WESTERN DIGITAL CORP
Form 10-Q
January 29, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended January 1, 2010

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

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

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company 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

As of the close of business on January 22, 2010, 228,641,577 shares of common stock, par value $.01 per share, were outstanding.

WESTERN DIGITAL CORPORATION
INDEX

	PAGE NO.
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements (unaudited)	3
Condensed Consolidated Balance Sheets January 1, 2010 and July 3, 2009	3
Condensed Consolidated Statements of Income Three and Six Months Ended January 1, 2010 and December 26, 2008	4
Condensed Consolidated Statements of Cash Flows Six Months Ended January 1, 2010 and December 26, 2008	5
Notes to Condensed Consolidated Financial Statements	6
Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3. Quantitative and Qualitative Disclosures About Market Risk	25
Item 4. Controls and Procedures	26
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	26
Item 1A. Risk Factors	26
Item 4. Submission of Matters to a Vote of Security Holders	43
Item 6. Exhibits	45
Signatures	46

EX-10.7
EX-31.1
EX-31.2
EX-32.1
EX-32.2
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

Our fiscal year ends on the Friday nearest to June 30 and typically consists of 52 weeks. Approximately every five years, we report a 53-week fiscal year to align our fiscal year with the foregoing policy. The additional week is typically included in our fourth fiscal quarter results. Fiscal year 2009 and our fourth fiscal quarter of 2009 were comprised of 53 weeks and 14 weeks, respectively, and ended on July 3, 2009. Our fiscal second quarters ended January 1, 2010 and December 26, 2008 both consisted of 13 weeks. Fiscal year 2010 will be comprised of 52 weeks and will end on July 2, 2010. 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 Quarterly Report on Form 10-Q.

Western Digital, WD, the WD logo, WD Caviar Black, WD VelociRaptor, WD Scorpio Blue, WD GreenPower Technology are trademarks of Western Digital Technologies, Inc. and/or its affiliates. All other trademarks mentioned are the property of their respective owners.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. *FINANCIAL STATEMENTS*

WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except par values; unaudited)

	Jan. 1, 2010	Jul. 3, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,435	$ 1,794
Accounts receivable, net	1,365	926
Inventories	453	376
Other current assets	163	134
Total current assets	4,416	3,230
Property and equipment, net	1,696	1,584
Goodwill	139	139
Other intangible assets, net	83	89
Other non-current assets	251	249
Total assets	$ 6,585	$ 5,291
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,507	$ 1,101
Accrued expenses	288	247
Accrued warranty	118	95
Current portion of long-term debt	94	82
Total current liabilities	2,007	1,525
Long-term debt	350	400
Other liabilities	237	174
Total liabilities	2,594	2,099
Commitments and contingencies (Notes 4 and 6)		
Shareholders equity:		
Preferred stock, $.01 par value; authorized 5 shares; outstanding none		
Common stock, $.01 par value; authorized 450 shares; outstanding 228 and 225 shares, respectively	2	2
Additional paid-in capital	976	896
Accumulated other comprehensive income	4	2
Retained earnings	3,009	2,292
Total shareholders equity	3,991	3,192
Total liabilities and shareholders equity	$ 6,585	$ 5,291

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

Table of Contents

WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in millions, except per share amounts; unaudited)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Jan. 1, 2010	Dec. 26, 2008	Jan. 1, 2010	Dec. 26, 2008
Revenue, net	$ 2,619	$ 1,823	$ 4,827	$ 3,933
Cost of revenue	1,932	1,533	3,626	3,219
Gross margin	687	290	1,201	714
Operating expenses:				
Research and development	154	119	296	252
Selling, general and administrative	60	42	113	99
Restructuring		113		113
Total operating expenses	214	274	409	464
Operating income	473	16	792	250
Other income (expense):				
Interest income	1	2	2	6
Interest and other expense	(3)	(11)	(6)	(19)
Total other expense, net	(2)	(9)	(4)	(13)
Income before income taxes	471	7	788	237
Income tax provision (benefit)	42	(7)	71	12
Net income	$ 429	$ 14	$ 717	$ 225
Income per common share:				
Basic	$ 1.89	$ 0.06	$ 3.17	$ 1.01
Diluted	$ 1.85	$ 0.06	$ 3.10	$ 1.00
Weighted average shares outstanding:				
Basic	227	222	226	222
Diluted	232	224	231	225

