current ADA and Title 24 requirements.
3. ELECTRICAL SERVICE
277/480-volt, three phase, 4 wire service.
4. PARKING LOT LIGHTING
High-pressure sodium, pole top, minimum lighting levels per City of Lake Forest security ordinance.

SHELL:

1. ON GRADE FLOOR SYSTEM
Concrete slab 5 inch thick with #4 at 18" o.c. over 2" sand over 6 mil. Visqueen.
2. COLUMNS
All columns will be tube steel.
3. INSULATION
R-19 BATT at roof.

4. ROOFING
4-ply built-up roof over plywood sheathing consisting of 3
plys of roofing material with mineral cap sheet.
5. 2nd FLOOR SYSTEM
(100 lbs. Reducible)
Metal deck over steel beams and Vulcraft trusses, 1/2" structural
grade plywood with 1" gyp-crete fill over metal deck.
6. ROOF SYSTEM
OSB or plywood over Vulcraft open web trusses.
7. CONCRETE TILE-UP PANELS
Concrete panels 10" + thick w/ integrated reveals and painted finish.
Concrete panel shear walls.
Interior concrete panels will be furred out at lobby. Rest of interior
walls will be furred out as part of the tenant improvement package,
when number and locations of wall plugs can be determined.
8. EXTERIOR DOOR
Glass doors.
9. FIRE PROTECTION
Looped site system.
All buildings fully sprinklered (drops by tenant).
Systems designed for ordinary hazard.

ARCHITECTURAL TREATMENT:

1. GLAZING
High performance glass on aluminum mullion system finished w/ Kynar
finish.
2. EXTERIOR PAINT
Three color scheme.
3. EXTERIOR SOFFIT MATERIAL
Material shall be metal (Alcan Planar Plus).
4. CONCRETE ENTRY
Concrete walk entry shall be scored washed aggregate concrete.
5. MAIN DOOR
Arcadia narrow stile.

SECONDARY EXIT

1. Secondary Exit provided for ingress and egress.

MECHANICAL SYSTEM FOR SHELL

HVAC

1. Air conditioning is provided by roof mounted VAV units.
2. Main trunk distribution will be part of the shell.
3. Exhaust air from restrooms will be provided by roof mounted exhaust fans with duct work extended to these areas.
4. A concrete roof platform will be provided under VAV units to attenuate noise.

MECHANICAL SCREEN

1. Acrylic plaster over metal studs at 16" o.c.
Paint to match concrete panels in color and texture.
2. Angle bracing for supports.

PLUMBING (SHELL)

1. RESTROOMS
Core restroom included w/ floor drains and flush valve fixtures.
2. HOSE BIBBS
Hose bib on roof and at rear of building and where service enters building.
3. JANITOR'S CLOSET
Janitor sinks at each core.
4. DRINKING FOUNTAINS
High/Low Upgraded refrigerated drinking fountains in core at each floor.

STANDARD ELECTRICAL

ELECTRICAL SYSTEM

- o 277/480-volt three phase, 4 wire service
 - Building A & C 800 amps
 - Building B 1200 amps
- o Transformer on grade underground utility secondary conduits.
- o Electrical service capacity suitable for approximately 22 watts per square foot to accommodate HVAC, lighting, data processing, computer loads and convenience outlets.
- o Main electrical room supplied with underground pull section, house meter and main circuit breaker. One 277/480-volt and one 120/208-volt house panel with space for tenants' meters (triple net lease).
- o Two (2) 4" underground incoming C.O. for telephone service - main building.
- o Conduit sized for 2000 amp service.
- o Two (2) 4" conduits interconnect electrical rooms of all buildings on site and extend to public utility easement(s) for connection to data/fiber-optic service as available.
 - o Four (4) conduits, from Bldg. B to Bldg. A and from Bldg. B to Bldg. C
 - o Two (2) conduits from building to street

STANDARD ELEVATORS AND CABS

PASSENGER ELEVATOR

- o Hydraulic
- o Speed: 125 feet per minute
- o Capacity: 2500#
- o Cab under top: 9'-7"
- o Cab return and door: Polished stainless steel
- o Cab ceiling: Polished stainless steel
- o Cab floor: Future carpet to match lobby carpet
- o Cab Walls: Plastic laminate panels
- o Cab Base: Polished stainless steel
- o Cab Rail: Satin stainless steel
- o Cab Lighting: Down lights

EXHIBIT C-2

BUILDING PUNCHLIST ITEMS

1. Tenant will be given a carpet allowance of \$18.00 per square yard of existing lobby areas in each Building for carpeting of the lobbies. Any cost of carpeting the lobbies in excess of this allowance shall be paid by Tenant in cash in the same manner as set forth in the Work Letter attached to this Lease for excess Tenant Improvement Costs.

2. Landlord shall complete tile work along the stair rails in each Building.

3. Tenant has been unable to date to confirm elevator power. Tenant shall have the right to confirm that elevators are operational once power is made available.

