WESTERN DIGITAL CORP
Form 10-K
August 28, 2007

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

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended June 29, 2007**

**or**

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

**For the transition period from to**

**Commission file number 1-8703**

**WESTERN DIGITAL CORPORATION**
**(Exact Name of Registrant as Specified in Its Charter)**

| | |
|---|---|
| **Delaware**<br>**(State or Other Jurisdiction of Incorporation or Organization)** | **33-0956711**<br>**(I.R.S. Employer Identification No.)** |
| **20511 Lake Forest Drive**<br>**Lake Forest, California**<br>**(Address of principal executive offices)** | **92630**<br>**(Zip Code)** |

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, $.01 Par Value Per Share | New York Stock Exchange |
| Rights to Purchase Series A Junior Participating Preferred Stock | New York Stock Exchange |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes o  No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.  Yes o  No þ

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 þ  No o

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.  o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of  accelerated filer and large accelerated filer  in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ  Accelerated filer o  Non-accelerated filer o

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

The aggregate market value of the registrant s common stock held by non-affiliates of the registrant on December 29, 2006, the last business day of the registrant s most recently completed second fiscal quarter, was approximately $4.6 billion, based on the closing sale price as reported on the New York Stock Exchange.

As of the close of business on August 16, 2007, 219 million shares of common stock, par value $.01 per share, were outstanding.

**Documents Incorporated by Reference**

Part III incorporates by reference certain information from the registrant s definitive proxy statement (the  Proxy Statement ) for the 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission within 120 days after the close of the 2007 fiscal year. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

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**WESTERN DIGITAL CORPORATION**

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**For the Fiscal Year Ended June 29, 2007**



Typically, our fiscal year ends on the Friday nearest to June 30 and consists of 52 weeks. However, approximately every six years, we report a 53-week fiscal year to align our fiscal quarters with calendar quarters by adding a week to our fourth fiscal quarter. The 2007, 2006 and 2005 fiscal years, which ended on June 29, 2007, June 30, 2006, and July 1, 2005, respectively, consisted of 52 weeks each. Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms we , us , our and WD refer to Western Digital Corporation and its subsidiaries.

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

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

Western Digital®, WD®, the WD logo®, WD Caviar®, WD Raptor®, WD Scorpio®, WD Passport®, My Book™, My DVR Expander™ and GreenPower™ are trademarks of Western Digital Technologies, Inc. and/or its affiliates. All other trademarks mentioned are the property of their respective owners.

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*Forward-Looking Statements*

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

*growth in demand for hard drives in the desktop, mobile, enterprise, consumer electronics and retail markets and factors contributing to such growth;*

*our expansion into hard drive markets, such as consumer electronics, enterprise and retail, and into emerging geographic markets;*

*increase in our sales of notebook hard drives;*

*growth of our market share in the retail market;*

*our planned use of new recording technologies;*

*expectations regarding seasonal demand trends and price declines for the hard drive industry;*

*our expansion of our head wafer fabrication facilities;*

*beliefs regarding the sufficiency of our cash, cash equivalents and short-term investments to meet our working capital needs;*

*beliefs regarding our operating performance and general industry conditions and their impacts on the realization of our deferred tax assets; and*

*beliefs concerning our proposed acquisition of Komag, Incorporated, including our beliefs that we will close the planned transaction during the third calendar quarter of 2007, our planned acquisition of Komag will result in certain benefits, including cost, operational and other efficiencies and synergies, and we will be able to integrate Komag s media business into our overall operations.*

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

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PART I

## Item 1. *Business*

### General

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

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

Hard drives provide non-volatile data storage, which means that the data remains present when power is no longer applied to the device. Our hard drives currently include 3.5-inch and 2.5-inch form factor drives, having capacities ranging from 40 gigabytes ( GB ) to 1 terabyte ( TB ), nominal rotation speeds of 5,400, 7,200 and 10,000 revolutions per minute ( RPM ), and offer interfaces including both Enhanced Integrated Drive Electronics ( EIDE ) and Serial Advanced Technology Attachment ( SATA ). We also embed our hard drives into WD-branded external storage appliances that utilize interfaces such as USB 2.0, external SATA, FireWire™ and Ethernet network connections. In addition, we recently announced a family of hard drives specifically designed to consume substantially less power than previous designs.

We manufacture hard drives and head stack assemblies ( HSAs ) in Malaysia and Thailand. We also design and manufacture a substantial portion of our required magnetic heads in California, and head gimbal assemblies ( HGAs ) in Thailand. Following our planned acquisition of Komag, Incorporated ( Komag ), a leading media manufacturer and one of our current suppliers, we will also design in California and manufacture in Malaysia most of our required media and substrates. For geographical financial data, see Part II, Item 8, Note 6 in the Notes to Consolidated Financial Statements, included in this Annual Report on Form 10-K.

On June 28, 2007, we entered into a definitive agreement to acquire all the outstanding shares of Komag for a value of approximately $1.0 billion. The planned acquisition of Komag is intended to strengthen our production efficiencies and enhance our hard drive manufacturing process by integrating media. The planned acquisition is structured as a cash tender offer at $32.25 per share for all the outstanding shares of Komag common stock, followed by a merger of our indirect wholly-owned subsidiary into Komag in which the remaining shareholders of Komag will receive $32.25 in cash per share. The planned acquisition is expected to close in the third calendar quarter of 2007. We intend to fund the planned acquisition, including the expected repurchase of Komag s convertible notes due 2014 and related fees and expenses, through a combination of cash and proceeds from a senior unsecured term bridge loan facility of up to $1.3 billion.

### Business Strategy

Our business strategy is to provide a broad selection of reliable, high quality hard drives at a low total cost of ownership and with high efficiency. We believe this strategy helps accomplish the following:

- distinguishes us in the dynamic and competitive hard drive industry;
- provides great value to our customers; and
- allows us to better achieve consistent financial performance, including strong returns on invested capital.

We have designed our business strategy to accommodate significant unit and revenue growth with relatively small increases in operating expenses and to consistently achieve high asset utilization.

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## Industry

We develop and manufacture hard drives for the desktop, mobile PC, enterprise, CE and branded product retail markets. We believe that growth in the sales of hard drives has outpaced growth in the sales of all PCs over the past five years. Based on industry data, in calendar 2001 there were approximately 50% more hard drives sold in the market than PCs. In contrast, in calendar 2006 there were approximately 79% more hard drives sold in the market than PCs. We believe the following factors primarily drive this accelerating growth of hard drive sales in addition to PC applications:

- consumer use of hard drives for the playing, retention, and creation of digital content for personal use in the rapidly growing CE market;
- growth of the external hard drive or branded products market, permitting the easy storage, portability and backup of data such as music, or digital photographs and video;
- increased use of multiple hard drives in PCs for data backup and expanded storage capacity; and
- increased use of multiple cost-optimized high performance hard drives in data-intensive applications such as Internet search engines.

Additionally, we believe that the demand for 2.5-inch hard drives has grown from approximately 16% of the overall hard drive market in calendar 2003 to 34% of the overall hard drive market in calendar 2006.

These factors and our product expansion strategy in the last three years have gradually increased our percentage of revenue derived from non-desktop sources. In 2007, 57% of our revenue was from desktop computers and 43% was from non-desktop sources, compared to 71% of our revenue from desktop computers and 29% from non-desktop sources in 2006.

For further discussion of the risks of the hard drive industry, please see Item 1A of this Annual Report on Form 10-K.

*Desktop Market*

The desktop market consists of the overall hard drive market for desktop computers. Individuals use desktop computers in homes, businesses and multi-user networks. Desktop computers use software applications for word processing, spreadsheet, desktop publishing, database management, multimedia, entertainment and for other needs. Hard drives store desktop computer operating system and application software, as well as the data used by the applications.

We believe that the demand for hard drives in the desktop market has grown in part due to:

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

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

*Mobile PC Market*

The mobile PC market consists primarily of notebook computers. Individuals use notebook computers both in and away from homes and businesses. Like desktop computers, notebook computers use software applications for various needs and hard drives store notebook operating system and application software, and the data used by the applications.

We believe that the demand for hard drives in the mobile PC market has grown in part due to:

- the overall growth of notebook sales;
- the increased mobility of the workforce;

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

We expect the mobile PC market to continue to grow faster than the desktop or enterprise markets in the next three years. As the mobile PC market continues to evolve to a higher volume market, we believe customers are placing increased emphasis on attributes such as quality, reliability, execution, flexibility, and competitive cost structures of their hard drive suppliers. These are the same attributes that have mattered for many years to customers in the high-volume desktop market.

*Enterprise Market*

The enterprise market for hard drives includes workstations, servers, network attached storage, storage area networks, other computing systems or subsystems, and video surveillance. Historically, hard drives for this market have utilized several interfaces, including the Small Computer Systems Interface ( SCSI ) and Fibre Channel Arbitrated Loop ( FCAL ). Beginning in 2003, these traditional enterprise interfaces have been supplemented or have been replaced in certain storage applications by hard drives featuring the SATA interface technology, which is supported by industry standards, as well as by Serial Attached SCSI ( SAS ). SATA hard drives typically cost customers less than SCSI hard drives while offering higher capacities and maintaining similar reliability, scalability and performance.

We believe that enterprise uses of SATA hard drives will continue to increase. During the past few years a new disk-based back-up application has emerged with high-capacity SATA hard drives augmenting SCSI hard drives, tape and optical media. This new application, popularly referred to as near-line storage, has created a growth market because hard drives back-up or access data more quickly than tape or optical solutions, and quickly retrieve critical back-up or near-line data. The availability of SATA hard drive solutions, which are more cost effective than SCSI hard drives, promotes the increasing use of high-capacity hard drives in near-line storage applications. The low price per capacity of SATA drives has stimulated new applications such as video surveillance, video editing/broadcasting and medical imaging. These applications represent segments of a growing market for high capacity storage in non-computing imaging and multimedia professions.

Enterprise-class SATA drives are becoming commonplace for IT infrastructure applications such as databases, scientific computing, web content, web caching, web search engines and electronic mail. These applications have become an important market for high-capacity SATA hard drives. We believe that this market will consume a growing portion of the highest capacity hard drives in the next three years.

SAS is the next generation SCSI technology and is expected to replace SCSI drives over the next few years. SATA technology is compatible with SAS technology, enabling customers the flexibility of incorporating SATA hard drives in SAS storage systems. We believe the market transition from SCSI to SAS will add to the growth of the enterprise-class SATA market, which currently is estimated to be more than 30% of the enterprise hard drive market.

High-performance applications such as blade servers are increasingly using 2.5-inch form factor hard drives, supplanting traditional 3.5-inch drives. Smaller form factors enable more drives per physical space for increased performance, high capacity per square foot and low power consumption. This trend demonstrates the fragmentation of the enterprise hard drive market and the need for application-specific enterprise-class hard drives.

*Consumer Electronics Market*

The use of hard drives in CE products has been a major growth area in recent years. Currently, the three largest segments of this market are:

- video content in applications such as DVRs;
- audio and video content in applications such as consumer handheld devices, including MP3 players; and
- hard drives in game consoles.

Since 1999, DVRs have been available for use in home entertainment systems and they offer enhanced capabilities such as pausing live television, simplifying the process of recording, cataloging recorded television programs and quickly forwarding or returning to any section of a recorded television program. Additionally, digital video disk ( DVD ) recorders increasingly incorporate hard drives to allow for DVR functionality and faster recording of content onto removable DVDs. The market for these products favors larger capacity hard drives and continues to grow in Japan, North America, and Europe. Additionally, the rest of Asia Pacific shows strong interest in this market. We believe growth in this market will continue to build demand for higher capacity hard drives.

The proliferation in the CE market of more sophisticated mobile devices including cell phones and MP3 players is driving the delivery of diverse content from hard drive intensive hosts. We believe this is one of the factors influencing increased sales of enterprise-class SATA drives. We also believe that multimedia handheld devices such video cameras and high-resolution still cameras are enabling consumer production of expansive digital content that requires increasing amounts of small form-factor hard drive storage.

Hard drives with 1.8-inch or 1.0-inch form factors primarily address the consumer handheld device and portable external storage markets. The majority of hard drives used in portable media players that play both digital audio and video content are 1.8-inch form factors. Currently, we believe the markets for these handheld devices are better served by flash memory as opposed to rotating magnetic storage.

*External Hard Drive Market*

Most new PC systems include high-speed external interfaces, such as USB 2.0, external SATA, FireWire™ or Ethernet network connections that permit users to supplement the storage space of their PC systems or home and small office networks with the use of external hard drives. Users store additional programs or multimedia content, and back up internal hard drives with external hard drives, as well as mobile external hard drives for mobility convenience. Although external hard drives are a small part of the overall hard drive market, we believe that sales will continue to grow. External storage can often be the easiest, quickest or only way of adding additional storage capacity to either a desktop or notebook computer. We believe there is an increasing consumer awareness of the need and value of securely storing personal digital content through backup applications and devices. In addition, there is opportunity for external storage as a way of expanding storage capacity in CE devices such as DVRs.

*Other Market Opportunities*

We regularly review opportunities to apply our knowledge of data storage technology to markets that we do not currently serve. Based on significant investments we made over the last four years, we believe we now have the technology building blocks to increase our overall market penetration and be a full-line hard drive supplier. Consistent with our measured and deliberate approach to new market entries in the recent past, our approach to additional new markets will be based on a careful assessment of the risks, rewards, requirements and profit potential of such actions.

## Products

We offer a broad line of hard drives designed for various markets. We market our hard drives under brand names including WD Caviar®, WD Raptor®, WD Scorpio®, WD Passport®, My Book™, My DVR Expander™ and GreenPower™. These hard drives service the desktop, mobile, enterprise, CE and branded products markets, and can be found in products including desktop computers, notebook computers, enterprise storage, workstations, video surveillance equipment, networking products, DVRs, STBs and external storage appliances.

*Desktop Hard Drive Products*

Our hard drives designed for the desktop market currently consist of 3.5-inch form factor products with capacities ranging from 40 GB to 1 TB. These products utilize either the EIDE or SATA interfaces, providing high performance while retaining ease of use and overall low cost of connection. The type of EIDE interface currently used in our hard drives is ATA/100, which signifies a burst data transfer rate of 100 megabytes per second, which is the maximum specified data transition that can be sustained under ideal conditions. The SATA interface available in many of our hard drives enable burst transfer rates of up to 300 megabytes per second.

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*Mobile Hard Drive Products*

Our hard drives used in mobile products typically include 2.5-inch form factor drives for notebook computers. Although the desktop market accounts for a majority of hard drive sales, unit shipments of hard drives for notebook computers represent a growing share of the total. We entered the 2.5-inch mobile market in September 2004. We are now shipping our fourth generation of the WD Scorpio® product family, offering up to 250 GB of capacity. Our product expansion has enabled us to provide customers with a full-line of 2.5-inch mobile drives and helped us enhance our market position in this fast-growing market.

*Enterprise Hard Drive Products*

We offer multiple product lines to address enterprise market needs, including:

- the WD Raptor®, which is a 10,000 RPM enterprise-class drive with the SATA interface for enterprise applications requiring high performance and high reliability; and

- the WD Raid Edition ( RE ), which is a 7,200 RPM drive with capacities ranging from 160 GB to 750 GB. The WD RE includes both SATA and EIDE interfaces and has enhanced reliability features and ratings when contrasted to our desktop products.

Both WD Raptor® and WD RE drives may be used in, but are not limited to, applications such as databases, e-commerce and super computing in life science, oil and gas and similar industries, business records management, e-mail, file serving, web serving, near-line storage, medical records, engineering data management, video broadcasting and video security.

*Consumer Electronics Products*

We offer a line of hard drives under the WD AV brand that are designed for use in products such as DVRs, STBs, karaoke systems, multi-function printers, and gaming systems. WD AV drives deliver the characteristics CE manufacturers seek most, which are quiet operation, low temperature, low power consumption specifications, high reliability and optimized streaming capabilities.

*Branded Products*

We sell a broad line of WD-branded hard drive-based storage appliances, which are internal drives embedded into PC peripheral-style enclosures that have USB 2.0, external SATA, FireWire™ and Ethernet network connections and include software that assists customers with back up, remote access and management of digital content. We sell these branded storage appliances, as well as related adapters, through retail store fronts, online stores and distributors. These include:

- the 3.5-inch hard drive-based My Book™ family of storage appliances, which are designed to reside on desktops as PC peripherals and simplify storage for mainstream consumers, and offer from 80 GB to 2 TB of capacity;

- The 3.5-inch My DVR Expander™ storage appliance, which adds recording time to STBs with DVR capability;

- the 2.5-inch hard drive-based WD Passport® Portable series of USB 2.0 storage devices, which, in a form measuring approximately 5.0 inches by 3.0 inches by 0.6 inches and weighing less than one-quarter of a pound, offer from 40 GB to 250 GB of portable storage capacity; and

3.5-inch and 2.5-inch internal hard drives packaged with PC installation kits under the WD brand for retail store sales.

**Research and Development**

We devote substantial resources to development of new products and improvement of existing products. We focus our engineering efforts on coordinating our product design and manufacturing processes to bring our products to market in a cost-effective and timely manner. Research and development expenses totaled $306 million, $297 million and $240 million in 2007, 2006 and 2005, respectively.

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For further discussion of risks related to our development of new products, see Item 1A of this Annual Report on Form 10-K.

**Technology and Product Development**

Hard drives record, store and retrieve digital data. Performance attributes of hard drives, such as their ability to access and transmit data and storage capacity, are currently better than removable or floppy disks, optical hard drives and tapes, and they are more cost effective than semiconductor technology. The primary measures of hard drive performance include:

- Acoustics which is the sound power emitted during hard drive operation, commonly expressed in decibels.

- Data transfer rate which is the sustained rate of data transfer to and from the disk, commonly expressed in megabits per second. One megabit equals one million bits.

- Seek time which is the time needed to position the heads over a selected track on the disk surface, commonly expressed in milliseconds.

- Spindle rotation speed which is the nominal rotation speed of the disks inside the hard drive, commonly expressed in RPM, revolutions per minute or latency. Spindle rotation speeds commonly stated as 5,400, 7,200 and 10,000 RPM are sometimes approximations.

- Storage capacity which is the amount of data that can be stored on the hard drive, commonly expressed in GB or TB. As defined in the hard drive industry, one GB equals one billion bytes and one TB equals one trillion bytes. A byte is a digital character, typically comprised of eight bits. A bit is a binary digit, the smallest unit of information in a digital system.

All of our hard drive products employ similar technology. The main components of the hard drive are a head disk assembly and a printed circuit board. The head disk assembly includes heads, media (disks), head positioning mechanism (actuator) and spindle motor. A rigid base and top cover contain these components in a contamination-controlled environment. The printed circuit board includes both standard and custom integrated circuits, an interface connector to the host computer and a power connector.

One or more disks positioned around a motor-driven spindle hub that rotates the disks comprise the head disk assembly. A thin coating of magnetic materials applied to a smooth substrate make the disk. Each disk has a head suspended directly above it, which can read data from or write data to the spinning disk.

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 divided into sectors. The computer sends instructions to the controller to read data from or write data to the disks based on logical track and sector locations. Guided by instructions from the controller, the head stack assembly pivots and swings 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 allow the hard drive to communicate with the computer. Currently, the primary interfaces for PCs are EIDE and SATA, and the primary interfaces for enterprise systems are SCSI, SATA, SAS and FCAL. As computer performance continues to improve, the hard drive will need to deliver information faster. We believe this will continue to drive the PC industry transition to higher speed interfaces, such as SATA, to handle the higher data transfer rates. We currently offer our WD Caviar® and WD Caviar® GreenPower™ ( GP ) drives with the SATA interface featuring capacities as large as 750 GB and 1 TB, respectively. We design these products for the PC, workstation, and external storage markets. We currently offer our WD Raptor®, a 10,000 RPM enterprise-class drive with the SATA interface, and the WD RE, 7,200 RPM drives manufactured to enterprise-class standards and available with a SATA interface.