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

WESTERN DIGITAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions; unaudited)

	SIX MONTHS ENDED	
	Jan. 1, 2010	**Dec. 26, 2008**
Cash flows from operating activities		
Net income	$ 717	$ 225
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	247	239
Stock-based compensation	27	21
Deferred income taxes	(5)	(7)
Loss on investments		9
Non-cash portion of restructuring		80
Changes in:		
Accounts receivable, net	(439)	84
Inventories	(77)	10
Accounts payable	428	(63)
Accrued expenses	57	11
Other assets and liabilities	36	(8)
Net cash provided by operating activities	991	601
Cash flows from investing activities		
Purchases of property and equipment	(375)	(302)
Sales and maturities of investments	3	1
Net cash used in investing activities	(372)	(301)
Cash flows from financing activities		
Issuance of stock under employee stock plans	47	12
Taxes paid on vested stock awards under employee stock plans	(7)	(3)
Increase in excess tax benefits from employee stock plans	20	4
Repurchases of common stock		(36)
Repayment of debt	(38)	(5)
Net cash provided by (used in) financing activities	22	(28)
Net increase in cash and cash equivalents	641	272
Cash and cash equivalents, beginning of period	1,794	1,104
Cash and cash equivalents, end of period	$ 2,435	$ 1,376

Supplemental disclosure of cash flow information:

Cash paid for income taxes	$	2	$	7
Cash paid for interest	$	2	$	4

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

Table of Contents

WESTERN DIGITAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

The accounting policies followed by Western Digital Corporation (the Company) are set forth in Note 1 of the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended July 3, 2009. In the opinion of management, all adjustments necessary to fairly state the unaudited condensed consolidated financial statements have been made. All such adjustments are of a normal, recurring nature. Certain information and footnote disclosures normally included in the consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended July 3, 2009. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year.

Company management has made estimates and assumptions relating to the reporting of certain assets and liabilities in conformity with U.S. GAAP. These estimates and assumptions have been applied using methodologies which are consistent throughout the periods presented. However, actual results could differ materially from these estimates.

2. Supplemental Financial Statement Data

Inventories

	Jan. 1, 2010	Jul. 3, 2009
	(in millions)	
Raw materials and component parts	**$ 102**	$ 97
Work-in-process	**212**	154
Finished goods	**139**	125
Total inventories	**$ 453**	$ 376

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 the Company 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. Changes in the warranty accrual for the three and six months ended January 1, 2010 and December 26, 2008 were as follows (in millions):

Table of Contents

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Jan. 1, 2010	**Dec. 26, 2008**	**Jan. 1, 2010**	**Dec. 26, 2008**
Warranty accrual, beginning of period	**$ 132**	$ 119	**$ 123**	$ 114
Charges to operations	**50**	30	**89**	61
Utilization	**(32)**	(26)	**(62)**	(48)
Changes in estimate related to pre-existing warranties	**5**	(2)	**5**	(6)
Warranty accrual, end of period	**$ 155**	$ 121	**$ 155**	$ 121

Accrued warranty also includes amounts classified in non-current other liabilities of $37 million at January 1, 2010 and $28 million at July 3, 2009.

Subsequent Events

The Company evaluated subsequent events through January 29, 2010, the date these financial statements were issued, and there were no material subsequent events that required recognition or disclosure in these financial statements.

3. Income per Common Share

The Company computes basic income per common share using net income and the weighted average number of common shares outstanding during the period. Diluted income per common share is computed using net income and the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares include certain dilutive outstanding employee stock options, rights to purchase shares of common stock under the Company s Employee Stock Purchase Plan (ESPP) and restricted stock unit awards.