EXHIBIT D

WORK LETTER

(Tenant Improvement Allowance)
(Pending Preliminary Plans)

1. APPLICATION OF EXHIBIT

Capitalized terms used and not otherwise defined herein shall have the same definitions as set forth in the Lease. The provisions of this Work Letter shall apply to the planning and completion of leasehold improvements requested by Tenant (the "Tenant Improvements") for the fitting out of the Premises, as more fully set forth herein.

2. LANDLORD AND TENANT PRE-CONSTRUCTION OBLIGATIONS

(a) PRELIMINARY PLANS. Within the time periods following full execution of the Lease by both Landlord and Tenant set forth below (the last day of each such period, including the last day for full execution of the Lease as set forth below, are hereinafter referred to as "Construction Information Submittal Dates"), Tenant's architect shall prepare and Tenant shall approve in writing preliminary space plans for the Tenant Improvements (the "Preliminary Plans") which shall include, without limitation, sketches and/or drawings showing the locations of doors, partitioning, electrical fixtures, outlets and switches, plumbing fixtures, floor loads and other requirements, and a list including all specifications and requirements of all specialized installations and improvements and upgrade specifications determined by Tenant as required for its use of the Premises. Tenant agrees to and shall promptly and fully cooperate with Tenant's architect and shall supply all information Tenant's architect deems necessary for the preparation of the Preliminary Plans. Tenant acknowledges that the Preliminary Plans shall be prepared by Tenant's architect after consultation and cooperation between Tenant, Tenant's architect, Landlord and Landlord's architect regarding the proposed Tenant Improvements and Tenant's requirements. Landlord and Landlord's architect shall be entitled, in all respects, to rely upon all information supplied by Tenant regarding the Tenant Improvements. The costs associated with preparation of the Preliminary Plans shall be paid as set forth in Sections 5 and 6 of this Work Letter.

(b) WORKING DRAWINGS. Within thirty (30) business days following submittal of the Preliminary Plans for each Building, Landlord's architect shall prepare working drawings (the "Working Drawings") for the Tenant Improvements based upon the approved Preliminary Plans. The Working Drawings shall include architectural, mechanical and electrical construction drawings for the Tenant Improvements based on the Preliminary Plans. Notwithstanding the Preliminary Plans, in all cases the Working Drawings (i) shall be subject to Landlord's final approval, which approval shall not be unreasonably withheld, (ii) shall not be in conflict with building codes for the City or with insurance requirements for a fire resistive Class A building, (iii) shall comply with all applicable building, fire, health and sanitary codes, regulations and requirements, and (iv) shall be in a form satisfactory to appropriate governmental authorities responsible for issuing permits and licenses required for construction. The costs associated with preparation of the Working Drawings shall be paid as set forth in Sections 5 and 6 of this Work Letter.

(c) APPROVAL OF WORKING DRAWINGS. Landlord or Landlord's architect shall submit the Working Drawings to Tenant for Tenant's review, and Tenant shall notify Landlord and Landlord's architect within five (5) business days after delivery thereof of any requested revisions. Within five (5) business days after receipt of Tenant's notice, Landlord's architect shall make all approved revisions to the Working Drawings and submit two (2) copies thereof to Tenant for its final review and approval, which approval shall be given within three (3) business days thereafter. Concurrently with the above review and approval process, Landlord may submit all plans and specifications to City and other applicable governmental agencies in an attempt to expedite City approval and issuance of all necessary permits and licenses to construct the Tenant Improvements as shown on the Working Drawings. Any changes or ancillary improvements (including without limitation improvements outside of the Premises) which are required by City or other governmental agencies shall be immediately submitted to Landlord for Landlord's review and reasonable approval, and Landlord shall promptly notify Tenant of such changes. If approved by Landlord, such changes and/or improvements shall be added to the Working Drawings and be deemed part of the Tenant Improvements. The last day of each period in which Tenant is required to give its approval under this paragraph is hereafter sometimes referred to as a "Construction Document Approval Date".

(d) SCHEDULE OF CRITICAL DATES. Set forth below is a schedule of certain critical dates relating to Landlord's and Tenant's respective obligations for the design and construction of the Tenant Improvements, including the Construction Information Submittal Dates and the Construction Document Approval Dates. Such dates and the respective obligations of Landlord and Tenant are more fully described elsewhere in this Work Letter. The purpose of the following

schedule is to provide a reference for Landlord and Tenant and to make certain the final approval of the Working Drawings by Tenant for each Building (hereafter each a "Final Approval Date") occurs as set forth herein. Following the Final Approval Date for each Building, Tenant shall be deemed to have released Landlord to commence construction of the Tenant Improvements for such Building as set forth in Section 4 below.