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, determines storage capacity of the hard drive. The higher the areal density, the more information can be stored on a single platter. Achieving a given drive capacity requires fewer disks as the areal density increases, potentially reducing product costs over time through reduced component requirements. Beginning in June

2007, we began shipping 3.5-inch hard drives with 188 GB per platter areal density and 2.5-inch hard drives with 125 GB per platter areal density. In July 2007, we introduced the WD Cavier® GP 3.5-inch hard drive which has 250 GB per platter areal density.

Head technology is one of the variables affecting areal density. Historically, there have been rapid technological changes resulting in several generations of head technology in a relatively short time. However, in recent years the time has lengthened between changes in generations of head technology. The hard drive industry is in the midst of a transition from the use of giant magnetoresistive head technology for the head writer function to perpendicular recording ( PMR ) technology, which allows for significantly higher storage capacities. In addition, the industry is making the transition to tunnel injunctive magneto resistive ( TMR ) technology for the head reader function. We have essentially completed the transition to PMR and TMR in our 2.5-inch products and we are in the midst of these transitions in our 3.5-inch products.

The WD product line generally leverages a common platform for various products within product families with different capacities to serve differing market needs. This platform strategy results in commonality of components across different products within product families and, in some cases, across product families, which reduces exposure to changes in demand, facilitates inventory management and allows us to achieve lower costs through purchasing economies. This platform strategy also enables our customers to leverage their qualification efforts onto successive product models.

In addition to the development of hard drives, we invest considerable resources in the development of head technology used in the majority of our hard drive products and we anticipate investing considerable resources in the development of media technology following our planned acquisition of Komag. The design and manufacturing of WD heads consists of engineering and fabricating a read element for reading data from media, a write element for writing data to media, and slider. The slider functions like an airplane wing and allows the read and write elements to fly over the surface of media and to land, on either the media or a special ramp, when power is not applied to the hard drive.

Fiscal 2007 represented the fifth consecutive year of substantial growth in our research and development and capital spending to support our significant broadening of our product and technology portfolios. Over that five-year period, we have grown our investment spending over 270% from $170 million in fiscal 2002 to approximately $630 million in fiscal 2007. As a result of this investment activity, we continue to expand our business beyond the desktop market into newer markets or markets in which we have not previously participated. Such investments have allowed us to execute against our strategic objective of revenue diversification to address the growth of new applications for hard drives and fast-growing new market opportunities.

We are currently expanding our existing head wafer fabrication facilities to accommodate our anticipated growth. The expansion will involve a process change to utilize 8.0-inch wafers from 6.0-inch wafers and will cost an estimated $400 million in the fiscal 2008 to 2010 timeframe. This will be in addition to our ongoing capital expenditures for hard drive and head assembly, and our anticipated capital expenditures for media development and manufacturing following our planned acquisition of Komag.

For an additional discussion of risks related to technological innovations, see Item 1A of this Annual Report on Form 10-K.

**Sales and Distribution**

We sell our products globally to OEMs, ODMs, distributors and retailers. OEMs purchase our hard drives, either directly or through a contract manufacturer such as an ODM, and assemble them into the computer or other CE systems they build. Distributors typically sell our hard drives to non-direct customers such as small computer and CE manufacturers, dealers, systems integrators, online retailers and other resellers. Retailers typically sell our hard drive products directly to end-users through their storefront or online facilities.

*Original Equipment Manufacturers*

Sales to OEMs, which include sales through ODMs, accounted for 48%, 54% and 58% of our revenue in 2007, 2006 and 2005, respectively. During 2007, our largest OEM customer was Dell. During 2007, 2006 and 2005, sales to Dell accounted for 10%, 12%, and 16%, respectively, of our revenue. We believe that our success depends on our ability to maintain and improve our strong relationships with the leading OEMs.

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OEMs evaluate and select their hard drive suppliers based on a number of factors, including quality and reliability, storage capacities, performance characteristics, price, service and support, ease of doing business, and the supplier s long-term financial stability. They typically seek to qualify two or more providers for each generation of hard drives, and once an OEM 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 success with OEM qualifications, a hard drive supplier must consistently offer hard drives featuring leading technology, quality, and reliability at acceptable capacity per disk. Suppliers must quickly achieve volume production of each new generation of high quality and reliable hard drives, requiring access to flexible, high-capacity, high-quality manufacturing capabilities.

Many of our OEM customers utilize just-in-time inventory management processes or supply chain business models that combine build-to-order, in which they do not build until there is a firm order, and contract manufacturing, in which the OEM contracts assembly work to a contract manufacturer, such as an ODM, who purchases components and assembles the computer based on the OEM s instructions. For certain OEMs, we maintain a base stock of finished goods inventory in facilities located near or adjacent to the OEM s operations.

For an additional discussion of risks related to our need to adapt to our customers business models and maintain customer satisfaction, refer to Item 1A of this Annual Report on Form 10-K.

*Distributors*

We use a broad group of distributors to sell our products to non-direct customers such as small computer and CE manufacturers, dealers, systems integrators, online retailers and other resellers. Distributors accounted for approximately 36%, 39% and 36% of our revenue for 2007, 2006 and 2005, respectively. Distributors generally enter into non-exclusive agreements for specific territories with us for the purchase and redistribution of our products in specific territories. We grant our distributors limited price protection rights.

*Retailers*

We sell our branded products directly to a select group of major retailers such as computer superstores, warehouse clubs, online retailers, and computer electronics stores, and authorize sales through distributors to smaller retailers. Retailers accounted for approximately 16%, 7% and 6% of our revenue for 2007, 2006 and 2005, respectively. Our current retail customer base is primarily in the United States, Canada and Europe. The retail channel complements our other sales channels while helping to build brand awareness for WD and our products. Retailers supply end-users with products to upgrade their computers and externally store their data for backup or mobility purposes. We grant our retailers price protection and limited rights to return product on an inventory rotation basis. We also sell our branded products at our web site.

*Sales and Marketing*

We maintain sales offices in selected parts of the world including the major geographies of the Americas, Asia Pacific, Japan, Europe, and the Middle East. Our international sales, which include sales to foreign subsidiaries of U.S. companies but do not include sales to U.S. subsidiaries of foreign companies, represented 68%, 68% and 65% of our revenue for 2007, 2006 and 2005, respectively. Sales to international customers may be subject to certain risks not normally encountered in domestic operations, including exposure to tariffs and various trade regulations. For further discussion regarding the risks related to sales to international customers, see Item 1A of this Annual Report on Form 10-K.

For additional information concerning revenue recognition, sales by geographic region and significant customer information, see Part II, Item 8, Notes 1 and 6 of the Notes to Consolidated Financial Statements.

We perform our marketing and advertising functions internally and through outside firms. We target advertising, worldwide packaging and marketing materials to various reseller and end-user categories. We utilize both consumer media and trade publications. We have programs under which we reimburse qualified distributors and retailers for certain marketing expenditures. We also maintain customer relationships by communicating with our resellers and providing end-users with information and support through our web site.

### Competition

We compete primarily with manufacturers of hard drives for use in desktop, notebook, enterprise, CE and external storage products. Our competitors in the hard drive market include ExcelStor Technology, Fujitsu Limited, Hitachi Global Storage Technologies, Samsung Electronics Incorporated, Seagate Technology and Toshiba Corporation. In 2006, Seagate completed the acquisition of Maxtor Corporation which, at the time of the acquisition, was one of the hard drive industry s four largest suppliers.

The hard drive industry is intensely competitive, with hard drive suppliers competing for sales to 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, service and support, and ease of doing business. The relative importance of these factors varies by customer and market. We believe that we are generally competitive in all of these factors.

We believe that there are no substantial barriers for existing competitors to offer competing products. Therefore, we believe that we cannot differentiate WD hard drive products solely on attributes such as storage capacity, buffer size or time-to-market. Accordingly, we differentiate WD by focusing on operational excellence, high product quality and reliability, and designing and incorporating into our hard drives desirable product performance attributes. Such performance attributes include seek times, data transfer rates, intelligent caching, failure prediction, remote diagnostics, acoustics, error recovery, low operating temperature, low power consumption and optimized streaming capabilities. In addition, we emphasize non-product related attributes, including rapid response to our customers. Rapid response requires accelerated design cycles, customer delivery, production flexibility and timely service and support, which contribute to customer satisfaction. We also rely on the strength of the WD brand name with value-added resellers, retailers and solution providers to whom we sell our hard drive products directly and indirectly. We believe that trust in a manufacturer s reputation, its execution track record and the establishment of strategic relationships have become important factors in the selection of a hard drive, particularly in a rapidly changing technology environment.

Advances in magnetic, optical or other data storage technologies could result in competitive products with better performance or lower cost per unit of capacity than our products. High-speed semiconductor memory could compete with our hard drive products in the future. Semiconductor memory is much faster in some applications than magnetic hard drives, but currently is not competitive from a cost standpoint. Flash memory, a non-volatile semiconductor memory, is currently much more costly and, while it has higher read performance attributes than hard drives, it has lower write performance attributes. Flash memory could become competitive in the near future for applications requiring less storage capacity than that provided by hard drives. We believe that the traditional high-volume computing markets will remain the domain of 3.5-inch and 2.5-inch hard drives based on the HDD industry s attributes of reliability, availability and cost.

For an additional discussion of risks related to competition, see Item 1A of this Annual Report on Form 10-K.

### Service and Warranty

We generally warrant our newly manufactured hard drives against defects in materials and workmanship from one to five years from the date of manufacture depending on the type of product. Our warranty obligation is generally limited to repair or replacement of the hard drive. We have engaged third parties in Australia, Brazil, Canada, China, Germany, Hungary, India, Korea, Russia, Singapore, Thailand and the United Arab Emirates to provide various levels of testing, processing and/or recertification of returned hard drives for our customers. In addition, we process, test and recertify returned hard drives at our facility in the United States.

**Manufacturing**

We believe that we have significant know-how, unique product manufacturing processes, execution skills and human resources to continue to be successful and have the ability to grow, as necessary, our manufacturing operations. To be competitive, we must manufacture high quality hard drives with industry leading time-to-volume production at competitive unit costs. We strive to maintain manufacturing flexibility, high manufacturing yields, reliable products, and high-quality components that we manufacture ourselves, while insisting that our suppliers provide high-quality components at competitive prices. The critical elements of our hard drive production are high volume, low cost assembly and testing, and establishment and maintenance of key supplier relationships. By establishing close relationships with our strategic component suppliers, we believe we access best-of-class manufacturing quality. In addition, we believe that our sourcing strategy currently enables us to have the business flexibility needed to select the highest quality low cost of ownership suppliers as product designs and technologies evolve.

Hard drive manufacturing is a complex process involving the assembly of precision components with narrow tolerances and thorough testing. The assembly process occurs in a clean room environment that demands skill in process engineering and efficient space utilization to control the operating costs of this manufacturing environment. Our clean room manufacturing process consists of modular production units, each of which contains a number of work cells.

We manufacture hard drives in Malaysia and Thailand. We continually evaluate our manufacturing processes in an effort to increase productivity, sustain and improve quality and decrease manufacturing costs. We continually evaluate which steps in the manufacturing process would benefit from automation and how automated manufacturing processes can improve productivity and reduce manufacturing costs.

In July 2003, we purchased substantially all of the assets of Read-Rite Corporation, formerly one of our suppliers of heads, including its wafer fabrication equipment in Fremont, California and its slider fabrication facility in Bang Pa-In, Thailand. We upgraded and enhanced these facilities to meet the demands of new technologies consistent with our hard drive production facilities. We use these facilities to design and manufacture a substantial portion of the heads, HGAs we include in the hard drives we manufacture.

We are currently expanding our head wafer manufacturing facilities in Fremont, California and expect to complete the expansion in calendar 2009, which will provide us with adequate wafer fabrication capacity for the foreseeable future.

Following our planned acquisition of Komag, we will also have media and substrate design and manufacturing facilities in Malaysia. We plan to use these facilities to design and manufacture most of the media and substrates that we use in our products.

For an additional discussion of risks related to manufacturing, see Item 1A of this Annual Report on Form 10-K.

**Materials and Supplies**

The following products are the major components currently used in the manufacture of our hard drives:

- magnetic heads and media;
- suspensions with related HGAs and head stack assemblies ( HSAs );
- spindle motors;
- custom and standard electronics such as system on chips, memory, motor controllers, pre-amps, and printed circuit boards;
- base and top covers; and
- magnets and related voice coil motors.

We also use several other components in our hard drives such as seals, filters, plastic molded parts, capacitors, resistors, connectors, and cables.

We design and manufacture a substantial portion of the heads required for the hard drives we manufacture. We purchase a portion of these components from third party suppliers. Following our planned acquisition of Komag, we intend to follow a similar operational strategy of internally supplying the majority of our media and substrate requirements and purchasing the remainder from independent media suppliers.

We acquire all of the remaining components for our products from third party suppliers. We generally retain multiple suppliers for each of our component requirements but in some instances use sole sources for business reasons.

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We sole-source some components, such as custom integrated circuit devices for certain products from suppliers like Marvell Technology, STMicroelectronics and Texas Instruments. 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. We expect this trend to continue in custom integrated circuits for hard drives.

For an additional discussion of risks related to our component supplies, see Item 1A of this Annual Report on Form 10-K.

**Backlog**

Historically, a substantial portion of our orders have been for shipments of hard drives within 30 to 60 days of the placement of the order. We generally negotiate pricing, order lead times, product support requirements and other terms and conditions before receiving a computer manufacturer s first purchase order for a product. Customers purchase orders typically may be canceled with relatively short notice to us, with little or no cost to the customer, or modified by customers to provide for delivery at a later date. In addition, we make many of our sales to OEMs under just-in-time delivery contracts that do not generally require firm order commitments by the customer until the time of sale. Instead, we receive a periodic forecast of requirements from the customer and invoice the customer upon shipment of the product from the just-in-time warehouse. Therefore, backlog information as of the end of a particular period is not necessarily indicative of future levels of our revenue and profit and may not be comparable to earlier periods.

**Patents, Licenses and Proprietary Information**

We own numerous patents and have many patent applications in process. We believe that, although our patents and patent applications have considerable value, the successful manufacturing and marketing of our products depends primarily upon the technical and managerial competence of our staff. Accordingly, the patents held and applied for do not ensure our future success.

In addition to patent protection of certain intellectual property rights, we consider elements of our product designs and processes to be proprietary and confidential. We believe that our non-patented intellectual property, particularly some of our process technology, is an important factor in our success. We rely upon non-disclosure agreements and contractual provisions and a system of internal safeguards to protect our proprietary information. Despite these safeguards, there is a risk that competitors may obtain and use such information. The laws of foreign jurisdictions in which we conduct business may provide less protection for confidential information than the United States.

We rely on certain technology that we license from other parties to manufacture and sell WD products. We believe that we have adequate cross-licenses and other agreements in place in addition to our own intellectual property portfolio to compete successfully in the hard drive industry. For additional discussion of risks related to our ownership and use of intellectual property, see Item 1A of this Annual Report on Form 10-K.

**Environmental Regulation**

We are subject to a variety of regulations in connection with our operations. We believe that we have obtained or are in the process of obtaining all necessary environmental permits for our operations. For additional discussion of risks related to environmental regulation, see Item 1A of this Annual Report on Form 10-K.

**Employees**

As of June 29, 2007, we employed a total of 29,572 employees worldwide. This represents an increase in headcount of approximately 20% since July 2, 2006 and an increase of approximately 28% since July 1, 2005. Many of our employees are highly skilled, and our continued success depends in part upon our ability to attract and retain such employees. Accordingly, we offer employee benefit programs, which we believe are, in the aggregate, competitive with those offered by our competitors. We and most of our competitors nevertheless have difficulty at times in hiring and retaining certain skilled employees. We have engaged consultants and contract personnel to fill these needs until full-time employees could be recruited. We consider our employee relations to be good.

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### Available Information

We maintain an Internet web site at http://www.westerndigital.com. Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on our web site at http://www.westerndigital.com, free of charge, as soon as reasonably practicable after the electronic filing of these reports with the SEC. Any materials we file with the SEC are available at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549. Additional information about the operation of the Public Reference Room can also be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a web site at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us.

### Executive Officers of the Registrant

Listed below are all of our executive officers as of June 29, 2007, 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 |
|---|---|---|
| John F. Coyne | 57 | Chief Executive Officer |
| Raymond M. Bukaty | 50 | Senior Vice President, Administration, General Counsel and Secretary |
| Timothy M. Leyden(1) | 55 | Executive Vice President, Finance |
| Stephen D. Milligan(1) | 44 | Senior Vice President and Chief Financial Officer |
| Hossein Moghadam | 63 | Senior Vice President and Chief Technology Officer |

(1) On April 26, 2007, we announced that Mr. Milligan will leave his position as Senior Vice President, Chief Financial Officer of Western Digital, and that his employment by us will terminate, effective August 31, 2007. Our Board of Directors has appointed Mr. Leyden to succeed Mr. Milligan as Chief Financial Officer of Western Digital, effective September 1, 2007, or earlier if Mr. Milligan resigns as Chief Financial Officer of Western Digital prior to August 31, 2007.

Mr. Coyne, 57, has been a director since October 2006. He joined us in 1983 and has served in various executive capacities. From November 2002 until June 2005, Mr. Coyne served as Senior Vice President, Worldwide Operations, from June 2005 until September 2005, he served as Executive Vice President, Worldwide Operations and from November 2005 until June 2006, he served as Executive Vice President and Chief Operations Officer. Effective June 2006, he was named President and Chief Operating Officer. In January 2007, he became President and Chief Executive Officer.

Mr. Bukaty, 50, joined us in 1999 as Vice President, Corporate Law. He was appointed to Vice President, General Counsel and Secretary in March 2002, and to Senior Vice President in January 2004, and assumed his current position as Senior Vice President, Administration, General Counsel and Secretary in October 2004.

Mr. Leyden, 55, re-joined us in May 2007 as Executive Vice President, Finance. From December 2001 to May 2007, Mr. Leyden served in senior finance capacities at Sage Software Inc. and Sage Software of California, subsidiaries of Sage Group PLC, a U.K. public company that supplies accounting and business management software to small and medium-sized businesses, including as Senior Vice President, Finance and Chief Financial Officer from May 2004 to May 2007, and as Vice President, Finance and Chief Financial Officer from December 2001 to May 2004. Mr. Leyden previously served in various worldwide finance, manufacturing and information technology capacities with us from 1983 to December 2000.

Mr. Milligan, 44, joined us in September 2002 as Vice President, Finance. He was appointed Senior Vice President and Chief Financial Officer in January 2004. Before joining us, Mr. Milligan served in a variety of senior finance capacities at Dell between April 1997 and September 2002, including Assistant Controller, European Controller, North European Finance Director, Director of Finance for the Americas, and Controller for Dell Financial Services.

## Item 1A. *Risk Factors*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*A low cost structure is critical to our operating results and increased costs may adversely affect our operating margin.*

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

*Shortages of commodity materials, or use by other industries of materials used in the hard drive industry, may increase our cost structure.*

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

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

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

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

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

New products in the hard drive market typically require higher areal densities than previous product generations, posing formidable technical and manufacturing challenges. Higher areal densities require existing head and media technology to be improved or new technology developed to accommodate more data on a single disk. In addition, our introduction of new products during a technology transition increases the likelihood of unexpected quality concerns. Our

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failure to bring high quality new products to market on time and at acceptable costs may put us at a competitive disadvantage to companies that achieve these results.

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

The industry is developing and now implementing new recording technologies that enable greater recording densities than currently available using magnetoresistive head technology, including perpendicular and tunneling junction technology, each of which represent a significant change in fundamental recording technology. This shift in technology is difficult to implement and historically, when the industry experiences a fundamental change in technology, any manufacturer that fails to successfully and timely adjust their designs and processes to accommodate the new technology, fails to remain competitive.