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

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Jan. 1, 2010	**Dec. 26, 2008**	**Jan. 1, 2010**	**Dec. 26, 2008**
Net income	**$ 429**	$ 14	**$ 717**	$ 225
Weighted average shares outstanding:				
Basic	**227**	222	**226**	222
Employee stock options and other	**5**	2	**5**	3
Diluted	**232**	224	**231**	225
Income per common share:				
Basic	**$ 1.89**	$ 0.06	**$ 3.17**	$ 1.01
Diluted	**$ 1.85**	$ 0.06	**$ 3.10**	$ 1.00
Anti-dilutive potential common shares excluded*	**1**	5	**1**	4

*

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

4. Debt

In February 2008, Western Digital Technologies, Inc. (WDTI), a wholly-owned subsidiary of the Company, entered into a five-year Credit Agreement (Credit Facility) that provides for a $750 million unsecured loan consisting of a $500 million term loan facility and a $250 million revolving credit facility. The revolving credit facility includes borrowing capacity available for letters of credit and for short-term borrowings referred to as swingline. In addition, WDTI may elect to expand the Credit Facility by up to $250 million if existing or new lenders provide additional term or revolving commitments. The $500 million term loan had a variable interest rate of 1.50% as of January 1, 2010 and requires sixteen quarterly principal payments, which began in June 2009, of approximately $19 million, $25 million, $31 million and $50 million per quarter for each four-quarter increment. As of January 1, 2010, WDTI had $250 million available for future borrowings on the revolving credit facility and was in compliance with all covenants.

5. Stock-Based Compensation

During the three and six months ended January 1, 2010, the Company charged to expense $9 million and $17 million, respectively, for stock-based compensation related to options issued under stock option plans and the ESPP, compared to $5 million and $10 million in the comparative prior-year periods. At January 1, 2010, total compensation cost related to unvested stock options and ESPP rights issued to employees but not yet recognized was $67 million and will be amortized on a straight-line basis over a weighted average service period of approximately 2.39 years.

The Company granted approximately 0.6 million restricted stock units during the six months ended January 1, 2010, which are payable in an equal number of shares of the Company s common stock at the time of vesting of the units. The aggregate market value of the shares underlying the restricted stock unit awards was $20 million at the date of grant. As of January 1, 2010, the aggregate unamortized fair value of all restricted stock unit awards was $41 million and will be recognized on a straight-line basis over a weighted average vesting period of approximately 1.7 years. For the three and six months ended January 1, 2010, the Company recognized approximately $4 million and $10 million, respectively, in expense related to restricted stock unit awards that vested during the period, compared to $6 million and $11 million in the comparative prior-year periods.

Stock Option Activity

The following table summarizes activity under the Company s stock option plans (in millions, except per share and remaining contractual life amounts):

	Number of Shares	Weighted Average Exercise Price Per Share	Remaining Contractual Life (in years)	Aggregate Intrinsic Value
Options outstanding at July 3, 2009	11.3	$ 17.00		
Granted	1.2	35.68		
Exercised	(1.0)	15.29		
Canceled or expired				
Options outstanding at October 2, 2009	11.5	$ 19.17		
Granted	0.2	38.40		
Exercised	(1.3)	13.80		
Canceled or expired	(0.1)	22.76		
Options outstanding at January 1, 2010	10.3	$ 20.08	5.32	$ 247
Exercisable at January 1, 2010	4.1	$ 14.05	4.29	$ 125

The aggregate intrinsic value is calculated based on 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 below the quoted price on the date the intrinsic value is determined. As of January 1, 2010, the Company had options outstanding to purchase an aggregate of 10.3 million shares with an exercise price below the quoted price of the Company s stock on that date resulting in an aggregate intrinsic value of $247 million. During the three and six months ended January 1, 2010, the aggregate intrinsic value of options exercised under the Company s stock option plans was $33 million and $50 million, respectively, determined as of the date of exercise, compared to $0.3 million and

$1.6 million in the comparative prior-year periods.

Fair Value Disclosures — Stock Options and ESPP

The fair value of stock options granted during the three and six months ended January 1, 2010 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 termination 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 and six months ended January 1, 2010 and December 26, 2008 was estimated using the following weighted average assumptions:

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	Jan. 1, 2010	**Dec. 26, 2008**	**Jan. 1, 2010**	**Dec. 26, 2008**
Suboptimal exercise factor	**1.77**	1.73	**1.73**	1.73
Range of risk-free interest rates	**0.47% to 3.39%**	0.38% to 1.80%	**0.37% to 3.39%**	0.38% to 3.44%
Range of expected stock price volatility	**0.51 to 0.63**	0.49 to 0.71	**0.51 to 0.72**	0.43 to 0.71
Weighted average expected volatility	**0.54**	0.56	**0.57**	0.49
Post-vesting termination rate	**3.81%**	4.15%	**3.60%**	4.39%
Dividend yield				
Fair value	**$17.26**	$ 7.01	**$17.10**	$ 9.62

The weighted average expected term of the Company s stock options for the three and six months ended January 1, 2010 was 4.73 years and 4.60 years, respectively, compared to 4.79 years and 5.49 years in the comparative prior-year periods.