| REFERENCE ----- | DATE DUE ----- | RESPONSIBLE PARTY ----- |
|---------------------------------|-------------------|-------------------------------|
| A. Execution Deadline for Lease | May 26, 2000 | Landlord and Tenant |
| B. Preliminary Plan Completion: | | |
| (i) First Building | May 26, 2000 | Tenant |
| (ii) Second Building | May 26, 2000 | Tenant |
| (iii) Third Building | May 26, 2000 | Tenant |

| | | | |
|----|------------------------------|--|----------|
| C. | Working Drawings Completion: | | |
| | (i) First Building | 30 business days after submittal of Preliminary Plans signed off by Tenant | Landlord |
| | (ii) Second Building | 30 business days after submittal of Preliminary Plans signed off by Tenant | Landlord |
| | (iii) Third Building | 30 business days after submittal of Preliminary Plans signed off by Tenant | Landlord |
| D. | Working Drawings Review: | | |
| | (i) First Building | 5 business days after submittal of Working Drawings | Tenant |
| | (ii) Second Building | 5 business days after submittal of Working Drawings | Tenant |
| | (iii) Third Building | 5 business days after submittal of Working Drawings | Tenant |
| E. | Working Drawings Revisions: | | |
| | (i) First Building | 5 business days after return of Working Drawings | Landlord |
| | (ii) Second Building | 5 business days after return of Working Drawings | Landlord |
| | (iii) Third Building | 5 business days after return of Working Drawings | Landlord |
| F. | Final Approval Dates: | | |
| | (i) First Building | 3 business days after submittal of revised Working Drawings | Tenant |
| | (ii) Second Building | 3 business days after submittal of revised Working Drawings | Tenant |
| | (iii) Third Building | 3 business days after submittal of revised Working Drawings | Tenant |

3. BUILDING PERMIT

After the Final Approval Date has occurred for each Building, Landlord shall, if Landlord has not already done so, submit the Working Drawings for such Building to the appropriate governmental body or bodies for final plan checking and a building permit. Landlord, with Tenant's cooperation, shall cause to be made any change in the Working Drawings necessary to obtain the building permit; provided, however, after the Final Approval Date, no changes shall be made to the Working Drawings without the prior written approval of both Landlord and Tenant which approval shall not be unreasonably withheld, and then only after agreement by Tenant to pay any reasonably and actual excess costs resulting from such changes to the extent such changes cause the cost of the work to exceed the Tenant Improvement Allowance.

4. CONSTRUCTION OF TENANT IMPROVEMENTS

After the Final Approval Date for each Building has occurred and a building permit for the work for such Building has been issued, Landlord shall, through a guaranteed maximum construction contract providing for not more than one (1) draw request for funds each month ("Construction Contract") with Coastal Pacific Construction, Ticon Construction Company or another reputable, licensed contractor selected by Landlord and reasonably approved by Tenant ("Contractor"), cause the construction of the Tenant Improvements for each Building to be carried out in substantial conformance with the Working Drawings in a good and workmanlike manner using first-class materials. The costs associated with the construction of the Tenant Improvements shall be paid as set forth in Sections 5 and 6 of this Work Letter. Landlord shall cause the Contractor to competitively bid all major subcontract trades by at least three (3) subcontractors for each such trade selected by Landlord or the Contractor and approved by Landlord. Landlord shall cause the Contractor to award each subcontract trade to the lowest bidder; unless such lowest bidder has presented an incomplete bid, or does not reasonably appear able to commence and complete its work in a manner and within a time frame reasonably determined necessary to complete the Tenant Improvements as required under this Work Letter, or otherwise does not reasonably appear to be best qualified to perform its trade within the time and in the manner contemplated in this Work Letter, and in any of such events Landlord shall have the right, in its reasonable discretion, to cause the Contractor to award the subcontract for such trade to the most appropriate bidder under the circumstances. Landlord agrees to advise and consult with Tenant throughout the bidding and contract process, so long as such consultation does not delay or interfere with Landlord's obligations in connection herewith, and in all events Landlord's determinations as to bid and contract decisions shall be final. Landlord shall see that the construction complies with all applicable building, fire, health, and sanitary codes and regulations, the satisfaction of which shall be evidenced by a certificate of occupancy for such Building.

For purposes of the Lease and this Work Letter, "substantial completion" and "substantially completed" means, with respect to each Building, (i) the City of Lake Forest ("City") has approved of the Tenant Improvements for such Building in accordance with its building code, as evidenced by its written approval thereof in accordance with the building permits issued for the Tenant Improvements for such Building, and (ii) Landlord's architect has certified in writing that the Tenant Improvements for such Building have been completed in accordance with the final Working Drawings therefor and any authorized change