There are some technologies, such as current perpendicular-to-plane and heat assisted magnetic recording, that, if they can be implemented by a competitor on a commercially viable basis, will represent a revolutionary recording technology that could put us at a competitive disadvantage.

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

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

Storage capacity of the hard drive, as manufactured by us, is determined by the number of disks and each disk s areal density. Areal density is a measure of the amount of magnetic bits that can be stored on the recording surface of the disk. Generally, the higher the areal density, the more information can be stored on a single platter. Historically, we have been able to achieve a large percentage of cost reduction through increases in areal density. Increases in areal density mean that the average drive we sell has fewer heads and disks for the same capacity and, therefore, may result in a lower component cost. However, because increasing areal density has become more difficult in the hard drive industry, such increases may require increases in component costs and other opportunities to reduce costs may not continue at historical rates. Additionally, increases in areal density may require us to make further capital expenditures on items such as new testing equipment needed as a result of an increased number of GB per platter. Our inability to achieve cost reductions could adversely affect our operating results.

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

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

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

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

- an increase in the cost of such components or equipment;
- an extended shortage of required components or equipment;
- consolidation of key suppliers, such as the acquisition of Brilliant Manufacturing Limited by Nidec Corporation, the acquisition of Agere Systems Inc. by LSI Logic Corporation, and the planned acquisition of Alps Electric Co. Ltd. s magnetic device division s assets and related intellectual property by TDK Corp;
- failure of a key supplier s business process; or
- the failure of key suppliers to remain in business, to remain independent merchant suppliers, to adjust to market conditions, or to meet our quality, yield or production requirements.

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

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

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

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

*Our high-volume hard drive manufacturing facilities, and the manufacturing facilities of many of our suppliers, are concentrated in Asia, and our planned media manufacturing facilities will be located in Asia, which subjects us to the risk of damage or loss of any of these facilities and localized risks to employees in these locations.*

Our high-volume hard drive manufacturing facilities are in Malaysia and Thailand and the manufacturing facilities of many of our suppliers are in Asia. Following our planned acquisition of Komag, we will also have media and substrate manufacturing facilities in Malaysia. A condition or event such as political instability, civil unrest or a power outage, or a fire, flood, earthquake or other disaster that adversely affects any of these facilities or our ability to manufacture could

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limit the total volume of hard drives we are able to manufacture and result in a loss of sales and revenue and harm our operating results. Similarly, a localized health risk affecting our employees or the staff of our suppliers, such as a new pandemic influenza in Asia, could impair the total volume of hard drives that we are able to manufacture.

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

As we have previously discussed in public statements, our business plan presently contemplates that we plan to design and manufacture approximately 70% to 80% of the heads required for the hard drives we manufacture. We fabricate wafers in our Fremont, California facility, and the wafers are then sent to our Thailand facility for slider fabrication and wafer slicing and HGA assembly and testing. Additionally, following our planned acquisition of Komag, we will manufacture the majority of our media and substrates in Malaysia facilities. A fire, flood, earthquake or other disaster, condition or event such as a power outage that adversely affects our facilities in Fremont, California or Bang Pa-In, Thailand, or in Malaysia following our planned acquisition of Komag, would significantly affect supply of our heads or media, respectively, and limit our ability to manufacture hard drives which would result in a substantial loss of sales and revenue and a substantial harm to our operating results.

*Following our planned acquisition of Komag, if we fail to successfully integrate Komag s business into our operations in the expected time frame, or at all, it may adversely affect our future results.*

We believe that our planned acquisition of Komag will result in certain benefits, including certain cost, operational and other efficiencies and synergies. The success of our planned acquisition will be dependent on our ability to realize the anticipated benefits from vertically integrating Komag s business into our operations and Komag s media technology with our head technology. Following the planned acquisition, we may fail to realize the anticipated benefits on a timely basis, or at all, for a variety of reasons, including the following:

- potential incompatibility of Komag s operating systems with our operating systems;
- failure to integrate Komag s media technology with our head technology, or failure to leverage such integration, quickly and effectively;
- failure to successfully manage relationships with Komag s suppliers;
- failure to successfully manage relationships with Komag s other customers and the possibility of unanticipated claims from such parties;
- failure to successfully manage relationships with our other media suppliers;
- potential difficulties integrating and harmonizing financial reporting systems; and
- the loss of key employees.

If we are not able to successfully integrate Komag s business and technology into our operations, the anticipated benefits and efficiencies of the planned acquisition may not be realized fully or at all, or may take longer to realize than expected, and our ability to compete, our profit margins and our results of operations may be adversely affected.

*The successful completion of our planned acquisition of Komag is subject to risks and uncertainties and in the event we fail to complete the acquisition our stock price could suffer and our relationship with vendors and customers may be adversely impacted.*

Our ability to complete the planned acquisition of Komag is subject to risks and uncertainties, including, but not limited to, the risk that a condition to closing of the transaction may not be satisfied and the risk that we fail to obtain the financing necessary to complete the transaction. There is also no assurance that an adequate number of Komag shares will be validly tendered, and not withdrawn, in the tender offer sufficient to satisfy our minimum tender offer condition. In the event that the tender offer or merger is not completed or is delayed, the current market price of our common stock may decline if based on an assumption that the merger will occur as contemplated during the third calendar quarter of 2007. Additionally, these uncertainties regarding the merger may adversely affect our relationships with our vendors and customers.

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*There are certain additional capital expenditure costs and asset utilization risks to our business associated with our strategy to vertically integrate our operations.*

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

In addition, we may incur additional risks, including:

- if we are unable to manufacture a sufficient supply of heads, or media following our planned acquisition of Komag, there may be insufficient third party sources to satisfy our needs;

- third party head or media suppliers may not continue to do business with us or may not do business with us on the same terms and conditions we have previously enjoyed;

- claims that our manufacturing of heads, or media following our planned acquisition of Komag, may infringe certain intellectual property rights of other companies; and

- difficulties locating in a timely manner suitable manufacturing equipment for our head or planned media manufacturing processes and replacement parts for such equipment.

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

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

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

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

- produce sufficient quantities of products at the capacities our customers demand while managing the integration of new and established technologies;

- develop and qualify new products that have changes in overall specifications or features that our customers may require for their business needs;

- obtain commitments from our customers to qualify new products, redesigns of current products, or new components in our existing products;

- qualify these products with key customers on a timely basis by meeting all of our customers needs for performance, quality and features;

- maintain an adequate supply of components required to manufacture our products;

- maintain the manufacturing capability to quickly change our product mix between different capacities, form factors and spin speeds in response to changes in customers product demands; or

- consistently meet stated quality requirements on delivered products,

our operating results will be adversely affected.

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

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

*Failure by certain suppliers to effectively and efficiently develop and manufacture components for our products may adversely affect our operations.*

We rely on suppliers for various component parts that we integrate into our hard drives but do not manufacture ourselves, such as semiconductors, motors, flex circuits and suspensions. We are dependent on the suppliers of these various components to be able and willing to dedicate adequate engineering resources to develop technology that can be successfully integrated with our products, and to manufacture these components efficiently. The failure of component suppliers to effectively and efficiently develop and manufacture technology that can be integrated into our products may cause us to experience inability or delay in our manufacturing and shipment of hard drive products, or our expansion into new technology and markets, therefore adversely affecting our business and financial results.

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

We regularly engage in new product qualification with our customers. Once a product is accepted for qualification testing, failures or delays in the qualification process can result in our losing sales to that customer until the next generation of products is introduced. The effect of missing a product qualification opportunity is magnified by the limited number of high volume OEMs, which continue to consolidate their share of the PC and CE markets. If product life cycles lengthen, we may have a significantly longer period to wait before we have an opportunity to qualify a new product with a customer, which could harm our competitive position. These risks are increased because we expect cost improvements and competitive pressures to result in declining gross margins on our current generation products.

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

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

Our standard warranties contain limits on damages and exclusions of liability for consequential damages and for misuse, improper installation, alteration, accident or mishandling while in the possession of someone other than us. We

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record an accrual for estimated warranty costs at the time revenue is recognized. We may incur additional operating expenses if our warranty provision does not reflect the actual cost of resolving issues related to defects in our products. If these additional expenses are significant, it could adversely affect our business, financial condition and results of operations.

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

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

Higher capacity storage needs have typically been better served by magnetic hard drives than flash memory as hard drive manufacturers can offer better value at high capacities, while lower capacity needs have been successfully served by solid state storage such as flash memory technology. Advances in magnetic, optical, semiconductor or other data storage technologies could result in competitive products that have better performance or lower cost per unit of capacity than our products. If we fail to be cost competitive against flash memory, we could be at a competitive disadvantage to companies using semiconductor technology.

*Further industry consolidation could provide competitive advantages to our competitors.*

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

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

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

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

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

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

Some of our competitors earn a significant portion of their revenue from business units outside the hard drive industry. Because they do not depend solely on sales of hard drives to achieve profitability, they periodically sell hard drives at lower prices and operate their hard drive business unit at a loss while still remaining profitable overall. In

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addition, if these competitors can increase sales of non-hard drive products to the same customers, they may benefit from selling their hard drives at low prices. Our results of operations may be adversely affected if we can not successfully compete with the pricing by these companies.

*If we do not successfully expand into new hard drive markets and manage the issues associated with new products and new markets, our business may suffer.*

To remain a significant supplier of hard drives, we will need to offer a broad range of hard drive products to our customers. We currently offer a variety of 3.5-inch hard drives for the desktop, enterprise, CE and external storage markets, and we also offer 2.5-inch form factor hard drives for the mobile, CE and external storage markets. However, demand for hard drives may shift to products in smaller form factors, which our competitors may already offer. Expansion into other hard drive markets and resulting increases in volume capacity requirements may require us to make substantial additional capital investments due in part because our operations are vertically integrated.

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

*If we do not properly manage the technology transitions of our products, our operating results may be negatively affected.*

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

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

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

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

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

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

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

We sell our branded products directly to a select group of major retailers, for example, computer superstores and CE stores, and authorize sales through distributors to other retailers and online resellers. Our current retail customer base is primarily in the United States, Canada and Europe. We are facing increased competition from other companies for shelf space at a small number of major retailers that have strong buying power and pricing leverage. If we fail to successfully maintain a customer preference for Western Digital brand products or fail to successfully expand into multiple channels, our operating results may be adversely affected. We face strong competition in maintaining and trying to grow our market share in the retail market, particularly because of the relatively low barriers to entry in this market. We will continue to introduce new products in the retail market that incorporate our disk drives, however there can be no assurance that these products will gain market acceptance, and if they do not, our operating results could suffer.

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

During 2007, a large percentage of our revenue came from sales to our top 10 customers, which accounted for 47% of our revenue. One of these customers, Dell, accounted for more than 10% of our revenue. These customers have a variety of suppliers to choose from and therefore can make substantial demands on us, including demands on product pricing and on contractual terms, which often results in the allocation of risk to us as the supplier. Even if we successfully qualify a product with a customer, the customer generally is not obligated to purchase any minimum volume of products from us and may be able to cancel an order or terminate its relationship with us at any time. Our ability to maintain strong relationships with our principal customers is essential to our future performance. If we lose a key customer, if any of our key customers reduce their orders of our products or require us to reduce our prices before we are able to reduce costs, if a customer is acquired by one of our competitors or if a key customer suffers financial hardship then our operating results would likely be harmed. In addition, if customer pressures require us to reduce our pricing such that our gross margins are diminished, we could decide not to sell our products to a particular customer, which could result in a decrease in our revenue.

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

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

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

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

obtaining requisite United States of America and foreign governmental permits and approvals;

currency exchange rate fluctuations or restrictions;

political instability and civil unrest;

limited transportation availability, delays, and extended time required for shipping, which risks may be compounded in periods of price declines;

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

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

*Terrorist attacks may adversely affect our business and operating results.*

The continued threat of terrorist activity and other acts of war or hostility have created uncertainty in the financial and insurance markets and have significantly increased the political, economic and social instability in some of the geographic areas in which we operate. Additionally, it is uncertain what impact the reactions to such acts by various governmental agencies and security regulators worldwide will have on shipping costs. Acts of terrorism, either domestically or abroad, could create further uncertainties and instability. To the extent this results in disruption or delays of our manufacturing capabilities or shipments of our products, our business, operating results and financial condition could be adversely affected.

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

We ship the majority of our products to our various customers via air freight. The sudden unavailability of air cargo operations used to ship our products would impair our ability to deliver our products in a timely and efficient manner, which could adversely impact our operating results. We also ship our product via ocean freight, and events or conditions at shipping ports, such as labor difficulties or disputes, could also impact our operating results by impairing our ability to timely and efficiently deliver these products.

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

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

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

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

The hard drive industry has been characterized by significant litigation. This includes litigation relating to patent and other intellectual property rights, product liability claims and other types of litigation. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of litigation are inherently uncertain and may

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result in adverse rulings or decisions. We may enter into settlements or be subject to judgments that may, individually or in the aggregate, have a material adverse effect on our business, financial condition or results of operations.

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

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

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

*Environmental regulation costs could harm our operating results.*

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

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

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

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

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

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

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

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

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

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

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

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

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

- accruals for warranty costs related to product defects;
- price protection adjustments and other sales promotions and allowances on products sold to retailers, resellers and distributors;

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- inventory adjustments for write-down of inventories to lower of cost or market value (net realizable value);
- reserves for doubtful accounts;
- accruals for product returns;
- accruals for litigation and other contingencies; and
- reserves for deferred tax assets.

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

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

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

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

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

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

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

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

Our most recent evaluation resulted in our conclusion that as of June 29, 2007, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal controls over financial reporting were effective. We believe that we currently have adequate internal control procedures in place for future periods; however, if our internal controls are found to be ineffective, our financial results or our stock price may be adversely affected.

**Item 1B.** ***Unresolved Staff Comments***

Not applicable.

**Item 2.** ***Properties***

Our corporate headquarters are located in Lake Forest, California. The Lake Forest facilities consist of approximately 257,000 square feet of leased space and house our management, research and development, administrative and sales staff. In addition, in Fremont, California, we own facilities consisting of approximately 189,000 square feet, and we lease facilities consisting of approximately 97,000 square feet, that we use for head wafer fabrication, research and development and warehousing. In San Jose, California, we lease facilities consisting of approximately 217,100 square feet, primarily for research and development activities. Following our planned acquisition of Komag, we will lease additional facilities in San Jose consisting of approximately 193,469 square feet, which we intend to use for media research and development and warehousing. In addition, we lease one facility in Irvine, California, which consists of approximately 60,000 square feet that we use as a hard drive return and refurbishing center. We also lease office space in various other locations throughout the world primarily for sales and technical support.

We own manufacturing facilities in Kuala Lumpur, Malaysia of approximately 484,000 square feet, which we use for assembly of hard drives, printed circuit boards and HSAs. We also own manufacturing facilities in Navanakorn, Thailand, of approximately 226,000 square feet, which we use for assembly of hard drives and HSAs, and facilities in Bang Pa-In, Thailand, consisting of four buildings with approximately 902,000 square feet, which we use for slider fabrication, the assembly of hard drives, HGAs and HSAs, and research and development. Following our planned acquisition of Komag, we will also own four additional manufacturing facilities in Penang, Johor and Sarawak, Malaysia of approximately 1,303,000 square feet, which we intend to use for our media operations.

We believe our present facilities are adequate for our current needs, although the process of upgrading our facilities to meet technological and market requirements is expected to continue. New manufacturing facilities, in general, can be developed and become operational within approximately nine to eighteen months should we require such additional facilities.

**Item 3.** ***Legal Proceedings***

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

**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 2007.

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# PART II

## Item 5. *Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities.*

Our common stock is listed on the New York Stock Exchange, Inc. ( NYSE ) under the symbol WDC . The approximate number of holders of record of our common stock as of August 16, 2007 was 2,252.

We have not paid any cash dividends on our common stock and do not intend to pay any cash dividends on common stock in the foreseeable future. The proposed bridge loan facility to be entered into for the planned acquisition of Komag may constrain our ability to pay dividends on our common stock.

The high and low sales prices of our common stock, as reported by the NYSE, for each quarter of 2007 and 2006 are as follows:

| | First | Second | Third | Fourth |
|---|---|---|---|---|
| **2007** | | | | |
| High | $ 19.96 | $ 21.64 | $ 21.15 | $ 20.09 |
| Low | 16.05 | 16.93 | 16.81 | 16.50 |
| **2006** | | | | |
| High | $ 15.08 | $ 18.93 | $ 24.18 | $ 21.79 |
| Low | 12.29 | 11.35 | 18.67 | 17.43 |

The following table provides information about repurchases by us of our common stock during the quarter ended June 29, 2007:

| | Total Number of Shares Purchased | Average Price Paid per Share(1) | Total Number of Shares Purchased as Part of Publicly Announced Program | Maximum Value of Shares that May Yet be Purchased Under the Program(2) |
|---|---|---|---|---|
| March 31, 2007 April 27, 2007 | 5,895(3) | $ 17.3700 | | $ 107,268,816 |
| April 29, 2007 May 25, 2007 | 1,850,043(4) | $ 17.5646 | 1,837,495 | $ 74,993,513 |
| May 26, 2007 June 29, 2007 | 1,077,481(5) | $ 18.3950 | 703,460 | $ 62,410,513 |
| | 2,933,419 | $ 17.8693 | 2,540,955 | $ 62,410,513 |

(1) Average price paid per share excludes commission.

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

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

(4) Represents 1,837,495 shares purchased in open-market transactions and 12,548 shares delivered by employees to us to satisfy tax-withholding obligations upon the vesting of restricted stock.

(5) Represents 703,460 shares purchased in open-market transactions and 374,021 shares delivered by employees to us to satisfy tax-withholding obligations upon the vesting of restricted stock.

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### Stock Performance Graph

The following graph compares the cumulative total stockholder return of our common stock with the cumulative total return of the S&P 500 Index and the Dow Jones US Technology Hardware & Equipment Index for the five years ended June 29, 2007. The graph assumes that $100 was invested on June 28, 2002 in our common stock and each index and that all dividends were reinvested. We have not declared any cash dividends on our common stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns.