The fair value of ESPP purchase rights issued is estimated at the date of grant of the purchase rights 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. Purchase rights under the current ESPP provisions are granted on either June 1 or December 1. ESPP activity was immaterial to the condensed consolidated financial statements for the three and six months ended January 1, 2010 and December 26, 2008.

6. Legal Proceedings

The Company discloses material loss contingencies deemed to be reasonably possible and accrues for loss contingencies when, in consultation with the Company s legal advisors, the Company concludes that a loss is probable and reasonably estimable. 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.

Intellectual Property Litigation

On June 20, 2008, plaintiff Convolve, Inc. (Convolve) filed a complaint in the Eastern District of Texas against the Company and two other companies alleging infringement of U.S. Patent Nos. 6,314,473 and 4,916,635. Plaintiff is seeking unspecified monetary damages and injunctive relief. On October 10, 2008, Convolve amended its complaint to allege infringement of only the 473 patent. The 473 patent allegedly relates to interface technology to select between certain modes of a disk drive s operations relating to speed and noise. The Company intends to defend itself vigorously in this matter.

On December 8, 2008, plaintiffs MagSil Corporation and the Massachusetts Institute of Technology filed a complaint in the District of Delaware against the Company and seven other companies in the disk drive industry alleging infringement of U.S. Patent Nos. 5,629,922 and 5,835,314. Plaintiffs are seeking unspecified monetary damages and injunctive relief. The asserted patents allegedly relate to tunneling magnetoresistive technology. The Company intends to defend itself vigorously in this matter.

On April 7, 2009, plaintiff Gregory Bender filed a complaint in the Northern District of California against the Company and Seagate Technology LLC alleging infringement of U.S. Patent No. 5,103,188. Plaintiff is seeking unspecified monetary damages. The asserted patent allegedly relates to buffered transconductance amplifier technology. The Company intends to defend itself vigorously in this matter.

On July 15, 2009, plaintiffs Carl B. Collins and Farzin Davanloo filed a complaint in the Eastern District of Texas against the Company and ten other companies alleging infringement of U.S. Patent Nos. 5,411,797 and 5,478,650. Plaintiffs are seeking injunctive relief and unspecified monetary damages, fees, and costs. The asserted patents allegedly relate to nanophase diamond films. The Company intends to defend itself vigorously in this matter.

On December 7, 2009, plaintiff Nazomi Communications filed a complaint in the Eastern District of Texas against the Company and seven other companies alleging infringement of U.S. Patent Nos. 7,080,362 and 7,225,436. Plaintiffs are seeking injunctive relief and unspecified monetary damages, fees, and costs. The asserted patents allegedly relate to processor cores capable of Java hardware acceleration. The Company intends to defend itself vigorously in this matter.

On January 5, 2010, plaintiff Enova Technology Corporation filed a complaint in the District of Delaware against the Company and Initio Corporation alleging infringement of U.S. Patent Nos. 7,136,995 and 7,386,734. Plaintiffs are seeking injunctive relief and unspecified monetary damages, fees, and costs. The asserted patents allegedly relate to real time full disk encryption application specific integrated circuits, or ASICs. The Company intends to defend itself vigorously in this matter.