orders, except for minor details of construction, mechanical adjustments or decorations which do not materially interfere with Tenant's use and enjoyment of such Building (items normally referred to as "punchlist" items). Issuance of a certificate of occupancy shall not be required for "substantial completion", provided however, that Landlord shall deliver to Tenant a certificate of occupancy (temporary or otherwise) from the City for such Building within ten (10) business days after the last to occur of the approvals under clauses (i) or (ii) of the preceding sentence. If Landlord fails to obtain a certificate of occupancy (temporary or otherwise) within such period, substantial completion shall be deemed not to have occurred until such certificate of occupancy or temporary certificate of occupancy is received, unless Landlord is unable to obtain such certificate of occupancy or temporary certificate of occupancy because of any acts or omissions of Tenant or any Tenant Parties, in which event the requirement of a certificate of occupancy (temporary or otherwise) in connection with substantial completion shall be waived. Within five (5) business days after substantial completion with respect to each Building, and prior to Tenant's move-in date, Tenant, Landlord and Landlord's architect shall jointly conduct a walk-through of the Building and create a mutually acceptable written punchlist setting forth any corrective work with respect to the Tenant Improvements in

such Building which the parties believe is required to be performed. In the event that no such punchlist is provided within said period through no fault of either Landlord or Landlord's architect, Tenant shall be deemed to have waived the right to such punchlist. Landlord shall use all reasonable efforts to complete all of the items on the punchlist for each Building within forty-five (45) days of receipt of the punchlist therefore. Nothing contained herein shall expand Landlord's maintenance and repair obligations set forth in Section 4.2 of the Lease.

5. TENANT IMPROVEMENT ALLOWANCE

Landlord shall provide Tenant with a Tenant Improvement Allowance in the amount of up to Four Million Four Hundred Forty-Three Thousand One Hundred Twenty-Five Dollars (\$4,443,125.00) towards the cost of the design, purchase and construction of the Tenant Improvements to the Premises, including without limitation design, engineering and consulting fees (collectively, the "Tenant Improvement Costs"). Tenant shall not be entitled to retain or receive any part of the Tenant Improvement Allowance not actually used to pay Tenant Improvement Costs. The Tenant Improvement Allowance shall be used for payment of the following Tenant Improvement Costs:

(i) Preparation of the Preliminary Plans and the Working Drawings as provided in Section 2 of this Work Letter, including without limitation all fees charged by City (including without limitation fees for building permits and plan checks) in connection with the Tenant Improvements work in the Premises;

(ii) Construction work for completion of the Tenant Improvements and any ancillary improvements required by any applicable governmental agency or authority arising out of the Tenant Improvements, as reflected in the Working Drawings and Construction Contract; and

(iii) All contractors' charges, general conditions, performance bond premiums, and construction fees as reflected in the Construction Contract.

6. COSTS IN EXCESS OF TENANT IMPROVEMENT ALLOWANCE AT TENANT'S EXPENSE

(a) COST APPROVAL. Tenant shall pay the excess of the Tenant Improvement Costs over the amount of the Tenant Improvement Allowance available to defray such costs. Concurrent with the plan checking referred to in Section 3 of this Work Letter, Landlord shall prepare and submit to Tenant a written estimate of the amount of the remaining Tenant Improvement Costs and the cost of the Tenant Improvement Allowance still available to defray such costs (after preparation of the Preliminary Plans and Working Drawings). Tenant shall approve or disapprove any such estimate by written notice to Landlord within three (3) days after receipt thereof. If Tenant fails to notify Landlord of its disapproval within such three (3) day period, Tenant shall be deemed to have approved such estimate. If Tenant disapproves such estimate within the three (3) day period, Tenant shall be required to direct Landlord and Landlord's architect to amend the Working Drawings in a manner satisfactory to Landlord so as to reduce the estimated costs to an amount acceptable to Tenant, and any excess estimated costs remaining after such amendment shall be paid by Tenant in the manner described in the preceding sentence. Tenant shall additionally pay any costs resulting from such amendment and Tenant shall be liable for the delay in completing the Tenant Improvements and the increased costs, if any, resulting from such delay. If Tenant is unwilling or unable to amend the Working Drawings in a manner acceptable to Landlord, then Tenant shall be deemed to have approved of the estimate for the Working Drawings as prepared, and shall pay the amount of any excess estimated costs together with any costs arising from delay as a result of Tenant's actions hereunder, in the manner provided below. Tenant shall pay the amount of such excess on a pro rata basis with the amounts to be funded by Landlord under Section 5 and Section 6(b) of this Work Letter, within five (5) days after written notice from Landlord setting forth the amounts to be funded by Landlord under each draw request submitted by the Contractor under the Construction Contract and approved by Landlord. The failure of Tenant to timely and fully pay any installment of excess amounts hereunder shall constitute a Tenant Delay and, at Landlord's option, without waiver of Landlord's right to declare an Event of Default by Tenant pursuant to Section 21.1.1 of the Lease, Landlord may cease further work on the Tenant Improvements until such installment has been fully paid, and any additional costs or delays arising out of such cessation of work by Landlord shall be additional Tenant Delay and shall be paid by Tenant.