**TOTAL RETURN TO STOCKHOLDERS**
**(Assumes $100 investment on 6/28/02)**

### Total Return Analysis

| | 6/28/02 | 6/27/03 | 7/2/04 | 7/1/05 | 6/30/06 | 6/29/07 |
|---|---|---|---|---|---|---|
| Western Digital Corporation | 100.00 | 328.62 | 258.46 | 423.38 | 609.54 | 595.38 |
| S&P 500 | 100.00 | 100.25 | 119.41 | 126.96 | 137.92 | 166.32 |
| Dow Jones US Technology Hardware & Equipment | 100.00 | 110.60 | 142.84 | 138.90 | 143.90 | 180.86 |

**The stock performance graph shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission or subject to Regulation 14A or 14C under the Securities Exchange Act or to the liabilities of Section 18 of the Securities Exchange Act, nor shall it be incorporated by reference into any past or future filing under the Securities Act or the Securities Exchange Act, except to the extent we specifically request that it be treated as soliciting material or specifically incorporate it by reference into a filing under the Securities Act or the Securities Exchange Act.**

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

**Financial Highlights**

This selected consolidated financial data should be read together with the Consolidated Financial Statements and related Notes contained in this Annual Report on Form 10-K and in the subsequent reports filed with the SEC, as well as the section of this Annual Report on Form 10-K, and the other reports entitled Management s Discussion and Analysis of Financial Condition and Results of Operations.

| | Years Ended | | | | |
|---|---|---|---|---|---|
| | **June 29, 2007** | **June 30, 2006** | **July 1, 2005** | **July 2, 2004** | **June 27, 2003** |
| | **(in millions, except per share and employee data)** | | | | |
| Revenue, net | $ 5,468 | $ 4,341 | $ 3,639 | $ 3,047 | $ 2,719 |
| Gross margin | $ 900 | $ 829 | $ 590 | $ 461 | $ 443 |
| Net income | $ 564 | $ 395 | $ 196 | $ 150 | $ 179 |
| Net income per common share: | | | | | |
| Basic | $ 2.57 | $ 1.84 | $ .94 | $ .73 | $ .91 |
| Diluted | $ 2.50 | $ 1.76 | $ .90 | $ .69 | $ .87 |
| Working capital | $ 899 | $ 633 | $ 361 | $ 270 | $ 238 |
| Total assets | $ 2,901 | $ 2,086 | $ 1,589 | $ 1,159 | $ 866 |
| Long-term debt | $ 10 | $ 19 | $ 33 | $ 53 | $ |
| Shareholders equity | $ 1,716 | $ 1,157 | $ 700 | $ 487 | $ 327 |
| Number of employees | 29,572 | 24,750 | 23,161 | 17,376 | 11,508 |

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**

*The following discussion and analysis contains forward-looking statements within the meaning of the federal securities laws. You are urged to carefully review our description and examples of forward-looking statements included earlier in this Annual Report on Form 10-K immediately prior to Part I, under the heading Forward Looking Statements. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. You are urged to carefully review the disclosures we make concerning risks and other factors that may affect our business and operating results, including those made in Item 1A of this Annual Report on Form 10-K, as well as our other reports filed with the SEC. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this document. We do not intend, and undertake no obligation, to publish revised forward-looking statements to reflect events or circumstances after the date of this document or to reflect the occurrence of unanticipated events.*

**Our Company**

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

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

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Hard drives provide non-volatile data storage, which means that the data remains present when power is no longer applied to the device. Our hard drives currently include 3.5-inch and 2.5-inch form factor drives, having capacities ranging from 40 gigabytes ( GB ) to 1 terabyte ( TB ), nominal rotation speeds of 5,400, 7,200 and 10,000 revolutions per minute ( RPM ), and offer interfaces including both Enhanced Integrated Drive Electronics ( EIDE ) and Serial Advanced Technology Attachment ( SATA ). We also embed our hard drives into WD-branded external storage appliances that utilize interfaces such as USB 2.0, external SATA, FireWire[tm] and Ethernet network connections. In addition, we recently announced a family of hard drives specifically designed to consume substantially less power than previous designs.

We manufacture hard drives and head stack assemblies ( HSAs ) in Malaysia and Thailand. We also design and manufacture a substantial portion of our required magnetic heads in California, and head gimbal assemblies ( HGAs ) in Thailand. Following our planned acquisition of Komag, Incorporated ( Komag ), a leading media manufacturer and one of our current suppliers, we will also design in California and manufacture in Malaysia most of our required media and substrates. For geographical financial data, see Part II, Item 8, Note 6 in the Notes to Consolidated Financial Statements, included in this Annual Report on Form 10-K.

On June 28, 2007, we entered into a definitive agreement to acquire all the outstanding shares of Komag for a value of approximately $1.0 billion. The planned acquisition of Komag is intended to strengthen our production effeciencies and enhance our hard drive manufacturing process by integrating media. The planned acquisition is structured as a cash tender offer at $32.25 per share for all the outstanding shares of Komag common stock, followed by a merger of our indirect wholly-owned subsidiary into Komag in which the remaining shareholders of Komag will receive $32.25 in cash per share. The planned acquisition is expected to close in the third calendar quarter of 2007. We intend to fund the planned acquisition, including the expected repurchase of Komag s convertible notes due 2014 and related fees and expenses, through a combination of cash and proceeds from a senior unsecured term bridge loan facility of up to $1.3 billion.

**Results of Operations**

*Fiscal 2007 Overview*

In 2007, our net revenue increased by 26% to $5.5 billion on unit shipments of 97 million as compared to $4.3 billion and 73 million units, respectively, in 2006. In 2007, 43% of our revenue was derived from non-desktop sources including CE products, enterprise applications, notebook computers and retail sales as compared to 29% in 2006. Gross margin percentage decreased to 16.5% from 19.1% in 2006. Operating income increased by $49 million to $415 million. As a percentage of net revenue, operating income was 7.6% in 2007 compared to 8.4% 2006. We generated $618 million in cash flow from operations in 2007 compared with $368 million in 2006, finishing the year with $907 million in cash and short-term investments, an increase of $208 million from the prior year. We utilized $73 million to repurchase 4 million shares of our common stock and $43 million to repay long-term debt.

*Summary Comparison of 2007, 2006 and 2005*

The following table sets forth, for the periods indicated, summary information from our consolidated statements of income by dollars and percentage of revenue (in millions, except percentages):

| | Years Ended | | | | | |
|---|---|---|---|---|---|---|
| | June 29, 2007 | | June 30, 2006 | | July 1, 2005 | |
| Revenue, net | $ 5,468 | 100% | $ 4,341 | 100% | $ 3,639 | 100% |

| | | | | | | |
|---|---|---|---|---|---|---|
| Gross margin | 900 | 16.5 | 829 | 19.1 | 590 | 16.2 |
| Operating expenses | 485 | 8.9 | 463 | 10.7 | 395 | 10.9 |
| Operating income | 415 | 7.6 | 366 | 8.4 | 195 | 5.3 |
| Non-operating income | 28 | 0.5 | 16 | 0.4 | 5 | 0.2 |
| Income before income taxes | 443 | 8.1 | 382 | 8.8 | 200 | 5.5 |
| Income tax (benefit) expense | (121) | (2.2) | (13) | (0.3) | 4 | 0.1 |
| Net income | 564 | 10.3 | 395 | 9.1 | 196 | 5.4 |

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The following table sets forth, for the periods indicated, summary information regarding volume shipments, average selling prices ( ASPs ) and revenues by geography, channel and product (in millions, except percentages and ASPs):

| | Years Ended | | |
|---|---|---|---|
| | June 29, 2007 | June 30, 2006 | July 1, 2005 |
| Net revenue | $ 5,468 | $ 4,341 | $ 3,639 |
| Unit shipments | 97 | 73 | 61 |
| ASPs (per unit) | $ 57 | $ 59 | $ 59 |
| ***Revenues by Geography(%)*** | | | |
| Americas | 37% | 36% | 38% |
| Europe | 29 | 28 | 29 |
| Asia | 34 | 36 | 33 |
| ***Revenues by Channel(%)*** | | | |
| OEM | 48% | 54% | 58% |
| Distributors | 36 | 39 | 36 |
| Branded products | 16 | 7 | 6 |
| ***Revenues by Product(%)*** | | | |
| Desktop computers | 57% | 71% | 79% |
| Non-desktop sources | 43 | 29 | 21 |

*Fiscal Year 2007 Compared to Fiscal Year 2006*

*Net Revenue.* Net revenue was $5.5 billion for 2007, an increase of 26% from 2006. Total unit shipments increased to 97 million as compared to 73 million for the prior year. This unit increase resulted from an increase in our desktop market share, stronger overall demand for hard drives in the desktop market and our increasing focus on the non-desktop market, including mobile, CE, enterprise and branded products. For example, we shipped 12 million drives to the mobile market in 2007 as compared to 5 million units in 2006. Additionally, we shipped 10 million units to the DVR market in 2007 as compared to 7 million units in 2006. ASPs declined to $57 due to normal technology price declines and a more competitive pricing environment in the notebook, desktop, and consumer electronics markets. Changes in revenue by geography generally reflect overall market demand fluctuations for hard drives. Changes in revenue by channel are a result of increases in sales of branded products due to the growing worldwide acceptance of our WD My Book™ and WD Passport® external digital storage appliances.

*Gross Margin.* Gross margin for 2007 was $900 million, an increase of $71 million, or 9% over the prior year. Gross margin percentage decreased to 16.5% in 2007 from 19.1% in 2006. The factors contributing to this decrease include normal technology price declines and a more competitive pricing environment in the notebook, desktop, and consumer electronics markets. In addition, gross margin in 2006 benefited from a more favorable supply/demand balance.

*Operating Expenses.* Total operating expenses, consisting of research and development ( R&D ) and selling, general and administrative ( SG&A ) expenses decreased to 8.9% of net revenue in 2007 compared to 10.7% in 2006. R&D expense was $306 million in 2007, an increase of $9 million, or 3% over the prior year. The increase in R&D expense was primarily related to the development of new product platforms in support of our entry into new markets and expenditures for advanced head technologies, partially offset by a decrease of $2 million in variable incentive compensation programs. SG&A expense was $179 million in 2007, an increase of $13 million, or 8% as compared to 2006. The increase in SG&A expense was primarily due to an increase of $19 million in stock based compensation expense and other long-term employee incentive programs, offset by a $5 million decrease in software write-offs that occurred in 2006.

*Interest and Other Income.* Net interest and other income was $28 million and $16 million in 2007 and 2006, respectively. This increase in net interest income was primarily due to higher average invested cash and short-term investment balances.

*Income Tax Benefit.* Income tax benefit was $121 million and $13 million in 2007 and 2006, respectively. Tax benefit as a percentage of income before taxes was 27% and 3% for 2007 and 2006, respectively. Differences between the effective tax rates and the U.S. Federal statutory rate are primarily due to tax holidays and incentive programs and reductions to our valuation allowance for deferred tax assets. We have tax holidays in Malaysia and Thailand that expire at various times ranging from 2008 to 2022. In addition to the tax holidays, the tax provision was impacted by favorable adjustments to the company s valuation allowance for deferred tax assets of $126 and $22 million in 2007 and 2006, respectively. These adjustments were based upon determination that it was more likely than not that all or a portion of our deferred tax assets will be realized. In the fourth quarter of 2007, we reversed the remaining valuation allowance for our deferred tax assets based on the weight of available evidence including our history of cumulative pretax income and the increased likelihood of our ability to generate profits in the future. In 2006, we released a portion of the valuation allowance on deferred tax assets due to the difficulty at the time in accurately projecting income for periods of longer than two years given the cyclical nature of our industry. The realization of the deferred tax assets is primarily dependent on our ability to generate sufficient earnings in certain jurisdictions in future years. The amount of deferred tax assets considered realizable may increase or decrease in subsequent periods based on fluctuating industry or company conditions.

*Fiscal Year 2006 Compared to Fiscal Year 2005*

*Net Revenue.* Net revenue was $4.3 billion for 2006, an increase of 19% from 2005. Total unit shipments increased to 73 million as compared to 61 million for the prior year. This unit increase resulted from an increase in our desktop market share, stronger overall demand for hard drives in the desktop market and our increasing focus on the non-desktop market, including mobile, CE and branded products. For example, we shipped 5 million drives to the mobile market in 2006 as compared to 1 million units in 2005. Additionally, we shipped 7 million units to the DVR market in 2006 as compared to 4 million units in 2005. ASPs remained at a relatively constant level of $59 due to an increase in the average storage capacity of hard drives sold offset by moderate price declines. Revenue contribution by geographic region for 2006 as compared to 2005 reflects our focus on revenue growth in emerging geographic markets, primarily in Asia. Changes in revenue by channel reflect overall market demand fluctuations for hard drives.

*Gross Margin.* Gross margin for 2006 was $829 million, an increase of $239 million, or 41% over the prior year. Gross margin percentage increased to 19.1% in 2006 from 16.2% in 2005. Gross margin in 2006 benefited from a more favorable supply/demand balance. In addition, gross margin was favorably impacted in 2006 by the following factors: 1) manufacturing efficiencies, 2) lower customer returns resulting from ongoing quality improvements that favorably impacted warranty obligations, and 3) an increase in the average storage capacity of hard drives sold. Moderate price declines somewhat offset the favorable impact of the aforementioned factors. During 2006 and 2005, our warranty accrual for prior quarters shipments was favorably adjusted by approximately $30 million and $1 million, respectively, as a result of improvements in quality and customer return rates and their expected impact on future levels of customer returns under warranty.

*Operating Expenses.* Total operating expenses, consisting of research and development ( R&D ) and selling, general and administrative ( SG&A ) expenses, were 10.7% of net revenue in 2006, as compared to 10.9% in 2005. R&D expense was $297 million in 2006, an increase of $57 million, or 24% over the prior year. The increase in R&D expense was primarily related to the development of new product platforms in support of our entry into new markets, expenditures for advanced head technologies and an increase of $18 million in employee incentive compensation programs, of which $12 million related to the adoption of Statement of Financial Accounting Standard ( SFAS ) No. 123-R. SG&A expense was $166 million in 2006, an increase of $11 million, or 7% as compared to 2005. This increase in SG&A expense was primarily due to an expansion of sales resources to support increasing desktop computer demand in certain geographic regions, the growing mobile and CE markets, an increase of $15 million in employee incentive compensation programs, of which $7 million related to the adoption of SFAS No. 123-R, and a

$5 million software write-off. The 2005 fiscal period included a $19 million charge for the settlement of a patent infringement lawsuit.

*Interest and Other Income.* Net interest and other income was $16 million and $5 million in 2006 and 2005, respectively. This increase in net interest income was primarily due to higher average invested cash and short-term investment balances as well as increases in the rates of return on investments.

*Income Tax Expense (Benefit).* Income tax (benefit) expense was $(13) million and $4 million in 2006 and 2005, respectively. Tax (benefit) expense as a percentage of income before taxes was (3)% and 2% for 2006 and 2005, respectively. Differences between the effective tax rates and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia and Thailand that expire at various times ranging from 2008 to 2022. In addition to the tax holidays, the tax provision for 2006 was favorably impacted by $22 million given the partial reduction of our valuation allowance on deferred tax assets upon determination that it was more likely than not that a portion of our deferred tax assets would be realized. The realization of the deferred tax assets is primarily dependent on our ability to generate sufficient earnings in certain jurisdictions in fiscal years 2007 and 2008. A two-year period was used due to the difficulty at the time in accurately projecting income for longer periods of time given the cyclical nature of our industry. The 2005 effective tax rate benefited by approximately 0.7% from the favorable resolution of certain tax contingencies.

**Liquidity and Capital Resources**

We ended 2007 with total cash, cash equivalents and short-term investments of $907 million, an increase of $208 million from June 30, 2006. Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing return through the full investment of available funds. A portion of our available funds is invested in auction rate securities, which are short-term investments in bonds with original maturities greater than 90 days. The following table summarizes the results of our statements of cash flows for the three years ended June 29, 2007:

| | | Years Ended | |
|---|---|---|---|
| | **June 29, 2007** | **June 30, 2006** | **July 1, 2005** |
| Net cash flow provided by (used in): | | | |
| Operating activities | $ 618 | $ 368 | $ 421 |
| Investing activities | (383) | (303) | (274) |
| Financing activities | (86) | 1 | (7) |
| Net increase in cash and cash equivalents | $ 149 | $ 66 | $ 140 |

*Operating Activities*

Net cash provided by operating activities during 2007 was $618 million as compared to $368 million during 2006 and $421 million for 2005. Cash flow from operations consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash used to fund working capital was $78 million for 2007 as compared to $207 million for 2006 and net cash provided by changes in working capital of $89 million for 2005.

Our working capital requirements depend upon the effective management of our cash conversion cycle, which measures how quickly a company can convert its products into cash through sales. The following table summarizes the cash conversion cycle for the three years ended 2007:

**Years Ended**

| | June 29, 2007 | June 30, 2006 | July 1, 2005 |
|---|---|---|---|
| Days sales outstanding | 45 | 39 | 40 |
| Days in inventory | 20 | 19 | 16 |
| Days payables outstanding | (66) | (64) | (65) |
| Cash conversion cycle | (1) | (6) | (9) |

The increase in the cash conversion cycle for 2007 was primarily due to our days sales outstanding ( DSOs ), which increased by six days from 2006. This increase was primarily due to the discontinuance of an early pay program with one of our larger customers and increasing sales to branded products customers and other customers who have longer payment terms.

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

*Investing Activities*

Net cash used in investing activities for 2007 was $383 million as compared to $303 million for 2006 and $274 million for 2005. During 2007, cash used in investing activities consisted of $324 million for capital expenditures and $59 million for short-term investments. During 2006, cash used in investing activities consisted of $268 million for capital expenditures and $35 million for short-term investments. The increase in capital expenditures in 2007 compared to 2006 primarily consists of equipment purchased to support our investments in advanced head technologies, new product platforms and capacity for our broadening and growing product portfolio. The increase in capital expenditures in 2006 compared to 2005 was primarily a result of assets purchased to upgrade our head manufacturing capabilities, increased desktop and mobile hard drive production capabilities and for the normal replacement of existing assets. Additionally, during 2006, we purchased our previously leased head wafer manufacturing facility in Fremont, California for $27 million. For 2008, we expect capital additions to be between $600 million and $650 million, of which approximately $200 million will be utilized for the expansion of our head wafer fabrication capacity. Depreciation and amortization for 2008 is expected to be between $270 and $290 million.

*Financing Activities*

Net cash used in financing activities for 2007 was $86 million as compared to net cash provided by financing activities of $1 million for 2006 and net cash used in financing activities of $7 million for 2005. The net cash used in financing activities in 2007 consisted of $73 million used for repurchases of our common stock and $43 million used for repayments of long-term debt, offset by $30 million received through the exercise of common stock options and our Employee Stock Purchase Plan. The net cash provided by financing activities in 2006 consisted of $78 million received through the exercise of common stock options and our Employee Stock Purchase Plan, offset by $54 million used in repurchases of our common stock and $23 million used for repayments of long-term debt. The net cash used in financing activities in 2005 consisted of $45 million used for repurchases of our common stock and $20 million for debt repayments, offset by $58 million received upon issuance of common stock under employee plans.

**Off-Balance Sheet Arrangements**

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

**Capital Commitments**

The following is a summary of our significant contractual cash obligations and commercial commitments as of June 29, 2007 (in millions):

| | Less than | More than |
|---|---|---|

| | Total | 1 Year | 1-3 Years | 3-5 Years | 5 Years |
|---|---|---|---|---|---|
| Long-term debt, including current portion | $ | $ | $ | $ | $ |
| Capital lease obligations | 22 | 12 | 10 | | |
| Operating leases | 44 | 11 | 20 | 8 | 5 |
| Purchase obligations(1)(2) | 3,338 | 2,584 | 754 | | |
| Total | $ 3,404 | $ 2,607 | $ 784 | $ 8 | $ 5 |

(1) Includes long-term purchase agreements entered into before August 16, 2007.

(2) These amounts do not reflect the reduction to commitments resulting from our planned acquisition of Komag.

In anticipation of our planned acquisition of Komag, we intend to fund the transaction, including the expected repurchase of Komag s convertible notes due 2014 and related fees and expenses, through a combination of our cash and proceeds from a senior unsecured term bridge loan facility of up to $1.3 billion.

*Long-Term Debt*

We maintained a $125 million credit facility ( Senior Credit Facility ) with a termination date of September 20, 2009. The facility provided for a revolving credit line (subject to outstanding letters of credit and a borrowing base calculation) and a term loan. The term loan was paid in full as of March 30, 2007, a letter of termination was submitted for the Senior Credit Facility on June 28th, 2007, and termination was finalized during the first quarter of 2008.

*Purchase Orders*

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

We have entered into long-term purchase agreements with various component suppliers. The commitments are subject to minimum quality requirements. In addition, the dollar amount of the purchases may depend on the specific products ordered and future price negotiations. The estimated related minimum purchase requirements are included in Purchase obligations in the table above.

From time to time, we enter into other long-term purchase agreements for components with certain vendors. Generally, future purchases under these agreements are not fixed and determinable as they depend on our overall unit volume requirements and are contingent upon the prices, technology and quality of the supplier s products remaining competitive. These arrangements are not included under Purchase obligations in the table above. Please see Item 1A of this Annual Report on Form 10-K for a discussion of risks related to these commitments.

*Forward Exchange Contracts*

We purchase short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. See Part II, Item 7A, under the heading Disclosure About Foreign Currency Risk, for our current forward exchange contract commitments.