Employment Litigation

On March 20, 2009, plaintiff Ghazala H. Durrani, a former employee of the Company, filed a putative class action complaint in the Alameda County (California) Superior Court. The complaint alleges that certain of the Company s engineers have been misclassified as exempt employees under California state law and are, therefore, due unpaid hourly overtime wages and other amounts, as well as penalties for allegedly missed meal and rest periods. By court order dated April 24, 2009, the case was transferred to the Orange County (California) Superior Court, where it is now pending. On or about June 16, 2009, the Company was dismissed from the case without prejudice by stipulation, leaving WDTI as the sole remaining defendant. On or about June 4, 2009, WDTI filed its Answer to the complaint, denying the substantive allegations thereof and raising several affirmative defenses. The case is in the preliminary stages, with no formal discovery having occurred. A court hearing on whether the case should be certified as a class action will likely not occur until mid 2010 at the earliest. If the Company is unsuccessful in its defense of this matter, potential liability could include unpaid wages, interest, penalties, attorneys fees and costs. The Company intends to defend itself vigorously in this matter.

Other Matters

In the normal course of business, the Company is subject to other legal proceedings, lawsuits and other claims. Although the ultimate aggregate amount of probable monetary liability or financial impact with respect to these other 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 other matters, individually and in the aggregate, would not be material to the Company s financial condition, results of operations or cash flows. However, there can be no assurance with respect to such result, and monetary liability or financial impact to the Company from these other matters could differ materially from those projected.

7. Income Taxes

The Company s income tax provision for the three months ended January 1, 2010 was $42 million compared to a benefit of $7 million in the prior-year period. The Company s income tax provision for the six months ended January 1, 2010 was $71 million as compared to $12 million in the prior-year period. The differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia and Thailand that expire at various dates through 2022 and the current year generation of income tax credits.

In the three months ended January 1, 2010, the Company recognized an increase of $26 million in liability for unrecognized tax benefits. As of January 1, 2010, the Company had approximately $178 million of unrecognized tax benefits. Interest and penalties recognized on such amounts were not material.

The United States Internal Revenue Service (the IRS) is currently examining fiscal years ended 2006 and 2007 for the Company and calendar years 2005 and 2006 for Komag, Incorporated, which was acquired by the Company on September 5, 2007. In the three months ended January 1, 2010, the local tax authorities completed, with no material adjustment, their examination of the Company s French subsidiary for fiscal years 2003 through 2005.

Table of Contents

Due to the risk that audit outcomes and the timing of audit settlements are subject to significant uncertainty, the Company s current estimate of the total amounts of unrecognized tax benefits could increase or decrease for all open tax years. As of January 1, 2010, it is not possible to estimate the amount of change, if any, in the unrecognized tax benefits that is reasonably possible within the next twelve months. Any significant change in the amount of the Company s unrecognized tax benefits would most likely result from additional information or settlements relating to the examination of the Company s uncertain tax positions.

8. Fair Value Measurements

Financial assets and liabilities that are remeasured and reported at fair value at each reporting period are classified and disclosed in one of the following three categories:

Level 1. Quoted prices in active markets for identical assets or liabilities.

Level 2. Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3. Inputs that are unobservable for the asset or liability and that are significant to the fair value of the assets or liabilities.

The following table presents information about the Company s financial assets and liabilities that are measured at fair value on a recurring basis as of January 1, 2010, and indicates the fair value hierarchy of the valuation techniques utilized to determine such value (in millions):

	Fair Value Measurements at Reporting Date Using			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total**
Assets				
Money market funds	$1,076	$	$	$1,076
U.S. Treasury securities		172		172
U.S. Government agency securities		221	1	222
Auction-rate securities			15	15
Foreign exchange contracts		7		7
Total assets at fair value	$1,076	$ 400	$ 16	$1,492

Money Market Funds. The Company s money market funds are AAA rated institutional money market funds that are invested in U.S. Treasury securities and are recorded within cash and cash equivalents in the condensed consolidated balance sheet. Money market funds are valued based on quoted market prices.

U.S. Treasury Securities. The Company s U.S. Treasury securities are investments in Treasury bills with original maturities of three months or less and are recorded within cash and cash equivalents in the condensed consolidated balance sheet. U.S. Treasury securities are valued based on broker quotations using observable inputs.

U.S. Government Agency Securities. The Company s U.S. Government agency securities are fixed income securities sponsored by the U.S. Government of which $221 million have original maturities of three months or less and are recorded within cash and cash equivalents and $1 million are classified as available-for-sale securities and are recorded within other current assets in the condensed consolidated balance sheet. U.S. Government agency securities classified within Level 2 are valued based on broker quotations using observable inputs. U.S. Government agency securities classified as Level 3 are valued using a third party pricing service.