(b) AMORTIZATION OF EXCESS COSTS. Provided that no Event of Default under the Lease has occurred and is continuing, Tenant may elect, by written notice delivered to Landlord within the time that Tenant is to pay to Landlord any excess Tenant Improvement Costs, to have such excess costs up to a maximum amount of One Million Seven Hundred Seventy-Seven Thousand Two Hundred Fifty Dollars (\$1,777,250.00) amortized over the first seven (7) years of the Lease Term only at a rate of eleven percent (11%) per annum, compounded ("Amortization Rate"), with all such amortized amounts paid by Tenant to Landlord as Additional Rent at the time and in the manner required for Tenant to pay Base Rent as set

forth in the Lease. The parties acknowledge that if the full amount of \$1,777,250.00 is amortized hereunder, the monthly payment shall be \$30,430.85. Upon the occurrence of any Event of Default by Tenant under the Lease, Landlord shall have the right to accelerate the remaining principal balance of excess Tenant Improvement Costs amortized hereunder and to require that the entire amount thereof be immediately paid in full by Tenant. Should Tenant fail to pay such remaining principal amount within five (5) business days after any such election by Landlord, such principal amount shall thereafter bear interest at the greater of the Amortization Rate or the rate described in Section 22.3 of the Lease until paid.

(c) FINAL COSTS. Within sixty (60) days after completion by Landlord of the Tenant Improvements to the Premises, Landlord shall determine the actual final Tenant Improvements Costs and shall submit a written statement of such amount to Tenant. If any estimate previously paid by Tenant exceeds the amount due hereunder from Tenant for such work, such excess shall be refunded to Tenant. If any amount is still due from Tenant for such work, then Tenant shall pay such amount in full within ten (10) days of receipt of Landlord's statement or, if available, by written notice to Landlord within such 10-day period, elect to have such amount or portion thereof amortized as provided in paragraph (b) next above.

7. CHANGE ORDERS

Tenant may from time to time request and obtain change orders during the course of construction provided that: (i) each such request shall be reasonable, shall be in writing and signed by or on behalf of Tenant, and shall not result in any structural change in the Building, as reasonably determined by Landlord; (ii) all additional charges and costs, including without limitation architectural and engineering costs, construction and material costs, processing costs of any governmental entity, and increased construction, shall be the sole and exclusive obligation of Tenant; and (iii) any resulting delay in the completion of the Tenant Improvements shall be deemed a Tenant Delay and in no event shall extend the Commencement Date of the Lease. Upon Tenant's request for a change order, Landlord shall as soon as reasonably possible submit to Tenant a written estimate of the increased or decreased cost and anticipated delay, if any, attributable to such requested change. Within three (3) days of the date such estimated cost adjustment and delay are delivered to Tenant, Tenant shall advise Landlord whether it wishes to proceed with the change order, and if Tenant elects to proceed with the change order, Tenant shall remit, concurrently with Tenant's notice to proceed, the amount of the increased cost, if any, attributable to such change order. Unless Tenant includes in its initial change order request that the work in process at the time such request is made be halted pending approval and execution of a change order, Landlord shall not be obligated to stop construction of the Tenant Improvements, whether or not the change order relates to the work then in process or about to be started.

8. TENANT DELAYS

In no event shall the Commencement Date of the Lease be extended or delayed due or attributable to delays due to the fault of Tenant ("Tenant Delays"). Tenant Delays shall include, but are not limited to, delays caused by or resulting from any one or more of the following:

(a) Tenant's failure to promptly cooperate with the architects and furnish information for the preparation of the Preliminary Plans and Working Drawings, or to prepare and submit to Landlord the Preliminary Plans within the applicable Construction Information Submittal Dates;

(b) Tenant's failure to timely review and reasonably approve the Working Drawings by the applicable Construction Document Approval Dates;

(c) Tenant's request for or use of special materials, finishes or installations which are not readily available, provided that Landlord shall notify Tenant in writing that the particular material, finish, or installation is not readily available promptly upon Landlord's discovery of same;

(d) Delay attributable to failure by Tenant to timely provide, or changes (including without limitation changes in location) to, specifications relating to the laboratories, data center, or any of the other specialized improvements;

(e) Change orders requested by Tenant which actually delay the completion of the Tenant Improvements;

(f) Interference by Tenant or by any Tenant Parties with Landlord's construction activities;

(g) Tenant's failure to approve any other item or perform any other obligation in accordance with and by the dates specified herein or in the Construction Contract;

(h) Requested or required changes in the Preliminary Plans, Working Drawings or any other plans and specifications after the approval thereof by Tenant or submission thereof by Tenant to Landlord;

(i) Unavailability of or delay in the ability to timely procure equipment or materials specified for the build-out of the laboratories, data center or other specialized improvements, provided that Landlord shall notify Tenant in writing that the particular equipment or material is not readily available promptly upon Landlord's discovery of same;

(j) Tenant's failure to timely approve written estimates of costs or to timely pay excess costs not timely elected to be amortized in accordance with this Work Letter; and

(k) Tenant's obtaining or failure to obtain any necessary governmental approvals or permits for Tenant's intended use of the Premises.