*Indemnifications*

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

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

*Stock Repurchase Program*

Our Board of Directors has authorized us to repurchase $250 million of our common stock in open market transactions. The term of the program is a five-year period from November 17, 2005 to November 17, 2010. We expect stock repurchases to be funded principally by operating cash flows. During 2007, we repurchased 4.0 million shares of common stock at a total cost of $73 million. Subsequent to the end of 2007, we purchased 0.8 million shares for approximately $16 million. During 2006, we repurchased 3.5 million shares of common stock at a total cost of $54 million. Since the inception of the program and through August 16, 2007, we have repurchased 15.1 million shares for a total cost of $204 million. Subject to any limitations that may be set forth in our proposed bridge loan facility to be entered into with our planned acquisition of Komag, we may continue to repurchase our stock as we deem appropriate and market conditions allow.

We believe our current cash, cash equivalents and short-term investments will be sufficient to meet our working capital needs through the foreseeable future. Our ability to sustain our working capital position is dependent upon a number of factors that we discuss in Item 1A of this Annual Report on Form 10-K.

## Critical Accounting Policies

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

*Revenue and Accounts Receivable*

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

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

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

*Warranty*

We record an accrual for estimated warranty costs when revenue is recognized. We generally warrant our products for a period of one to five years. Our warranty provision considers estimated product failure rates and trends, estimated repair or replacement costs and estimated costs for customer compensatory claims related to product quality issues, if any. We use a statistical warranty tracking model to help with our estimates and we exercise judgment in determining the underlying estimates. Our statistical tracking model captures specific detail on hard drive reliability, such as factory test data, historical field return rates, and costs to repair by product type. If actual product return trends, costs to repair returned products or costs of customer compensatory claims differ significantly from our estimates, our future results of operations could be materially affected. Our judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base our warranty estimates. We review our warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross margin and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. For a summary of historical changes in estimates related to pre-existing warranty provisions, refer to Part II, Item 8, Note 4 of the Notes to Consolidated Financial Statements, included in this Annual Report on Form 10-K.

*Inventory*

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

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

*Litigation and Other Contingencies*

We apply SFAS No. 5, Accounting for Contingencies, to determine when and how much to accrue for and disclose related to legal and other contingencies. Accordingly, we disclose contingencies deemed to be reasonably possible and accrue loss contingencies when, in consultation with our legal advisors, we conclude that a loss is probable and reasonably estimable (Refer to Part II, Item 8, Note 5 of the Notes to Consolidated Financial Statements, included in this Annual Report on Form 10-K). The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management s estimates.

*Income Taxes*

We account for income taxes under the asset and liability method, which provides that deferred tax assets and liabilities be recognized for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities and expected benefits of utilizing net operating loss ( NOL ) and tax credit carryforwards. We record a valuation allowance where it is more likely than not that the deferred tax assets will not be realized. Each period we evaluate the need for a valuation allowance for our deferred tax assets and we adjust the valuation allowance so that we record net deferred tax assets only to the extent that we conclude it is more likely than not that these deferred tax assets will be realized.

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

*Stock-Based Compensation*

We account for all stock-based compensation in accordance with the fair value recognition provisions of SFAS No. 123-R, Share-Based Payment . Under these provisions, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Under SFAS No. 123-R, we are required to use judgment in estimating the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ significantly from the original estimate, stock-based compensation expense and our results of operations could be materially impacted.

Prior to the adoption of SFAS No. 123-R, we accounted for stock-based employee compensation plans (including shares issued under our stock option plans and ESPP) in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and its related interpretations ( APB No. 25 ), and followed the pro forma net income, pro forma income per share, and stock-based compensation plan disclosure requirements set forth in SFAS No. 123, Accounting for Stock-Based Compensation. All other types of equity awards were previously accounted for in accordance with SFAS No. 123.

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The fair values of all stock options granted on and subsequent to January 1, 2005, were estimated using a binomial model and the fair values of all options granted on and prior to December 31, 2004, and all ESPP shares were estimated using the Black-Scholes-Merton option pricing model. Both the binomial and the Black-Scholes-Merton models require the input of highly subjective assumptions.

*New Accounting Standards*

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

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

In February 2007, the FASB issued SFAS Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact SFAS 159 will have on our consolidated financial statements.

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

### Disclosure About Foreign Currency Risk

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

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As of June 29, 2007, we had outstanding the following purchased foreign currency forward exchange contracts (in millions, except weighted average contract rate):

| | Contract Amount | Weighted Average Contract Rate* | Unrealized Gain (Loss) |
|---|---|---|---|
| **Foreign currency forward contracts:** | | | |
| Thai Bhat | $ 256.1 | 33.10 | $ 0.1 |
| Malaysian Ringgit | $ 231.8 | 3.41 | $ (1.1) |
| Euro | $ 2.9 | 0.74 | |
| British Pound Sterling | $ 1.9 | 0.50 | |

* Expressed in units of foreign currency per dollar.

In 2007, 2006 and 2005, total realized transaction and forward exchange contract currency gains and losses were not material to our consolidated financial statements.

**Disclosure About Other Market Risks**

*Variable Interest Rate Risk*

We maintained a $125 million credit facility ( Senior Credit Facility ) with a termination date of September 20, 2009. The term loan was paid in full as of March 30, 2007, a letter of termination was submitted for the Senior Credit Facility on June 28th, 2007, and termination was finalized during the first quarter of 2008.

**Item 8.** ***Financial Statements and Supplementary Data***

**Index to Financial Statements and Financial Statement Schedule**

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Western Digital Corporation:

We have audited the accompanying consolidated balance sheets of Western Digital Corporation and subsidiaries as of June 29, 2007 and June 30, 2006, and the related consolidated statements of income, shareholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended June 29, 2007. In connection with our audits of the consolidated financial statements, we have also audited the related financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 June 29, 2007 and June 30, 2006, and the results of their operations and their cash flows for each of the years in the three-year period ended June 29, 2007, in conformity with U.S. generally accepted accounting principles. 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.

As discussed in Note 1 to the consolidated financial statements, the Company has adopted the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payment, on July 2, 2005 and accordingly, has changed its method of accounting for share-based compensation.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of June 29, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated August 24, 2007 expressed an unqualified opinion on management s assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Costa Mesa, California
August 24, 2007

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Western Digital Corporation:

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting appearing under Item 9A, that Western Digital Corporation and subsidiaries maintained effective internal control over financial reporting as of June 29, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Western Digital Corporation and subsidiaries maintained effective internal control over financial reporting as of June 29, 2007, is fairly stated, in all material respects, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Western Digital Corporation and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 29, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Western Digital Corporation and subsidiaries as of June 29, 2007 and June 30, 2006, the related consolidated statements of income, shareholders equity and comprehensive income, and cash flows for each of the years in the three-year period ended June 29, 2007, and the related financial statement schedule, and our report dated August 24, 2007 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule.

/s/ KPMG LLP

Costa Mesa, California
August 24, 2007

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**WESTERN DIGITAL CORPORATION**

**CONSOLIDATED BALANCE SHEETS**
**(in millions)**

| | June 29, 2007 | June 30, 2006 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 700 | $ 551 |
| Short-term investments | 207 | 148 |
| Accounts receivable, net | 697 | 481 |
| Inventories | 259 | 205 |
| Advances to suppliers | 63 | 80 |
| Other current assets | 103 | 40 |
| Total current assets | 2,029 | 1,505 |
| Property and equipment, net | 741 | 549 |
| Other non-current assets | 131 | 32 |
| Total assets | $ 2,901 | $ 2,086 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 882 | $ 632 |
| Accrued expenses | 163 | 144 |
| Accrued warranty | 73 | 71 |
| Current portion of long-term debt | 12 | 25 |
| Total current liabilities | 1,130 | 872 |
| Long-term debt | 10 | 19 |
| Other liabilities | 45 | 38 |
| Total liabilities | 1,185 | 929 |
| Commitments and contingencies (Notes 3 and 4) | | |
| Shareholders equity: | | |
| Preferred stock, $.01 par value; authorized 5 shares; Outstanding None | | |
| Common stock, $.01 par value; authorized 450 shares; Outstanding 225 and 222 shares, respectively | 2 | 2 |
| Additional paid-in capital | 811 | 775 |
| Accumulated comprehensive income (loss) | (1) | 1 |
| Retained earnings | 955 | 391 |
| Treasury stock common shares at cost; 3 and 1 shares, respectively | (51) | (12) |
| Total shareholders equity | 1,716 | 1,157 |

| | | |
|---|---|---|
| Total liabilities and shareholders equity | $ 2,901 | $ 2,086 |

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

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**WESTERN DIGITAL CORPORATION**

**CONSOLIDATED STATEMENTS OF INCOME**
**(in millions, except per share amounts)**

| | Years Ended June 29, 2007 | June 30, 2006 | July 1, 2005 |
|---|---|---|---|
| Revenue, net | $ 5,468 | $ 4,341 | $ 3,639 |
| Cost of revenue | 4,568 | 3,512 | 3,049 |
| Gross margin | 900 | 829 | 590 |
| Operating expenses: | | | |
| Research and development | 306 | 297 | 240 |
| Selling, general and administrative | 179 | 166 | 155 |
| Total operating expenses | 485 | 463 | 395 |
| Operating income | 415 | 366 | 195 |
| Non-operating income: | | | |
| Interest income | 32 | 20 | 8 |
| Interest and other expense | 4 | 4 | 3 |
| Total non-operating income | 28 | 16 | 5 |
| Income before income taxes | 443 | 382 | 200 |
| Income tax (benefit) expense | (121) | (13) | 4 |
| Net income | $ 564 | $ 395 | $ 196 |
| **Income per common share:** | | | |
| Basic | $ 2.57 | $ 1.84 | $ .94 |
| Diluted | $ 2.50 | $ 1.76 | $ .90 |
| **Weighted average shares outstanding:** | | | |
| Basic | 219 | 215 | 208 |
| Diluted | 226 | 224 | 217 |

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

**WESTERN DIGITAL CORPORATION**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(in millions)**

| | Years Ended | | |
|---|---|---|---|
| | **June 29, 2007** | **June 30, 2006** | **July 1, 2005** |
| **Cash flows from operating activities** | | | |
| Net income | $ 564 | $ 395 | $ 196 |
| Adjustments to reconcile net income to net cash provided by operations: | | | |
| Depreciation and amortization | 210 | 160 | 131 |
| Stock-based compensation | 48 | 37 | 5 |
| Deferred income taxes | (126) | (22) | |
| Other non-cash items | | 5 | |
| Changes in: | | | |
| Accounts receivable | (218) | (77) | (90) |
| Inventories | (53) | (52) | (4) |
| Accounts payable | 196 | 30 | 94 |
| Accrued expenses | 6 | (27) | 100 |
| Advances to suppliers | (7) | (80) | (13) |
| Prepaid expenses and other | (2) | (1) | 2 |
| Net cash provided by operating activities | 618 | 368 | 421 |
| **Cash flows from investing activities** | | | |
| Capital expenditures | (324) | (268) | (194) |
| Purchases of short-term investments | (68) | (109) | (95) |
| Redemption of short-term investments | 9 | 74 | 15 |
| Net cash used in investing activities | (383) | (303) | (274) |
| **Cash flows from financing activities** | | | |
| Issuance of common stock under employee plans | 30 | 78 | 58 |
| Repurchase of common stock | (73) | (54) | (45) |
| Repayment of long-term debt | (43) | (23) | (20) |
| Net cash provided by (used in) financing activities | (86) | 1 | (7) |
| Net increase in cash and cash equivalents | 149 | 66 | 140 |
| Cash and cash equivalents, beginning of year | 551 | 485 | 345 |
| Cash and cash equivalents, end of year | $ 700 | $ 551 | $ 485 |
| **Supplemental disclosure of cash flow information:** | | | |
| Cash paid during the period for income taxes | $ 8 | $ 5 | $ 5 |
| Cash paid during the period for interest | $ 3 | $ 2 | $ 3 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Supplemental disclosure of non-cash investing and financing activities:** | | | | | | |
| Equipment acquired under capital lease | $ | 21 | $ | 15 | $ | 4 |

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

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**WESTERN DIGITAL CORPORATION**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY and COMPREHENSIVE INCOME**
**(in millions)**

| | Common Stock | | Treasury Stock | | Additional Paid-In | Accumulated Comprehensive Income | Retained Earnings (Accumulated | Total Shareholders | Total Comprehensive |
|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Capital | (Loss) | Deficit) | Equity | Income |
| **Balance at July 2, 2004** | 209 | $ 2 | (3) | $ (29) | $ 714 | $ | $ (200) | $ 487 | $ 150 |
| Employee Stock Plans | 4 | | 7 | 57 | | | | 57 | |
| Deferred compensation | 2 | | | 5 | | | | 5 | |
| Repurchase of common stock | | | (5) | (45) | | | | (45) | |
| Net income | | | | | | | 196 | 196 | $ 196 |
| Unrealized gain (loss) on foreign currency contracts | | | | | | | | | |
| **Balance at July 1, 2005** | 215 | 2 | (1) | (12) | 714 | | (4) | 700 | $ 196 |
| Employee Stock Plans | 6 | | 4 | 50 | 29 | | | 79 | |
| Deferred compensation | 1 | | | 4 | 11 | | | 15 | |
| Stock based compensation | | | | | 21 | | | 21 | |
| Repurchase of common stock | | | (4) | (54) | | | | (54) | |
| Net income | | | | | | | 395 | 395 | $ 395 |
| Unrealized gain on foreign currency contracts | | | | | | 1 | | 1 | 1 |
| **Balance at June 30, 2006** | 222 | 2 | (1) | (12) | 775 | 1 | 391 | 1,157 | $ 396 |
| Employee Stock Plans | 1 | | 3 | 50 | (12) | | | 38 | |
| Deferred compensation | 2 | | (1) | (16) | 30 | | | 14 | |
| Stock based compensation | | | | | 18 | | | 18 | |
| Repurchase of common stock | | | (4) | (73) | | | | (73) | |
| Net income | | | | | | | 564 | 564 | $ 564 |
| Unrealized gain on foreign currency contracts | | | | | | (2) | | (2) | (2) |
| **Balance at June 29, 2007** | 225 | $ 2 | (3) | $ (51) | $ 811 | $ (1) | $ 955 | $ 1,716 | $ 562 |

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

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## Note 1. Organization and Summary of Significant Accounting Policies

Western Digital Corporation (the Company or Western Digital or WD ) designs, develops, manufactures and sells hard drives. A hard drive is a device that stores data on one or more rotating magnetic disks to allow fast access to data. The Company s hard drives are used in desktop computers, notebook computers, external storage devices, enterprise applications such as servers, workstations, network attached storage and storage area networks and in consumer electronics products such as personal/digital video recorders, satellite and cable set-top boxes and video game consoles. The Company sells its products worldwide to original equipment manufacturers and original design manufacturers for inclusion in computer systems or subsystems, and to distributors, resellers and retailers.

Western Digital has prepared its consolidated financial statements in accordance with accounting principles generally accepted in the United States ( GAAP ) and has adopted accounting policies and practices which are generally accepted in the industry in which it operates. The Company s significant accounting policies are summarized below.

*Fiscal Year*

The Company has a 52 or 53-week fiscal year. The 2007, 2006 and 2005 fiscal years, which ended on June 29, 2007, June 30, 2006 and July 1, 2005, respectively, consisted of 52 weeks each.

*Basis of Presentation*

The consolidated financial statements include the accounts of the Company and its wholly 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, gains or losses resulting from remeasurement of these accounts from local currencies into U.S. dollars are reflected in the results of operations. These gains and losses were immaterial to the consolidated financial statements.

*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.

*Short-Term Investments*

The Company s short-term investments consist primarily of auction rate securities, which are short-term investments in bonds with original maturities greater than 90 days. The Company has classified these investments as available for sale securities under Statement of Financial Accounting Standards ( SFAS ) No. 115 Accounting for Certain Investments in Debt and Equity Securities. These investments are carried at fair value.

*Fair Value of Financial Instruments*

The carrying amounts of cash and cash equivalents, accounts receivable, short-term investments, accounts payable and accrued expenses approximate fair value for all periods presented because of the short-term maturity of these assets and liabilities.

*Concentration of Credit Risk*

The Company designs, develops, manufactures and markets hard drives to 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 allowances for potential credit losses, and such losses have historically been within management s expectations. At any given point in time, the total amount outstanding from any one of a number of its customers may be individually significant to the Company s financial results. At June 29, 2007 and June 30, 2006, the Company had reserves for potential credit losses of $5 million and $5 million, respectively, and net

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

accounts receivable of $697 million and $481 million, respectively. The Company also has cash equivalent and short-term investment 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*

The Company values inventory at the lower of cost (first-in, first-out basis) or net realizable value. Inventory write-downs are recorded to reduce the carrying value of inventory to the lower of cost or net realizable value by analyzing market conditions and estimates of future sales prices as compared to inventory costs and inventory balances. The Company evaluates inventory balances for excess quantities and obsolescence on a regular basis by analyzing estimated demand, inventory on hand, sales levels and other information, and reduces inventory balances to net realizable value for excess and obsolete inventory based on this analysis.

*Property and Equipment*

The cost of property and equipment is depreciated over the estimated useful lives of the respective assets. The Company s buildings are being depreciated over periods ranging from fifteen to thirty years. The majority of the Company s equipment is being depreciated over periods of three to seven years. Depreciation is computed on a straight-line basis. Leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the related lease terms.

*Intangible Assets*

Intangible assets consist of purchased technology acquired in asset acquisitions. These assets are being amortized over a weighted average period of three years. During the fiscal years ended June 29, 2007, June 30, 2006 and July 1, 2005, the Company recorded $3 million, $4 million and $14 million of amortization expense related to these intangible assets, respectively. Amortization expense for intangible assets is estimated to be $3 million in 2008.

*Revenue Recognition*

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin ( SAB ) No. 104, Revenue Recognition in Financial Statements. Under SAB No. 104, revenue is recognized when the title and risk of loss have passed to the customer, there is persuasive evidence of an arrangement, delivery has occurred, or services have been rendered, the sales price is fixed or determinable and collectibility is reasonably assured. The Company establishes provisions against revenue and cost of revenue for estimated sales returns in the same period that the related revenue is recognized based on existing product return notifications.

In accordance with standard industry practice, the Company has agreements with resellers that provide limited price protection for inventories held by resellers at the time of published list price reductions and other incentive programs. Either party may terminate these agreements upon written notice. In the event of termination, the Company may be obligated to repurchase a certain portion of the resellers inventory. The Company records a reduction to revenue for estimated price protection and other programs in effect until the resellers sell such inventory to their customers. These adjustments are based on anticipated price decreases during the reseller holding period, estimated amounts to be reimbursed to qualifying customers, as well as historical pricing information. If end-market demand for hard drives declines significantly, the Company may have to increase sell-through incentive payments to resellers, resulting in an increase in price protection allowances, which could adversely impact operating results. Net revenue recognized on sales to resellers was approximately $2.8 billion, $2.0 billion and $1.5 billion in 2007, 2006 and 2005, respectively. Repurchases of reseller inventory were not material in 2007, 2006 or 2005.

Western Digital establishes an allowance for doubtful accounts by analyzing specific customer accounts and assessing the risk of loss based on insolvency, disputes or other collection issues. In addition, the Company routinely

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  (Continued)**

analyzes the different receivable aging categories and its bad debt loss history and establishes reserves based on a combination of past due receivables and expected future losses based primarily on the Company s historical levels of bad debt losses. If the financial condition of a significant customer deteriorates resulting in its inability to pay its accounts when due, or if the overall loss history of the Company changes significantly, an adjustment in the Company s allowance for doubtful accounts would be required, which could affect operating results.

*Warranty*

The Company records an accrual for estimated warranty costs when revenue is recognized. The Company generally warrants its products for a period of one to five years. The warranty provision considers estimated product failure rates and trends, estimated repair or replacement costs and estimated costs for customer compensatory claims related to product quality issues, if any. A statistical warranty tracking model is used to help with estimates and assists in exercising judgment in determining the underlying estimates. The statistical tracking model captures specific detail on hard drive reliability, such as factory test data, historical field return rates, and costs to repair by product type. If actual product return trends, costs to repair returned products or costs of customer compensatory claims differ significantly from estimates, future results of operations could be materially affected. Management s judgment is subject to a greater degree of subjectivity with respect to newly introduced products because of limited field experience with those products upon which to base warranty estimates. Management reviews the warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross margin and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair.