If the Commencement Date of the Lease is delayed by any Tenant Delays, whether or not within the control of Tenant, then the Commencement Date of the Lease and the payment of Rent shall be accelerated by the number of days of such delay. Landlord shall give Tenant written notice within ten (10) business days

following Landlord's discovery of any circumstance that Landlord believes constitutes a Tenant Delay, and in the event of such timely notice the Tenant Delay shall relate back to the date such Tenant Delay began. If such notice is not given within ten (10) business days following Landlord's discovery of the circumstances that Landlord believes constitutes the Tenant Delay, then the Tenant Delay claim shall only be effective commencing from and after the date of delivery of such notice.

9. TRADE FIXTURES AND EQUIPMENT

Tenant acknowledges and agrees that Tenant is solely responsible for obtaining, delivering and installing in the Premises all necessary and desired furniture, trade fixtures, equipment and other similar items, and that Landlord shall have no responsibility whatsoever with regard thereto. Any Tenant expenditures on the same shall not be reimbursable or amortizable as Tenant Improvements. Tenant further acknowledges and agrees that neither the Commencement Date of the Lease nor the payment of Rent shall be delayed for any period of time whatsoever due to any delay in the furnishing of the Premises with such items.

10. FAILURE OF TENANT TO COMPLY

Any failure of Tenant to comply with any of the provisions contained in this Work Letter within the times for compliance herein set forth shall be deemed a default under the Lease. In addition to the remedies provided to Landlord in this Work Letter upon the occurrence of such a default by Tenant, Landlord shall have all remedies available at law or equity to a landlord against a defaulting tenant pursuant to a written lease, including but not limited to those set forth in the Lease.

11. COORDINATION OF LABOR

Landlord and Tenant shall cause their respective contractors, employees, servants and agents to work in harmony with each other so as not to interfere with any labor employed by the other on the Premises.

12. REMOVAL OF SPECIALIZED IMPROVEMENTS

Upon the expiration or earlier termination of the Lease Term and upon demand by Landlord, Tenant shall remove all or any portion of those certain specialized improvements installed as part of the Tenant Improvements more particularly described in Schedule "1" attached to this Work Letter, and Tenant shall repair and restore any damages occasioned thereby and shall leave the area in which such specialized improvements are located in a clean shell condition (with respect to the laboratory and data center areas in the Buildings) and in the condition existing prior to the installation of all exterior specialized improvements (ordinary wear and tear excepted), and otherwise in conformance with the requirements of Schedule "1" attached to this Work Letter. Such removal, repair and restoration shall be done promptly and with all due diligence at Tenant's sole cost and expense.

SCHEDULE "1"
TO EXHIBIT D (WORK LETTER)

SPECIALIZED IMPROVEMENTS TO BE REMOVED BY TENANT

Upon the expiration or earlier termination of the Lease Term, upon Landlord's request in accordance with the provisions of the Lease, Tenant shall be responsible for removing (and repairing and restoring the Premises as appropriate) the following Tenant Improvements:

- A. Exterior Improvements.
 - 1. Exterior pad and structure.
 - 2. All equipment within the exterior structure and electrical, gas and water lines connecting such equipment to the Buildings.
 - 3. Restore landscaping in the area where exterior pad and structure are located to condition matching landscaping in vicinity of such area.
 - 4. Re-asphalt and stripe parking stalls in the area where exterior pad and structure are located.

- B. Interior Improvements.
 - 1. All cabling.
 - 2. All specialized equipment and supporting electrical, gas and water lines.
 - 3. All personalized equipment.
 - 4. Specialized improvements including, but not limited to flooring, ceiling, and walls and millwork in the laboratory and data center areas.

EXHIBIT E

COMMENCEMENT DATE MEMORANDUM

DATE: _____, 200_

RE: Net Lease dated May __, 2000, by and between SERRANO JACK, L.L.C., a Delaware limited liability company, as "Landlord" and WESTERN DIGITAL CORPORATION, a Delaware corporation, as "Tenant", for the Premises known as 20411, 20511 and 20521 Lake Forest Drive, Lake Forest, California.

Agreement

The undersigned hereby agree as follows:

1. The Tenant Improvements (as defined in the Lease) to the Premises have been substantially completed in accordance with the terms and conditions of the Lease, subject only to "punch list" items agreed to by Landlord and Tenant pursuant to the terms of the Work Letter.

2. The Commencement Date, as defined in and determined in accordance with the Lease, is hereby stipulated for all purposes to be _____. Unless sooner terminated pursuant to the terms of the Lease, the expiration date of the Lease is _____ (i.e., the last day of the 120th month following the Commencement Date).

3. Pursuant to Paragraph 6(b) of Exhibit D attached to the Lease, Tenant has elected to amortize \$_____ of excess Tenant Improvement Costs as Additional Rent, and the monthly amount of Additional Rent attributable thereto (calculated in accordance with Paragraph 6(b) of Exhibit D and payable at the same time and in the same manner as Base Rent) is \$_____ per month during the first seven (7) years of the Lease Term.

4. Pursuant to Section 30.3 of the Lease, the last day for Tenant to exercise each option to extend the Term is _____ for the first option, and _____ for the second option.

5. Pursuant to Section 30.4 of the Lease, the last day for Tenant to exercise each option for early termination of the Lease Term is _____ for the first option and _____ for the second option.

"Landlord"

SERRANO JACK, L.L.C.,
a Delaware limited liability company

By: _____
Name (print): _____
Title: _____
Date: _____

By: _____
Name (print): _____
Title: _____
Date: _____

"Tenant"

WESTERN DIGITAL CORPORATION,
a Delaware corporation

By: _____
Name (print): _____
Title: _____
Date: _____

By: -----
Name (print): -----
Title: -----
Date: -----

EXHIBIT F

LEASE

RULES AND REGULATIONS

The following rules and regulations shall apply to the Project and the use and occupancy thereof. All capitalized terms used in these rules and regulations and in any amendments or additions thereto shall, unless otherwise defined, have the same meaning as given in the Lease to which these rules and regulations are attached.

A. The sidewalks, entries, passages, corridors and stairways of a Building shall not be obstructed or used for any purpose other than ingress or egress to and from the Building. Further, Tenant shall not misuse or in any manner damage the landscaped or other Park Common Areas. No furniture, equipment, or picnic tables or chairs may be placed in the Project Common Areas unless they conform to Landlord's standard furniture for outside Buildings or are otherwise approved by Landlord, such approval not to be unreasonably withheld or delayed. Tenant shall be permitted to place moveable, non-fixed basketball hoops in the parking lot portion of the Park Common Areas, and, subject to the provisions of Article 13 of the Lease, to install a volleyball court in place of the existing Bocci ball court in the Park Common Areas.

B. In the event Tenant or any Tenant Parties damages any parts of a Building during any move-in of furniture, equipment or supplies at any time, Tenant shall forthwith pay to Landlord the amount required to repair said damage.

C. No safe or article, the weight of which may, in the opinion of Landlord, constitute a hazard or damage to a Building or its equipment, shall be moved into the Building without prior written consent of Landlord, which shall not be unreasonably withheld. If such consent is granted, such article may be moved into the Building and located in the Building only in the manner designated by Landlord.

D. Omitted.

E. Water closets and other water fixtures shall not be used for any purpose other than that for which the same are intended, and any damage resulting to the same from misuse on the part of Tenant or any Tenant Parties shall be paid for by Tenant. No person shall waste water by tying back or wedging the faucets or by any other means.

F. Omitted.

G. There shall be no obstruction of common roadways or drives of the Park Common Areas. Further, no unlicensed vehicles may be parked in any common parking or drives, or truck loading areas of the Park Common Areas and no vehicles or bicycles may be stored in any Park Common Areas, except where designated.

H. Tenant shall not allow anything to be placed on the outside of the Premises, other than permitted signs, and then only to the extent expressly provided in the Lease, nor shall anything be thrown by Tenant or any Tenant Parties out of the windows of any Building. Landlord shall have the right to remove all non-permitted signs, or non-permitted furniture, equipment or supplies located in any Park Common Areas without notice to Tenant and at the expense of Tenant.

I. Omitted.

J. No awning shall be placed over the windows, except with the prior written consent of Landlord.

K. Omitted.

L. Omitted.

M. Tenant shall comply with all applicable laws and regulations of any public authority affecting the Project or the use thereof, and correct at Tenant's expense any failure to comply created through Tenant's or any Tenant Parties' fault or by reason of Tenant's or any Tenant Parties' use.

N. Except with the prior written consent of Landlord, Tenant shall not conduct any retail sales in or from the Project, or any business other than that specifically provided for in the Lease.

O. Omitted.

P. The sashes, sash doors, windows, glass lights, and any lights or skylights that reflect or admit light into the halls or other places of the

Buildings shall not be covered or obstructed. The toilet rooms, water and wash closets and other water apparatus shall not be used for any purpose other than that for which they were constructed, and no foreign substances of any kind whatsoever shall be thrown therein, and the expense of any breakage, stoppage or damage, resulting from the violation of this rule shall be borne by Tenant.

Q. In order to maintain the outward professional appearance of the Project, all window coverings to be installed at the Premises shall be subject to Landlord's prior approval, which approval shall not be unreasonably withheld. If Landlord, by a notice in writing to Tenant, shall object to any curtain, blind, shade or screen attached to, or hung in, or used in connection with, any window or door of the Premises, such use of such curtain, blind, shade or screen shall be forthwith discontinued by Tenant.

R. No cooking shall be done or permitted by Tenant on the Project other than (i) in a cafeteria operated in compliance with law and applicable covenants affecting the Premises, or (ii) the use of a microwave oven for food or Underwriter's Laboratory approved equipment for brewing coffee, tea, and similar beverages, provided that the use is in compliance with law. Offices in the Premises shall not be used for lodging.