*Advertising Expense*

Advertising costs are expensed as incurred. Selling, general and administrative expenses of the Company include advertising costs of $5 million, $6 million and $2 million in 2007, 2006 and 2005, respectively.

*Income Taxes*

The Company accounts for income taxes under the asset and liability method, whereby deferred tax assets and liabilities are recognized for temporary differences between the financial reporting basis and the tax basis of the assets and liabilities and expected benefits of utilizing net operating loss ( NOL ) carryforwards. The Company records a valuation allowance where it is more likely than not that the deferred tax assets will not be realized. Each period the Company evaluates the need for a valuation allowance for the deferred tax assets and adjusts the valuation allowance so that the Company records net deferred tax assets only to the extent that it has concluded it is more likely than not that these deferred tax assets will be realized.

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

*Per Share Information*

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

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**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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

| | Years Ended | | |
|---|---|---|---|
| | **June 29, 2007** | **June 30, 2006** | **July 1, 2005** |
| Net income | $ 564 | $ 395 | $ 196 |
| Weighted average shares outstanding: | | | |
| Basic | 219 | 215 | 208 |
| Employee stock options and other | 7 | 9 | 9 |
| Diluted | 226 | 224 | 217 |
| Income per share: | | | |
| Basic | $ 2.57 | $ 1.84 | $ .94 |
| Diluted | $ 2.50 | $ 1.76 | $ .90 |
| Antidilutive common share equivalents excluded* | 2 | 2 | 6 |

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

*Stock-Based Compensation*

Effective July 2, 2005, the Company accounts for all stock-based compensation in accordance with the fair value recognition provisions in SFAS No. 123-R, Share-Based Payment. Under the fair value recognition provisions of SFAS No. 123-R, stock-based compensation cost is measured at the grant date based on the value of the award and is recognized on a straight-line basis as expense over the vesting period. Under SFAS No. 123-R, the Company is required to use judgment in estimating the amount of stock-based awards that are expected to be forfeited. If actual forfeitures differ significantly from the original estimate, stock-based compensation expense and the results of operations could be materially impacted.

Prior to the adoption of SFAS No. 123-R, the Company accounted for stock-based employee compensation plans (including shares or other equity instruments issued under its stock incentive plans and employee stock purchase plan) in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and its related interpretations ( APB No. 25 ), and followed the pro forma net income, pro forma income per share, and stock-based compensation plan disclosure requirements set forth in SFAS No. 123, Accounting for Stock-Based Compensation.

The fair values of all stock options granted subsequent to January 1, 2005 were estimated using a binomial model and the fair values of all options granted prior to December 31, 2004 and all ESPP shares were estimated using the Black-Scholes-Merton option pricing model. Both the binomial and the Black-Scholes-Merton models require the input of highly subjective assumptions.

*Other Comprehensive Income*

Other comprehensive income refers to revenue, expenses, gains and losses that are recorded as an element of shareholders equity but are excluded from net income. The Company s other comprehensive income is comprised of unrealized gains and losses on foreign currency contracts and marketable securities categorized as available for sale under SFAS No. 115.

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Foreign Exchange Contracts*

Although the majority of the Company s transactions are in U.S. Dollars, some transactions are based in various foreign currencies. The Company purchases short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The contracts have maturity dates that do not exceed six months. The Company does not purchase short-term forward exchange contracts for trading purposes.

The Company applies the provisions of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities , as amended, which establishes accounting and reporting standards for derivative instruments embedded in other contracts and for hedging activities. The Company had outstanding forward exchange contracts with commercial banks for Thai Baht, Malaysian Ringgit, British Pound Sterling and Euro with values of $493 million and $264 million at June 29, 2007 and June 30, 2006, respectively. Thai Baht and Malaysian Ringgit contracts are designated as cash flow hedges under SFAS No. 133. If the derivative is designated as a cash flow hedge, the effective portion of the change in fair value of the derivative is initially deferred in other comprehensive income (loss), net of tax. These amounts are subsequently recognized into earnings when the underlying cash flow being hedged is recognized into earnings. Recognized gains and losses on foreign currency contracts entered into for factory related activities are reported in cost of revenues. Hedge effectiveness is measured by comparing the hedging instrument s cumulative change in fair value from inception to maturity to the underlying exposure s terminal value. The Company has determined that all of its hedging instruments for all years presented were effective as defined under SFAS No. 133.

All other contracts are related to international sales activities and are designated as fair value hedges. These contracts are not designated as hedging instruments under U.S. GAAP, and therefore, the change in the instrument s fair value is recognized currently in earnings and is reported as a component of non-operating income. Changes in fair value on these contracts were not material to the consolidated financial statements for all years presented.

*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. These estimates and assumptions have been applied using methodologies, which are consistent throughout the periods presented. However, actual results could differ from these estimates.

*New Accounting Standards*

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

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances, but provides clarification on acceptable fair valuation methods and applications. SFAS 157 is

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of SFAS 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits entities to choose to measure many financial assets and financial liabilities at fair value. Unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact SFAS 159 will have on its consolidated financial statements.

*Reclassifications*

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

| | Years Ended | | | |
|---|---|---|---|---|
| | June 30, 2006 | | July 1, 2005 | |
| | Current Classification | Previous Classification | Current Classification | Previous Classification |
| Changes in accounts payable | $ 30 | $ 64 | $ 94 | $ 134 |
| Net cash provided by operating activities | 368 | 402 | 421 | 461 |
| Capital expenditures | 268 | 302 | 194 | 234 |
| Net cash used in investing activities | 303 | 337 | 274 | 314 |

**Note 2. Supplemental Financial Statement Data**

| | Years Ended | |
|---|---|---|
| | June 29, 2007 | June 30, 2006 |
| | (in millions) | |
| Inventories: | | |
| Finished goods | $ 153 | $ 120 |
| Work in process | 94 | 62 |
| Raw materials and component parts | 12 | 23 |

| | | |
|---|---|---|
| | $ 259 | $ 205 |
| Property and Equipment: | | |
| Land and buildings | $ 189 | $ 163 |
| Machinery and equipment | 1,203 | 906 |
| Machinery and equipment recorded under capital leases | 60 | 38 |
| Furniture and fixtures | 12 | 8 |
| Leasehold improvements | 53 | 28 |
| | 1,517 | 1,143 |
| Accumulated depreciation and amortization | (776) | (594) |
| Net property and equipment | $ 741 | $ 549 |

WESTERN DIGITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Amortization expense for assets under capital lease was $14 million, $5 million and $4 million for the years ended June 29, 2007, June 30, 2007, and July 1, 2005, respectively. Accumulated amortization on machinery and equipment recorded under capital leases was $20 million and $10 million as of June 29, 2007 and June 30, 2006, respectively.

**Note 3. Short-term Borrowings and Long-term Debt**

Short-term borrowings and long-term debt consisted of the following as of June 29, 2007 and June 30, 2006 (in millions):

| | 2007 | 2006 |
|---|---|---|
| Term loan | $ | $ 25 |
| Capital lease obligations (Note 4) | 22 | 19 |
| Total debt | 22 | 44 |
| Less amounts due in one year | (12) | (25) |
| Long-term debt | $ 10 | $ 19 |

*Line of Credit*

The Company maintained a $125 million credit facility ( Senior Credit Facility ) with a termination date of September 20, 2009. The facility provided for a revolving credit line (subject to outstanding letters of credit and a borrowing base calculation) and a term loan. The term loan was paid in full as of March 30, 2007, a letter of termination was submitted for the Senior Credit Facility on June 28th, 2007, and termination was finalized during the first quarter of 2008.

**Note 4. Commitments and Contingencies**

*Lease Commitments*

The Company leases certain facilities and equipment under long-term, non-cancelable operating and capital leases. The Company s operating leases consist of leased property and equipment that expire at various dates through 2015. Rental expense under these operating leases, including month-to-month rentals, was $15 million, $16 million and $16 million in 2007, 2006 and 2005, respectively. The Company s capital leases consist of leased equipment. These leases have maturity dates through July 2009 and interest rates averaging approximately 5.9%. Future minimum lease payments under operating and capital leases that have initial or remaining non-cancelable lease terms in excess of one year at June 29, 2007 are as follows (in millions):

| | Operating | Capital |
|---|---|---|

| | | | | |
|---|---|---|---|---|
| 2008 | $ | 11 | $ | 13 |
| 2009 | | 10 | | 10 |
| 2010 | | 10 | | |
| 2011 | | 6 | | |
| 2012 | | 2 | | |
| Thereafter | | 5 | | |
| Total future minimum payments | $ | 44 | $ | 23 |
| Less: interest on capital leases | | | | (1) |
| Total principal payable on capital leases | | | $ | 22 |

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Product Warranty Liability*

The warranty provision considers estimated product failure rates and trends, estimated repair or replacement costs and estimated costs for customer compensatory claims related to product quality issues, if any. Management uses a statistical warranty tracking model to help estimate and exercise judgment in determining the underlying estimates. Management reviews the warranty accrual quarterly for products shipped in prior periods and which are still under warranty. Any changes in the estimates underlying the accrual may result in adjustments that impact current period gross margin and income. Such changes are generally a result of differences between forecasted and actual return rate experience and costs to repair. Changes in the warranty accrual for the years ended June 29, 2007, June 30, 2006 and July 1, 2005 were as follows (in millions):

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Warranty accrual, beginning of period | $ 89 | $ 92 | $ 57 |
| Charges to operations | 74 | 76 | 82 |
| Utilization | (52) | (49) | (46) |
| Changes in estimate related to pre-existing warranties | (21) | (30) | (1) |
| Warranty accrual, end of period | $ 90 | $ 89 | $ 92 |

Accrued warranty also includes amounts classified in non-current liabilities of $17 million at June 29, 2007 and $18 million at June 30, 2006.

*Long-term Purchase Agreements*

The Company has entered into long-term purchase agreements with various component suppliers. The commitments depend on specific products ordered and may be subject to minimum quality requirements and future price negotiations. For 2008 and 2009, WD expects these commitments to total approximately $985 million and $754 million, respectively. In conjunction with these agreements, the Company has advanced approximately $99 million related to 2008 and 2009 purchase commitments, of which $63 million is included in advances to suppliers and $36 million is included in other long-term assets as of June 29, 2007. These amounts do not reflect the reduction in commitments resulting from the planned acquisition of Komag.

**Note 5. Legal Proceedings**

In the normal course of business, the Company is subject to legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of monetary liability or financial impact with respect to these matters is subject to many uncertainties and is therefore not predictable with assurance, management believes that any monetary liability or financial impact to the Company from these matters or the specified matters below, individually and in the aggregate, beyond that provided at June 29, 2007, would not be material to the Company s financial condition. However, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these legal proceedings, lawsuits and other claims could differ materially from those projected.

In June 1994, Papst Licensing ( Papst ) brought suit against the Company alleging infringement by the Company of five hard drive motor patents owned by Papst. In December 1994, Papst dismissed its case without prejudice. In July 2002, Papst filed a new complaint against the Company and several other defendants alleging infringement by the Company of seventeen of Papst s patents related to hard drive motors that the Company purchased from motor vendors. Papst sought an injunction and damages. The Company filed an answer on September 4, 2002, denying Papst s complaint, and the lawsuit was subsequently stayed pending the outcome of certain other related litigation. On July 4, 2005, the Company entered into a Settlement and License Agreement with Papst. In connection with the settlement, the Company made a one-time payment of $24 million to Papst on July 29, 2005, of which $19 million represented a charge to selling, general and administrative expense for the Company s 2005 fiscal fourth quarter ($5 million had been accrued

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

in a prior year). In exchange for the payment, Papst has dismissed with prejudice its lawsuit pending against the Company, granted the Company a fully-paid license to certain patents owned by Papst, and released the Company of all past, present and future claims alleging infringement by the Company of those Papst patents. The Settlement and License Agreement resolved all outstanding litigation between the two companies without any admission of infringement by the Company.

Since the Company s announcement on July 27, 2006 that it was conducting a company-initiated, voluntary review of its historical stock option grants, several purported derivative actions were filed nominally on behalf of the Company against certain current and former directors and officers of the Company in the United States District Court for the Central District of California and the Superior Court of the State of California for the County of Orange. These complaints assert claims for violations of Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act, accounting, breach of fiduciary duty and/or aiding and abetting, constructive fraud, waste of corporate assets, unjust enrichment, rescission, breach of contract, violation of the California Corporations Code, abuse of control, gross mismanagement, and constructive trust in connection with the Company s option granting practices. The complaints seek unspecified monetary damages and other relief against the individual defendants and certain governance reforms affecting the Company. The Company is named solely as a nominal defendant in each action. The parties in the actions engaged in a voluntary mediation on June 6, 2007, and these discussions are continuing.

On January 22, 2007, StorMedia Texas LLC filed a complaint against the Company and several other companies, including other disk drive manufacturers, for patent infringement in the Eastern District of Texas alleging infringement of U.S. Patent No. 6,805,891. The Company served an answer to the complaint denying all material allegations and asserting affirmative defenses, and has also filed counterclaims against StorMedia. The Company intends to defend itself vigorously in this matter. As described elsewhere in this Annual Report on Form 10-K, the Company has entered into a definitive agreement to acquire Komag. Komag has provided its customers with certain contractual indemnification undertakings for patent infringement involving its products and Komag has received claims for reimbursement of legal defense costs from its customers related to the StorMedia patent infringement litigation. The Company is evaluating the position of Komag in relation to this litigation.

**Note 6. Business Segment, International Operations and Major Customers**

*Segment Information*

The Company operates in one segment, the hard drive business.

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*International Operations*

The Company s operations outside the United States include manufacturing facilities in Malaysia and Thailand as well as sales offices throughout Canada, Europe, Asia, Japan, India and the Middle East. The following table summarizes the Company s operations by geographic area for the three years ended June 29, 2007 (in millions):

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| **Revenue from external customers(1):** | | | |
| United States | $ 1,780 | $ 1,386 | $ 1,268 |
| Asia | 1,840 | 1,550 | 1,197 |
| Europe, the Middle East and Africa | 1,591 | 1,225 | 1,069 |
| Other | 257 | 180 | 105 |
| Total | $ 5,468 | $ 4,341 | $ 3,639 |
| **Long-lived assets:** | | | |
| United States | $ 409 | $ 261 | $ 163 |
| Asia | 462 | 320 | 244 |
| Europe, the Middle East and Africa | 1 | | |
| Total | $ 872 | $ 581 | $ 407 |

(1) Revenue is attributed to geographic regions based on location of customer.

*Major Customer*

During 2007, 2006 and 2005, sales to Dell, Inc. accounted for 10%, 12% and 16% of the Company s revenue, respectively.

**Note 7. Western Digital Corporation 401(k) Plan**

The Company has adopted the Western Digital Corporation 401(k) Plan (the Plan ). The Plan covers substantially all domestic employees, subject to certain eligibility requirements. The Company makes annual contributions to the Plan, subject to approval from the Board of Directors. For 2007, 2006 and 2005 the Company made Plan contributions of $4 million, $4 million and $3 million, respectively.

**Note 8. Shareholders Equity**

*Stock Incentive Plans*

The Company has four stock-based incentive plans (collectively referred to as the Stock Plans ): The 2004 amended and restated Performance Incentive Plan, the Employee Stock Option Plan, the Broad-Based Stock Incentive Plan and the Stock Option Plan for Non-Employee Directors. Subsequent to the expiration of the Employee Stock Option Plan on November 10, 2004 and approval of the 2004 Performance Incentive Plan by the Company s shareholders on November 18, 2004, no new awards are permitted under the Employee Stock Option Plan, the Broad-Based Stock Incentive Plan or the Stock Option Plan for Non-Employee Directors (collectively referred to as the Prior Stock Plans ). As of June 29, 2007, options to purchase 7.2 million shares of the Company s common stock remain outstanding under the Prior Stock Plans, of which 6.2 million shares were exercisable and 0.1 million shares of restricted stock remain unvested. Options granted under the Prior Stock Plans vested over periods from one to four years. Options granted under the Prior Stock Plans expire either five or ten years from the date of grant.

In November 2004, the Company s shareholders approved the 2004 Performance Incentive Plan. Subsequently, in November 2005, the Company s shareholders approved an authorization for an additional 13 million shares. The types of

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

awards that may be granted under the 2004 Performance Incentive Plan include stock options, stock appreciation rights, restricted stock, stock bonuses and other forms of awards granted or denominated in the Company s common stock or units of the Company s common stock, as well as certain cash bonus awards. Persons eligible to receive awards under the 2004 Performance Incentive Plan include officers or employees of the Company or any of its subsidiaries, directors of the Company and certain consultants and advisors to the Company or any of its subsidiaries. The vesting of awards under the Performance Incentive Plan is determined at the date of grant. Each award expires on a date determined at the date of grant; however, the maximum term of options, stock appreciation rights and other rights to acquire common stock under the 2004 Performance Incentive Plan is ten years after the grant date of the award.

As of June 29, 2007, the maximum number of shares of the Company s common stock that are authorized for award grants under the 2004 Performance Incentive Plan is 22.1 million shares. Any shares subject to awards under the prior stock plans that are cancelled, forfeited, or otherwise terminate without having vested or been exercised, as applicable, will become available for other award grants under the 2004 Performance Incentive Plan. The 2004 Performance Incentive Plan will terminate on September 21, 2014 unless terminated earlier by the Company s Board of Directors.

*Employee Stock Purchase Plan*

During 2006, the Company adopted the Western Digital Corporation 2005 Employee Stock Purchase Plan ( ESPP ) whereby eligible employees may authorize payroll deductions of up to 10% of their eligible compensation to purchase shares of the Company s common stock at 95% of the fair market value of common stock on either the date of grant or on the exercise date, whichever is less. The date of grant of each offering period is June 1st or December 1st, except for the initial offering period, which began on December 15, 2005. Each offering period is 24 months and consists of four exercise dates. If the fair market value of the common stock is less on a given exercise date than on the date of grant, employee participation in that offering period is terminated and re-enrollment in the new offering period occurs automatically. The Company s ESPP operates in accordance with Section 423 of the Internal Revenue Code. The 1993 Employee Stock Purchase Plan, which was previously suspended by the Board of Directors, terminated upon stockholder approval of the 2005 ESPP.

*Stock-Based Compensation Expense*

Effective July 2, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment ( SFAS No. 123-R ) using the modified prospective method. SFAS No. 123-R establishes the financial accounting and reporting standards for stock-based compensation plans. As required by SFAS No. 123-R, the Company recognized the cost resulting from all share-based payment transactions including shares issued under the Company s stock option plans and employee stock purchase plans in the financial statements. During the fiscal year ended June 29, 2007, the Company expensed $18 million related to stock-based compensation from stock options and ESPP shares. At June 29, 2007, total compensation cost related to unvested stock options granted to employees and ESPP shares, but not yet recognized, was $26 million and will be amortized on a straight-line basis over a weighted average period of approximately 2.2 years.