S. Tenant shall not lay linoleum or other similar floor covering so that the same be affixed to the floor of the Premises in any manner except by a paste, or other material which may easily be removed with water, the use of cement or other similar adhesive materials being expressly prohibited. The method of affixing any such linoleum or other similar floor covering to the floor, as well as the method of affixing carpets or rugs to the Premises, shall be subject to approval by Landlord, which approval shall not be unreasonably withheld. Tenant shall not drill through or similarly alter or damage any designer flooring in the common areas of any Building with Landlord's prior written consent. The expense of repairing any damage resulting from a violation of this rule shall be borne by Tenant.

T. Omitted.

U. Smoking is prohibited in all areas of the Buildings, and smoking will be permitted only in those outdoor areas of the Project.

Landlord may reasonably amend, modify, delete or add new and additional rules and regulations regarding the use and care of the Premises and Project. Tenant and Tenant Parties shall comply with all such rules and regulations upon notice thereof to Tenant from Landlord. In addition, Landlord shall have the right to enact customary reasonable additional rules and regulations if the Project becomes multi-tenant as a result of surrender of any portion thereof by Tenant to Landlord which has been agreed upon in writing by Landlord. Any breach by Tenant or Tenant Parties of any rules and regulations herein set forth or any nondiscriminatory amendments, modifications or additions thereto beyond any applicable notice and/or care period, shall constitute an Event of Default by Tenant under the Lease and Landlord shall have all rights and remedies set forth therein.

EXHIBIT G

HAZARDOUS MATERIALS LIST

[SEE ATTACHED]

EXHIBIT H

SIGNAGE PROGRAM

[SEE ATTACHED]

EXHIBIT I

MAINTENANCE SPECIFICATIONS

| EXPENSE DESCRIPTION | COMMENTS |
|------------------------------|---|
| ----- | ----- |
| Parking Lot Sweeping | Sweep parking lot one time per week |
| Parking Lot Lights | Light inspection/service one time per month |
| Pest Control | One time per month exterior service |
| Steam Cleaning | One time per year steam clean exterior walkways |
| Window Washing | Three times per year exterior window washing |
| Water | Landscape irrigation |
| HVAC | Monthly equipment inspections and filter changes as required |
| Landscape - Exterior | Weekly service to include mowing, weeding, fertilizing and trimming |
| Landscape - Miscellaneous | Flower replacement quarterly |
| Management Fee | 2.5% of Gross Receipts |
| Administrative Fees | Office supplies, telephones, answering service, postage, etc. |
| Roof | Semi-annual roof inspections |
| Insurance | Property Insurance including earthquake insurance |
| Taxes | Property Taxes |
| Association Fees | Foothill Ranch Community Association fees |
| Maintenance Salary | Exterior maintenance 2 hours per day - 5 days per week |
| Elevators | Monthly contract service |
| Elevator Phones | Monthly elevator emergency phone lines |
| Building Maintenance | Miscellaneous building maintenance |
| Tools & Equipment | Miscellaneous tools and equipment |
| Building Electrical Supplies | Miscellaneous electrical supplies |
| Fire Protection | Monitoring of fire, life safety systems (smoke detectors, sprinklers, alarms, etc.) |
| Building | Contingency account for miscellaneous electrical supplies |
| Plumbing | Contingency account for miscellaneous plumbing repairs |
| Building Contingency | Miscellaneous |
| Life Safety | Annual certification of fire alarm system and start up of tenant evacuation program |

EXHIBIT J

TRANSFEREE MINIMUM FINANCIAL PARAMETERS

| CATEGORY ----- | MINIMUM AMOUNT ----- |
|---|-------------------------|
| Cash balance plus line of credit availability | \$200,000,000.00* |
| Tangible net worth | \$100,000,000.00 |
| EBITDA w/o nonrecurring | \$ 5,000,000.00 |

* Cash balance portion must be at least \$50,000,000.00

WESTERN DIGITAL CORPORATION
 SUBSIDIARIES OF THE COMPANY

| Name ----- | State or other Jurisdiction of Incorporation ----- |
|---|---|
| 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.

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

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED STATEMENTS OF OPERATIONS AND BALANCE SHEETS OF WESTERN DIGITAL CORPORATION AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH ANNUAL REPORT ON FORM 10K FOR THE YEAR ENDED JUNE 30, 2000.

1,000

| YEAR | |
|-------------|-----------|
| JUN-30-2000 | |
| JUL-04-1999 | |
| JUN-30-2000 | 184,021 |
| | 22,322 |
| | 162,451 |
| | 13,316 |
| | 84,546 |
| | 451,395 |
| | 389,851 |
| | 290,899 |
| | 615,574 |
| 445,066 | 225,496 |
| 0 | 0 |
| | 1,534 |
| | (111,368) |
| 615,574 | 1,957,580 |
| | 1,957,580 |
| | 1,949,511 |
| | 1,949,511 |
| | 387,358 |
| | 1,000 |
| | 4,874 |
| | (374,415) |
| | 19,500 |
| | 0 |
| | 0 |
| | 166,899 |
| | 0 |
| | (188,016) |
| | (1.53) |
| | (1.53) |