*Pro forma Information for Periods Prior to the Adoption of SFAS No. 123-R*

Prior to July 2, 2005, the Company accounted for stock-based employee compensation plans (including shares issued under the Company s stock option plans and ESPP) in accordance with APB No. 25 and followed the pro forma net income, pro forma income per share, and stock-based compensation plan disclosure requirements set forth in the Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123 ). The following table sets forth the computation of basic and diluted income per share for the years ended July 1, 2005, and

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**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

illustrates the effect on net income and income per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation (in millions, except per share data):

| | July 1, 2005 |
|---|---|
| Net income | |
| As reported | $ 196 |
| Stock-based employee compensation included in reported earnings | 5 |
| Stock-based employee compensation expense determined under fair-value based methods for all awards | (30) |
| Pro forma net income | $ 171 |
| Basic income per share: | |
| As reported | $ 0.94 |
| Pro forma | $ 0.83 |
| Diluted income per share: | |
| As reported | $ 0.90 |
| Pro forma | $ 0.79 |

The 2005 pro forma income per share information is estimated using the Black-Scholes-Merton option-pricing model for all stock options granted on or prior to December 31, 2004, as well as all ESPP shares granted on or prior to July 1, 2005. The Black-Scholes-Merton option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. For stock options granted January 1, 2005 through July 1, 2005, the 2005 pro forma income per share information is estimated using a binomial model. Both the Black-Scholes-Merton and the binomial option pricing models require the input of highly subjective assumptions such as the expected stock price volatility and expected employee exercise behavior. The resulting fair value of employee stock options is amortized on a straight-line basis over the service period of the options.

*Stock Options*

The following table summarizes activity under the Stock Plans (in millions, except per share amounts):

| | Number of Shares | Weighted Average Exercise Price Per Share | Remaining Contractual Life (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|

| | | | | | | |
|---|---|---|---|---|---|---|
| **Options outstanding at July 2, 2004** | 25.1 | $ | 7.75 | | | |
| Granted | 4.4 | | 10.05 | | | |
| Exercised | (9.2) | | 5.26 | | | |
| Canceled or expired | (0.8) | | 9.07 | | | |
| **Options outstanding at July 1, 2005** | 19.5 | | 9.39 | | | |
| Granted | 1.2 | | 17.22 | | | |
| Exercised | (7.6) | | 8.36 | | | |
| Canceled or expired | (0.7) | | 11.79 | | | |
| **Options outstanding at June 30, 2006** | 12.4 | | 10.65 | | | |
| Granted | 1.6 | | 19.30 | | | |
| Exercised | (2.7) | | 8.34 | | | |
| Canceled or expired | (0.5) | | 18.68 | | | |
| **Options outstanding at June 29, 2007** | 10.8 | $ | 12.15 | 5.6 | $ | 86 |
| **Exercisable at June 29, 2007** | 7.1 | $ | 10.35 | 4.3 | $ | 71 |

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**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of the Company s common stock for those awards that have an exercise price currently below the quoted price. As of June 29, 2007, the Company had options outstanding to purchase an aggregate of 8.5 million shares with an exercise price below the quoted price of the Company s stock resulting in an aggregate intrinsic value of $86 million. During the years ended June 29, 2007 and June 30, 2006, the aggregate intrinsic value of options exercised under the Company s stock option plans was $30 million and $84 million, respectively, determined as of the date of exercise.

The following tables summarize information about options outstanding and exercisable under the Stock Plans at June 29, 2007 (in millions, except per share amounts):

| | | Options Outstanding | | | Options Exercisable | | |
|---|---|---|---|---|---|---|---|
| **Range of Exercise Prices** | | **Number of Shares** | **Remaining Contractual Life* (in years)** | **Weighted Average Exercise Price** | **Number of Shares** | **Weighted Average Exercise Price** |
| $ 2.10 | 3.85 | 1.6 | 4.33 | $ 2.98 | 1.6 | $ 2.95 |
| 3.94 | 6.58 | 1.2 | 3.43 | 5.29 | 1.2 | 5.29 |
| 6.64 | 8.58 | 0.5 | 4.25 | 7.87 | 0.4 | 7.89 |
| 8.63 | 8.89 | 1.4 | 7.13 | 8.88 | 0.7 | 8.86 |
| 8.99 | 11.98 | 1.1 | 5.62 | 10.76 | 0.7 | 10.63 |
| 11.99 | 13.00 | 1.0 | 5.55 | 12.78 | 0.8 | 12.79 |
| 13.04 | 15.65 | 1.2 | 5.83 | 13.70 | 0.8 | 13.54 |
| 16.96 | 19.19 | 0.5 | 6.04 | 18.32 | 0.2 | 18.61 |
| 19.40 | 21.00 | 1.5 | 8.88 | 19.64 | 0.1 | 20.26 |
| 21.04 | 48.50 | 0.8 | 3.30 | 30.20 | 0.6 | 32.41 |
| | | 10.8 | 5.64 | $ 12.15 | 7.1 | $ 10.35 |

* Represents the weighted average remaining contractual lives of the options outstanding.

*Deferred Stock Compensation*

The Company granted approximately 1.8 million, 2.0 million and 1.6 million shares of restricted stock during 2007, 2006 and 2005, respectively. The restricted stock vests annually over periods from one to five years. The aggregate market value of the restricted stock at the date of issuance was $36 million, $27 million and $17 million in 2007, 2006 and 2005, respectively. These amounts have been recorded as deferred compensation and are being amortized to operating expense over the corresponding vesting periods. For purposes of valuing these awards, the Company has assumed a forfeiture rate of zero based on a historical analysis indicating minimal forfeitures for these types of awards. For the year ended June 29, 2007, the Company charged to expense $29 million related to restricted stock awards that were vested during the period. Of this amount, $12 million represented the incremental cost from the modification of pre-existing awards. As of June 29, 2007, the aggregate unamortized fair value of all unvested restricted stock awards was $38 million, which will be amortized on a straight-line basis over a weighted average vesting period of approximately 2.7 years.

During 2005, the Company also awarded certain executives and other key employees 0.5 million restricted stock units with performance-based vesting ( Performance Shares ). However, during 2006, the Company cancelled all outstanding Performance Shares. The impact of these awards, and subsequent cancellation, were not material to the consolidated financial statements.

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Stock Reserved for Issuance*

The following table summarizes all shares of common stock reserved for issuance at June 29, 2007 (in millions):

| | Number of Shares |
|---|---|
| Maximum shares issuable in connection with: | |
| Outstanding awards and shares available for award grants | 21.6 |
| ESPP | 3.4 |
| | 25.0 |

*Fair Value Disclosure Binomial Model*

The fair value of stock options granted for the years ended June 29, 2007, June 30, 2006 and all options granted between January 1, 2005 and July 1, 2005 was estimated using a binomial option pricing model. The binomial model requires the input of highly subjective assumptions including the expected stock price volatility, the expected price multiple at which employees are likely to exercise stock options and the expected employee forfeiture rate. The Company uses historical data to estimate option exercise, employee termination, and expected stock price volatility within the binomial model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The fair value of stock options granted during the three years ended June 29, 2007 was estimated using the following weighted average assumptions:

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Suboptimal exercise factor | 1.62 | 1.58 | 1.79 |
| Range of risk-free interest rates | 4.48% to 5.12% | 4.01% to 5.21% | 3.34% to 4.46% |
| Range of expected volatility | 0.34 to 0.79 | 0.38 to 0.82 | 0.43 to 0.84 |
| Weighted average expected volatility | .59 | .67 | .70 |
| Post-vesting termination rate | 5.34% | 14.00% | 13.54% |
| Expected term (in years) | 5.34 | 4.32 | 3.82 |
| Dividend yield | | | |
| Fair value | $8.18 | $7.11 | $4.86 |

*Fair Value Disclosure Black-Scholes-Merton Model*

Pro forma information regarding net income and earnings per share is required by SFAS No. 123. This information is required to be determined as if the Company had accounted for its stock options (including shares issued under the

Stock Incentive Plans and the ESPP, collectively called Options ) granted subsequent to July 1, 1995, under the fair value method of that statement.

The 2005 pro forma income per share information for all stock options granted on or prior to December 31, 2004 as well as all ESPP shares granted on or prior to July 1, 2005 was estimated using the Black-Scholes-Merton option-pricing model. The Black-Scholes-Merton option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes-Merton option pricing model requires the input of highly subjective assumptions such as the expected stock price volatility and the expected period until options are exercised. The pro forma impact of applying SFAS No. 123 at June 29, 2007 is not necessarily representative of future periods.

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**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The fair values of all stock options granted on or prior to December 31, 2004 and all ESPP shares granted on or prior to June 29, 2007 have been estimated at the date of grant using a Black-Scholes-Merton option-pricing model with the following weighted average assumptions:

| | Stock Option Plan | | ESPP | |
|---|---|---|---|---|
| | 2005 | 2007 | 2006 | 2005 |
| Option life (in years) | 4.51 | 1.22 | 1.21 | 1.25 |
| Risk-free interest rate | 3.23% | 4.51% | 4.45% | 2.25% |
| Stock price volatility | 0.74 | 0.40 | 0.42 | 0.55 |
| Dividend yield | | | | |
| Fair value | $ 5.33 | $ 3.83 | $ 3.85 | $ 3.00 |

*Stock Repurchase Program*

The Company s Board of Directors has authorized the repurchase of up to $250 million of the Company s common stock in open market transactions. Stock repurchases are expected to be funded principally from operating cash flows. During 2007, the Company repurchased 4.0 million shares of common stock at a total cost of $73 million. Subsequent to the end of 2007, the Company purchased 0.8 million shares for approximately $16 million. Since the inception of the program, the Company has repurchased 15.1 million shares for a total cost of $204 million. Subject to any limitations that may be set forth in the proposed bridge loan facility to be entered into for the planned acquisition of Komag, the Company may continue to repurchase its stock as it deems appropriate and market conditions allow.

*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 carried one Right to Purchase Series A Junior Participating Preferred Stock (the Right ). The Right enabled the holder, under certain circumstances, to purchase common stock of Western Digital or of an 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 1998. The Rights under the 1998 plan were similar to the rights under the 1989 plan except they were redeemable by the Company at $.01 per Right and expired in 2008. In connection with the establishment of a holding company structure on April 6, 2001, the Company terminated the Rights under the 1998 plan and adopted a new Rights plan. The 2001 plan is similar to the terminated 1998 plan, except that the exercise price was reduced from $150.00 to $50.00 per share and the expiration date for the 2001 Rights plan was extended to April 2011.

**Note 9. Income Taxes**

*Pre-tax Income*

The domestic and foreign components of income (loss) before income taxes were as follows for the three years ended June 29, 2007 (in millions):

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Foreign | $ 322 | $ 272 | $ 236 |
| Domestic | 121 | 110 | (36) |
| Income before income taxes | $ 443 | $ 382 | $ 200 |

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Income Tax (Benefit) Expense*

The components of the (benefit) provision for income taxes were as follows for the three years ended June 29, 2007 (in millions):

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| Current: | | | |
| Foreign | $ 8 | $ 6 | $ 2 |
| Domestic-federal | (4) | 3 | 1 |
| Domestic-state | | | 1 |
| Deferred: | | | |
| Domestic-federal | (65) | (19) | |
| Domestic-state | (60) | (3) | |
| Income tax (benefit) provision | $ (121) | $ (13) | $ 4 |

Remaining net undistributed earnings from foreign subsidiaries at June 29, 2007 on which no U.S. tax has been provided amounted to approximately $1.1 billion. The net undistributed earnings are intended to finance local operating requirements. Accordingly, an additional U.S. tax provision has not been made on these earnings. The tax liability for these earnings approximates $433 million, if the Company repatriates the $1.1 billion in undistributed earnings from the foreign subsidiaries.

*Deferred Taxes*

Temporary differences and carryforwards, which give rise to a significant portion of deferred tax assets and liabilities as of June 29, 2007 and June 30, 2006 were as follows (in millions):

| | 2007 | 2006 |
|---|---|---|
| Deferred tax assets: | | |
| Reserves and accrued expenses not currently deductible | $ 88 | $ 99 |
| Domestic net operating loss (NOL) carryforward | | 10 |
| Business credit carryforward | 35 | 40 |
| Other | 34 | 28 |
| | 157 | 177 |
| Deferred tax liabilities | (10) | |
| Valuation allowance | | (155) |

| | | |
|---|---|---|
| Deferred tax assets, net | $ 147 | $ 22 |

| | 2007 | 2006 |
|---|---|---|
| Deferred tax assets: | | |
| Current portion (included in other current assets) | $ 69 | $ 10 |
| Non-current portion (included in other non-current assets) | 88 | 12 |
| Deferred tax liabilities | (10) | |
| Deferred tax assets, net | $ 147 | $ 22 |

In addition to the deferred tax assets presented above, the Company had additional NOL and credit benefits related to stock option deductions of approximately $106 million and $90 million at June 29, 2007 and June 30, 2006, respectively. In accordance with the provisions of SFAS No. 123-R, this will be recorded as a credit to shareholders equity when an incremental benefit is recognized after considering all other tax attributes available to the Company.

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Accordingly, these amounts are excluded from the table above. The 2006 deferred tax assets presented above have been reclassified to reflect the 2007 presentation.

Reserves and accrued expenses not currently deductible consisted of the following as of June 29, 2007 and June 30, 2006 (in millions):

| | 2007 | 2006 |
|---|---|---|
| Sales related reserves and adjustments | $ 54 | $ 69 |
| Accrued compensation and benefits | 25 | 21 |
| Other accrued liabilities | 4 | 5 |
| Inventory reserves and adjustments | 5 | 4 |
| Total reserves and accrued expenses not currently deductible | 88 | 99 |

The Company determines deferred taxes for each of its tax-paying subsidiaries within each tax jurisdiction. The Company s deferred tax assets had previously been partially reserved in the form of a valuation allowance. As of the end of fiscal 2007, the Company determined that it is more likely than not that these assets will be realized. Accordingly, the Company reduced the remainder of the valuation allowance which resulted in the recognition of additional net deferred tax assets of $125 million. The realization of the deferred tax assets is primarily dependent on the Company s ability to generate sufficient earnings in certain jurisdictions in future years. The Company released the remainder of the valuation allowance for its deferred tax assets based on the weight of available evidence including the history of cumulative pretax income and the increased likelihood of the Company s ability to generate profits in the future. In 2006, the Company released a portion of the valuation allowance on deferred tax assets due to the difficulty at the time in accurately projecting income for periods of longer than two years given the cyclical nature of the industry. The amount of deferred tax assets considered realizable may increase or decrease in subsequent periods based on fluctuating industry or company conditions.

*Effective Tax Rate*

Reconciliation of the U.S. Federal statutory rate to the Company s effective tax rate is as follows for the three years ended June 29, 2007:

| | 2007 | 2006 | 2005 |
|---|---|---|---|
| U.S. Federal statutory rate | 35% | 35% | 35% |
| Tax rate differential on international income | (24) | (25) | (40) |
| Utilization of domestic NOL carryforward | (9) | (16) | (22) |
| Tax effect of repatriation | | 1 | 15 |
| Increase in non-NOL deductible temporary differences not benefited | | 6 | 15 |
| Release of valuation allowance | (30) | (6) | |

| | | | |
|---|---|---|---|
| Other | 1 | 2 | (1) |
| Effective tax rate | (27)% | (3)% | 2% |

*Tax Holidays and Carryforwards*

A substantial portion of the Company s manufacturing operations in Malaysia and Thailand operate under various tax holidays and tax incentive programs which will expire in whole or in part at various dates through 2022. Certain of the holidays may be extended if specific conditions are met. The net impact of these tax holidays and tax incentives was to increase the Company s net earnings by $86 million ($0.38 per diluted share), $81 million ($0.36 per diluted share) and $67 million ($0.31 per diluted share) in 2007, 2006, and 2005 respectively.

As of June 29, 2007, the Company had federal and state NOL carryforwards of approximately $308 million and $139 million, respectively. In addition, the Company had various federal and state tax credit carryforwards combined of approximately $90 million. The loss carryforwards available to offset future federal and state taxable income expire at

**WESTERN DIGITAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

various times from 2019 to 2021 and 2008 to 2026, respectively. Approximately $37 million of the credit carryforwards available to offset future taxable income expire at various times from 2009 to 2027. The remaining amount is available indefinitely.

**Note 10. Planned Acquisition**

The Company has a definitive agreement to acquire Komag, Incorporated, a media manufacturer and current supplier to the Company, for $32.25 per share for a value of approximately $1.0 billion, which is expected to close during the third calendar quarter of 2007. The planned acquisition of Komag is intended to strengthen production efficiencies and enhance the Company s hard drive manufacturing process by integrating media, one of the critical technology components of hard drives.

The planned acquisition is structured as a cash tender offer for all the outstanding shares of Komag common stock followed by a merger of an indirect wholly-owned subsidiary of the Company into Komag in which the remaining shareholders of Komag will receive $32.24 in cash per share.

The Company intends to fund the planned acquisition, including the expected repurchase of Komag s convertible notes due 2014 and related fees and expenses, through a combination of the Company s cash and proceeds from a senior unsecured term bridge loan facility of up to $1.3 billion.

**Note 11. Quarterly Results of Operations (unaudited)**

| | First | Second | Third | Fourth |
|---|---|---|---|---|
| **2007(1)** | | | | |
| Revenue, net | $ 1,264 | $ 1,428 | $ 1,410 | $ 1,367 |
| Gross margin | 218 | 255 | 222 | 205 |
| Operating income | 99 | 122 | 115 | 79 |
| Net income | 103 | 128 | 121 | 212 |
| Basic earnings per share | $ 0.47 | $ 0.58 | $ 0.55 | $ 0.97 |
| Diluted earnings per share | $ 0.46 | $ 0.57 | $ 0.53 | $ 0.94 |
| **2006(2)** | | | | |
| Revenue, net | $ 1,010 | $ 1,117 | $ 1,129 | $ 1,086 |
| Gross margin | 178 | 228 | 218 | 204 |
| Operating income | 68 | 104 | 100 | 94 |
| Net income | 69 | 104 | 102 | 120 |
| Basic earnings per share | $ 0.32 | $ 0.49 | $ 0.47 | $ .55 |
| Diluted earnings per share | $ 0.31 | $ 0.47 | $ 0.45 | $ .53 |

(1) The fourth quarter of 2007 included a $126 million benefit to income taxes from an adjustment to the valuation allowance for deferred income taxes. This benefit is net of an adjustment made in the fourth quarter to reduce the deferred tax asset and the related valuation allowance by approximately $21 million to correct the amount of state deferred tax asset recognized in prior periods. As both the deferred tax asset and the related valuation allowance were overstated in prior periods, there was no net effect to the total assets or net income as reported in those prior periods, or in the fourth quarter 2007.

(2) The fourth quarter of 2006 included a $13 million benefit to gross margin related to the resolution of certain items that impacted amounts previously recorded as costs primarily in earlier quarters of 2006, and a $22 million benefit to income taxes from an adjustment to the valuation allowance for deferred income taxes.

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**WESTERN DIGITAL CORPORATION**

**SCHEDULE II CONSOLIDATED VALUATION AND QUALIFYING ACCOUNTS**
**Three years ended June 30, 2006**
**(in millions)**

| | | Allowance for Doubtful Accounts |
|---|---|---|
| **Balance at July 2, 2004** | $ | 6 |
| Charges to operations | | 2 |
| Deductions | | (5) |
| **Balance at July 1, 2005** | $ | 3 |
| Charges to operations | | 5 |
| Deductions | | (3) |
| **Balance at June 30, 2006** | $ | 5 |
| Charges to operations | | |
| Deductions | | ( ) |
| **Balance at June 29, 2007** | $ | 5 |

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

None.

**Item 9A.** ***Controls and Procedures***

***Evaluation of Disclosure Controls and Procedures***

As required by SEC Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act ), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Annual Report on Form 10-K, our disclosure controls and procedures were effective.

***Management s Report on Internal Control over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and our directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management evaluated the effectiveness of our internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework.* Based on this evaluation, our management concluded that our internal control over financial reporting was effective as of the end of the period covered by this Annual Report on Form 10-K. KPMG LLP, our independent registered public accounting firm which audited the consolidated financial statements included in this Annual Report on Form 10-K, has issued an attestation report on our assessment of our internal control over financial reporting. See page 48 herein.

***Changes in Internal Control over Financial Reporting***

There has been no change in our internal control over financial reporting during the fourth fiscal quarter ended June 29, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

***Inherent Limitations of Effectiveness of Controls***

Our management, including our Chief Executive Officer and its Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all error and all fraud.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving

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its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Item 9B.** ***Other Information***

None.

## PART III

**Item 10.** ***Directors, Executive Officers and Corporate Governance***

There is incorporated herein by reference the information required by this Item included in the Company s Proxy Statement for the 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2007, except that the information required by this Item 10 concerning executive officers is set forth in Part I of this report under Item 1. Business Executive Officers of the Registrant.

**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 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2007.

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

There is incorporated herein by reference the information required by this Item included in the Company s Proxy Statement for the 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2007.

**Item 13.** ***Certain Relationships and Related Transactions, and Director Independence***

There is incorporated herein by reference the information, if any, required by this Item included in the Company s Proxy Statement for the 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2007.

**Item 14.** ***Principal Accountant Fees and Services***

There is incorporated herein by reference the information required by this Item included in the Company s Proxy Statement for the 2007 Annual Meeting of Shareholders, which will be filed with the Securities and Exchange Commission no later than 120 days after the close of the fiscal year ended June 29, 2007.

# PART IV

**Item 15.** ***Exhibits and Financial Statement Schedules***

(a) Documents filed as a part of this Annual Report on Form 10-K:

(1) **Financial Statements**

The financial statements included in Part II, Item 8 of this document are filed as part of this Annual Report on Form 10-K.

(2) **Financial Statement Schedules**

The financial statement schedule included in Part II, Item 8 of this document is filed as part of this Annual Report on Form 10-K.

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

(3) **Exhibits**

The following exhibits are filed herewith or are incorporated by reference, as specified below, from exhibits previously filed with the Securities and Exchange Commission. We shall furnish copies of exhibits for a reasonable fee (covering the expense of furnishing copies) upon written request to our Secretary at our principal executive offices.

| Exhibit Number | Description |
|---|---|
| 2.1 | Agreement and Plan of Merger, dated as of June 28, 2007, by and among Western Digital Corporation, State M Corporation and Komag, Incorporated(30) |
| 3.1 | Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date(22) |
| 3.2 | Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of May 10, 2006(25) |
| 4.1 | Rights Agreement between Western Digital Corporation and American Stock Transfer & Trust Company, as Rights Agent, dated as of April 6, 2001, which includes as Exhibit A thereto the Form of Right Certificate to be distributed to holders of Rights after the Distribution Date (as that term is defined in the Rights Agreement)(5) |
| 4.2 | Form of Common Stock Certificate(1) |
| 4.3 | |

| | |
|---|---|
| | Certificate of Designations of Series A Junior Participating Preferred Stock of Western Digital Corporation, dated April 6, 2001(5) |
| 10.1 | Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan, effective as of November 17, 2005(21)* |
| 10.1.1 | Form of Notice of Grant of Stock Option and Option Agreement Executives, under the Western Digital Corporation 2004 Performance Incentive Plan(25)* |
| 10.1.2 | Form of Notice of Stock Option Grant and Stock Option Agreement Non-Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(25)* |
| 10.1.3 | Form of Notice of Grant of Restricted Stock and Restricted Stock Agreement Executives, under the Western Digital Corporation 2004 Performance Incentive Plan(14)* |
| 10.1.4 | Form of Notice of Grant of Restricted Stock and Restricted Stock Agreement Non-Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(14)* |
| 10.1.5 | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.6 | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |

| Exhibit Number | Description |
|---|---|
| 10.1.7 | Form of Notice of Grant of Long-Term Cash Award and Long-Term Cash Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.8 | Form of Notice of Grant of Long-Term Cash Award and Long-Term Cash Award Agreement Employees, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.9 | Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan Non-Employee Director Option Grant Program, effective as of November 17, 2005, and Form of Notice of Grant of Stock Option and Option Agreement Non-Employee Directors(27) |
| 10.1.10 | Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan Non-Employee Director Restricted Stock Unit Grant Program, as amended November 9, 2006(27) |
| 10.2 | Western Digital Corporation Amended and Restated Employee Stock Option Plan, as amended on November 5, 1998(2)* |
| 10.2.1 | First Amendment to the Western Digital Corporation Employee Stock Option Plan, dated April 6, 2001(6)* |
| 10.2.2 | Form of Notice of Grant of Stock Options and Stock Option Agreement under the Western Digital Corporation Amended and Restated Employee Stock Option Plan as amended(19)* |
| 10.3 | Western Digital Corporation Broad-Based Stock Incentive Plan(3)* |
| 10.3.1 | First Amendment to the Western Digital Corporation Broad-Based Stock Incentive Plan, dated April 6, 2001(6)* |
| 10.3.2 | Form of Notice of Grant of Restricted Stock and Restricted Stock Agreement under the Western Digital Corporation Broad Based Stock Incentive Plan as amended(19)* |
| 10.4 | Western Digital Corporation Amended and Restated Stock Option Plan for Non-Employee Directors, effective as of May 25, 2000(6) |
| 10.4.1 | First Amendment to the Western Digital Corporation Amended and Restated Stock Option Plan for Non-Employee Directors, dated April 6, 2001(6) |
| 10.5 | Western Digital Corporation 2005 Employee Stock Purchase Plan, effective as of November 17, 2005(21)* |
| 10.6 | Amended and Restated Western Digital Corporation Non-Employee Directors Stock-For-Fees Plan, effective as of November 17, 2005(22) |
| 10.7 | Western Digital Corporation Incentive Compensation Plan(7)* |
| 10.8 | Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors * |
| 10.9 | Amended and Restated Deferred Compensation Plan, effective March 28, 2003(11)* |
| 10.10 | Amended and Restated Executive Bonus Plan, effective March 28, 2003(11)* |
| 10.11 | Amended and Restated 401(k) Plan, adopted as of March 28, 2002(8)* |
| 10.11.1 | First Amendment to Western Digital Corporation 401(k) Plan, effective as of July 1, 2002(10)* |
| 10.11.2 | Second Amendment to Western Digital Corporation 401(k) Plan, effective as of March 28, 2005(24)* |
| 10.11.3 | Third Amendment to Western Digital Corporation 401(k) Plan, effective as of March 31, 2006(24)* |
| 10.12 | Employment Agreement dated as of August 25, 2005, between Western Digital Corporation and Arif Shakeel(18)* |
| 10.12.1 | Amendment to Employment Agreement, dated as of October 31, 2006, between Western Digital Corporation and Arif Shakeel(26)* |
| 10.13 | Long-Term Retention Agreement Cash, between Western Digital Corporation and Hossein M. Moghadam, dated as of September 21, 2004(19)* |

| | |
|---|---|
| 10.13.1 | Letter Agreement, dated February 16, 2006, between Western Digital Corporation and Hossein M. Moghadam(24)* |
| 10.13.2 | Letter Agreement, dated November 15, 2006, between Western Digital Corporation and Hossein M. Moghadam(29)* |
| 10.14 | Letter agreement, dated September 10, 2004, by and between Western Digital Technologies, Inc. and Stephen D. Milligan(13)* |
| 10.14.1 | Letter agreement, dated February 16, 2006, by and between Western Digital Corporation and Stephen D. Milligan(24)* |
| 10.15 | Letter Agreement, dated May 25, 2005, between Western Digital Corporation and John F. Coyne(21)* |

| Exhibit Number | Description |
|---|---|
| 10.15.1 | Letter Agreement, dated November 17, 2005, between Western Digital Corporation and John F. Coyne(22)* |
| 10.15.2 | Long-Term Retention Agreement Cash, between Western Digital Corporation and John F. Coyne, dated as of September 21, 2004(27)* |
| 10.15.3 | Employment Agreement, dated as of October 31, 2006, between Western Digital Corporation and John Coyne(26)* |
| 10.15.4 | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement between Western Digital Corporation and John Coyne(26)* |
| 10.15.5 | Form of Notice of Grant of Stock Option and Option Agreement between Western Digital Corporation and John Coyne(26)* |
| 10.15.6 | Letter Agreement, dated November 15, 2006, between Western Digital Corporation and John F. Coyne(29)* |
| 10.16 | Letter Agreement, dated February 16, 2006, between Western Digital Corporation and Raymond M. Bukaty(24)* |
| 10.17 | Letter Agreement, dated April 4, 2007, between Western Digital Corporation and Timothy Leyden * |
| 10.18 | Western Digital Corporation Amended and Restated Change of Control Severance Plan, amended as of February 16, 2006(23)* |
| 10.19 | Western Digital Corporation Executive Severance Plan, effective February 16, 2006(29)* |
| 10.20 | Form of Indemnity Agreement for Directors of Western Digital Corporation(9) |
| 10.21 | Form of Indemnity Agreement for Officers of Western Digital Corporation(9) |
| 10.22 | Sublease, dated as of September 23, 2003, by and between Advanced Logic Research, Inc. and Western Digital Corporation(13) |
| 10.22.1 | First Amendment to Sublease, dated as of September 28, 2005, by and between Advanced Logic Research, Inc. and Western Digital Technologies, Inc.(20) |
| 10.23 | Lease by and between Serrano Jack, L.L.C. and Western Digital Corporation, dated May 30, 2000(4) |
| 10.24 | Standard Industrial/Commercial Single-Tenant Lease and Addendum No. 1, dated May 1, 2000, between One Morgan, LLC and Western Digital Corporation(12) |
| 10.25 | Lease Agreement, dated June 3, 1996, together with First Amendment, between South Bay/Edenvale Associates and Western Digital Corporation(12) |
| 10.25.1 | Second Amendment to Lease, dated as of April 6, 2004, between Trinet Essential Facilities XXVI, Inc. and Western Digital Technologies, Inc.(16) |
| 10.25.2 | Third Amendment to Lease, dated as of March 1, 2005, between Trinet Essential Facilities XXVI, Inc. and Western Digital Technologies, Inc.(16) |
| 10.25.3 | Fourth Amendment to Lease, dated as of December 21, 2005, between Trinet Essential Facilities XXVI, Inc. and Western Digital Technologies, Inc.(22) |
| 10.26 | Volume Purchase Agreement, dated as of June 6, 2005, by and between Komag USA (Malaysia) Sdn., Komag, Incorporated, and Western Digital Technologies, Inc.(19)(28) |
| 10.26.1 | Amendment No. 1 to Volume Purchase Agreement, dated as of July 22, 2005, by and between Komag USA (Malaysia) Sdn., Komag, Incorporated, and Western Digital Technologies, Inc.(19)(28) |
| 10.26.2 | Amendment No. 2 to Volume Purchase Agreement, dated as of November 29, 2005, by and between Komag USA (Malaysia) Sdn., Komag, Incorporated, and Western Digital Technologies, Inc.(22)(28) |
| 10.26.3 | Amendment No. 3 to Volume Purchase Agreement, dated as of January 31, 2006, by and between Komag USA (Malaysia) Sdn., Komag, Incorporated, and Western Digital Technologies, Inc.(22)(28) |
| 10.27 | Supply Agreement, dated as of August 17, 2005, by and between Showa Denko K.K. and Western Digital Technologies, Inc.(19)(28) |

| | |
|---|---|
| 10.27.1 | Amendment No. 1 to Supply Agreement, dated as of July 16, 2006, by and between Showa Denko K.K. and Western Digital Technologies, Inc.(27)(31) |
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| 10.30 | Master Equipment Lease Agreement dated June 24, 2004 between CIT Technologies Corporation, doing business as CIT Systems Leasing, and Western Digital Technologies, Inc.(13) |
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| 21 | Subsidiaries of Western Digital Corporation |
| 23 | Consent of Independent Registered Public Accounting Firm |
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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 Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

WESTERN DIGITAL CORPORATION

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

Dated: August 24, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ John F. Coyne<br>John F. Coyne | Chief Executive Officer (Principal (Executive Officer), Director | August 24, 2007 |
| /s/ Stephen D. Milligan<br>Stephen D. Milligan | Senior Vice President and Chief Financial Officer (Principal Financial Officer) | August 24, 2007 |
| /s/ Joseph R. Carrillo<br>Joseph R. Carrillo | Vice President and Corporate Controller (Principal Accounting Officer) | August 24, 2007 |
| /s/ Thomas E. Pardun<br>Thomas E. Pardun | Chairman of the Board | August 24, 2007 |
| /s/ Peter D. Behrendt<br>Peter D. Behrendt | Director | August 24, 2007 |
| /s/ Kathleen A. Cote<br>Kathleen A. Cote | Director | August 24, 2007 |
| /s/ Henry T. DeNero<br>Henry T. DeNero | Director | August 24, 2007 |

| | | |
|---|---|---|
| /s/ William L. Kimsey | Director | August 24, 2007 |
| William L. Kimsey | | |
| /s/ Michael D. Lambert | Director | August 24, 2007 |
| Michael D. Lambert | | |
| /s/ Matthew E. Massengill | Director | August 24, 2007 |
| Matthew E. Massengill | | |
| /s/ Roger H. Moore | Director | August 24, 2007 |
| Roger H. Moore | | |
| /s/ Arif Shakeel | Director | August 24, 2007 |
| Arif Shakeel | | |

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## EXHIBIT INDEX

| Exhibit Number | Description |
|---|---|
| 2.1 | Agreement and Plan of Merger, dated as of June 28, 2007, by and among Western Digital Corporation, State M Corporation and Komag, Incorporated(30) |
| 3.1 | Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date(22) |
| 3.2 | Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of May 10, 2006(25) |
| 4.1 | Rights Agreement between Western Digital Corporation and American Stock Transfer & Trust Company, as Rights Agent, dated as of April 6, 2001, which includes as Exhibit A thereto the Form of Right Certificate to be distributed to holders of Rights after the Distribution Date (as that term is defined in the Rights Agreement)(5) |
| 4.2 | Form of Common Stock Certificate(1) |
| 4.3 | Certificate of Designations of Series A Junior Participating Preferred Stock of Western Digital Corporation, dated April 6, 2001(5) |
| 10.1 | Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan, effective as of November 17, 2005(21)* |
| 10.1.1 | Form of Notice of Grant of Stock Option and Option Agreement Executives, under the Western Digital Corporation 2004 Performance Incentive Plan(25)* |
| 10.1.2 | Form of Notice of Stock Option Grant and Stock Option Agreement Non-Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(25)* |
| 10.1.3 | Form of Notice of Grant of Restricted Stock and Restricted Stock Agreement Executives, under the Western Digital Corporation 2004 Performance Incentive Plan(14)* |
| 10.1.4 | Form of Notice of Grant of Restricted Stock and Restricted Stock Agreement Non-Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(14)* |
| 10.1.5 | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.6 | Form of Notice of Grant of Stock Units and Stock Unit Award Agreement, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.7 | Form of Notice of Grant of Long-Term Cash Award and Long-Term Cash Award Agreement Executives, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.8 | Form of Notice of Grant of Long-Term Cash Award and Long-Term Cash Award Agreement Employees, under the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan(23)* |
| 10.1.9 | Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan Non-Employee Director Option Grant Program, effective as of November 17, 2005, and Form of Notice of Grant of Stock Option and Option Agreement Non-Employee Directors(27) |
| 10.1.10 | Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan Non-Employee Director Restricted Stock Unit Grant Program, as amended November 9, 2006(27) |
| 10.2 | Western Digital Corporation Amended and Restated Employee Stock Option Plan, as amended on November 5, 1998(2)* |
| 10.2.1 | First Amendment to the Western Digital Corporation Employee Stock Option Plan, dated April 6, 2001(6)* |
| 10.2.2 | |

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|---|---|
| | Form of Notice of Grant of Stock Options and Stock Option Agreement under the Western Digital Corporation Amended and Restated Employee Stock Option Plan as amended(19)* |
| 10.3 | Western Digital Corporation Broad-Based Stock Incentive Plan(3)* |
| 10.3.1 | First Amendment to the Western Digital Corporation Broad-Based Stock Incentive Plan, dated April 6, 2001(6)* |
| 10.3.2 | Form of Notice of Grant of Restricted Stock and Restricted Stock Agreement under the Western Digital Corporation Broad Based Stock Incentive Plan as amended(19)* |
| 10.4 | Western Digital Corporation Amended and Restated Stock Option Plan for Non-Employee Directors, effective as of May 25, 2000(6) |
| 10.4.1 | First Amendment to the Western Digital Corporation Amended and Restated Stock Option Plan for Non-Employee Directors, dated April 6, 2001(6) |
| 10.5 | Western Digital Corporation 2005 Employee Stock Purchase Plan, effective as of November 17, 2005(21)* |

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| 10.6 | Amended and Restated Western Digital Corporation Non-Employee Directors Stock-For-Fees Plan, effective as of November 17, 2005(22) |
| 10.7 | Western Digital Corporation Incentive Compensation Plan(7)* |
| 10.8 | Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors * |
| 10.9 | Amended and Restated Deferred Compensation Plan, effective March 28, 2003(11)* |
| 10.10 | Amended and Restated Executive Bonus Plan, effective March 28, 2003(11)* |
| 10.11 | Amended and Restated 401(k) Plan, adopted as of March 28, 2002(8)* |
| 10.11.1 | First Amendment to Western Digital Corporation 401(k) Plan, effective as of July 1, 2002(10)* |
| 10.11.2 | Second Amendment to Western Digital Corporation 401(k) Plan, effective as of March 28, 2005(24)* |
| 10.11.3 | Third Amendment to Western Digital Corporation 401(k) Plan, effective as of March 31, 2006(24)* |
| 10.12 | Employment Agreement dated as of August 25, 2005, between Western Digital Corporation and Arif Shakeel(18)* |
| 10.12.1 | Amendment to Employment Agreement, dated as of October 31, 2006, between Western Digital Corporation and Arif Shakeel(26)* |
| 10.13 | Long-Term Retention Agreement Cash, between Western Digital Corporation and Hossein M. Moghadam, dated as of September 21, 2004(19)* |
| 10.13.1 | Letter Agreement, dated February 16, 2006, between Western Digital Corporation and Hossein M. Moghadam(24)* |
| 10.13.2 | Letter Agreement, dated November 15, 2006, between Western Digital Corporation and Hossein M. Moghadam(29)* |
| 10.14 | Letter agreement, dated September 10, 2004, by and between Western Digital Technologies, Inc. and Stephen D. Milligan(13)* |
| 10.14.1 | Letter agreement, dated February 16, 2006, by and between Western Digital Corporation and Stephen D. Milligan(24)* |
| 10.15 | Letter Agreement, dated May 25, 2005, between Western Digital Corporation and John F. Coyne(21)* |
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| 10.16 | Letter Agreement, dated February 16, 2006, between Western Digital Corporation and Raymond M. Bukaty(24)* |
| 10.17 | Letter Agreement, dated April 4, 2007, between Western Digital Corporation and Timothy Leyden * |
| 10.18 | Western Digital Corporation Amended and Restated Change of Control Severance Plan, amended as of February 16, 2006(23)* |
| 10.19 | Western Digital Corporation Executive Severance Plan, effective February 16, 2006(29)* |
| 10.20 | Form of Indemnity Agreement for Directors of Western Digital Corporation(9) |

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| 10.21 | Form of Indemnity Agreement for Officers of Western Digital Corporation(9) |
| 10.22 | Sublease, dated as of September 23, 2003, by and between Advanced Logic Research, Inc. and Western Digital Corporation(13) |
| 10.22.1 | First Amendment to Sublease, dated as of September 28, 2005, by and between Advanced Logic Research, Inc. and Western Digital Technologies, Inc.(20) |
| 10.23 | Lease by and between Serrano Jack, L.L.C. and Western Digital Corporation, dated May 30, 2000(4) |

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| 10.24 | Standard Industrial/Commercial Single-Tenant Lease and Addendum No. 1, dated May 1, 2000, between One Morgan, LLC and Western Digital Corporation(12) |
| 10.25 | Lease Agreement, dated June 3, 1996, together with First Amendment, between South Bay/Edenvale Associates and Western Digital Corporation(12) |
| 10.25.1 | Second Amendment to Lease, dated as of April 6, 2004, between Trinet Essential Facilities XXVI, Inc. and Western Digital Technologies, Inc.(16) |
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