Auction-Rate Securities. The Company s auction-rate securities are primarily backed by insurance products and are expected to be held until secondary markets become available. As a result, they are classified as long-term investments. These investments are currently accounted for as available-for-sale securities and recorded within other non-current assets in the condensed consolidated balance sheet. Auction-rate securities are valued using a third party pricing service.

Foreign Exchange Contracts. The Company s foreign exchange contracts are short-term contracts to hedge the Company s foreign currency risk related to the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling. Foreign exchange contracts are classified within other current assets in the condensed consolidated balance sheet. Foreign exchange contracts are valued based on the present value of future cash flows using market-based observable inputs, including forward rates and credit default swap rates.

The following table presents the changes in Level 3 instruments measured on a recurring basis for the three months ended January 1, 2010 (in millions):

	U.S. Government agency securities	Auction-rate securities	Total
October 2, 2009	$ 1	$ 18	$ 19
Sales		(3)	(3)
January 1, 2010	$ 1	$ 15	$ 16

In the three months ended October 2, 2009, there were no changes in Level 3 instruments measured on a recurring basis. The Company had no liabilities that were re-measured and reported at fair value on a recurring basis at January 1, 2010.

The carrying amounts of cash, accounts receivable, accounts payable and accrued expenses approximate fair value for all periods presented because of the short-term maturity of these assets and liabilities. The carrying amount of debt approximates fair value because of its variable interest rate.

9. 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, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, revenue, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. The purpose of entering into these hedging transactions is to minimize the impact of foreign currency fluctuations on the Company s results of operations. These contract maturity dates do not exceed 12 months. All forward exchange contracts are for risk management purposes only. The Company does not purchase forward exchange contracts for trading purposes. Currently, the Company focuses on hedging its foreign currency risk related to the Thai Baht, Malaysian Ringgit, Euro, and British Pound Sterling. Malaysian Ringgit contracts are designated as cash flow hedges. Euro and British Pound Sterling contracts are designated as fair value hedges. Thai Baht contracts are designated as either cash flow or fair value hedges.

If a 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. As of January 1, 2010, the net amount of existing gains expected to be reclassified into earnings within the next twelve months was $4 million. The Company determined the ineffectiveness associated with its cash flow hedges to be immaterial.

A change in the fair value of fair value hedges is recognized in earnings in the period incurred and is reported as a component of operating expenses. All fair value hedges were determined to be effective. The fair value and the changes in fair value on these contracts were not material to the condensed consolidated financial statements.

As of January 1, 2010, the Company did not have any foreign exchange contracts with credit-risk-related contingent features. The Company opened $1.5 billion and $2.9 billion, and closed $1.2 billion and $1.9 billion, in

12

foreign exchange contracts in the three and six months ended January 1, 2010, respectively. The fair value, balance sheet location and the impact on the condensed consolidated financial statements during the three and six months ended January 1, 2010 were as follows (in millions):

Derivatives Designated as Hedging Instruments	Asset Derivatives Jan. 1, 2010 Balance Sheet Location	Fair Value	Liability Derivatives Jan. 1, 2010 Balance Sheet Location	Fair Value
Foreign exchange contracts	Other current assets	$ 7	Accrued expenses	

Derivatives in Cash Flow Hedging Relationships	Amount of Gain Recognized in Accumulated OCI on Derivatives Three Months Ended Jan. 1, 2010	Six Months Ended Jan. 1, 2010	Location of Gain Reclassified from Accumulated OCI into Income	Amount of Gain Reclassified from Accumulated OCI into Income Three Months Ended Jan. 1, 2010	Six Months Ended Jan. 1, 2010
Foreign exchange contracts	$8	$22	Cost of revenue	$13	$20

The total net realized transaction and forward exchange contract currency gains and losses were not material to the condensed consolidated financial statements during this period.

10. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued ASC 820, Fair Value Measurements and Disclosures (ASC 820), which establishes a framework for measuring fair value under U.S. GAAP and expands disclosures about fair value measurement. In February 2008, FASB issued ASC 820-10-65-1, Fair Value Measurements and Disclosures Transition and Open Effective Date Information, which delayed the effective date of ASC 820 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal years beginning after November 15, 2008 and interim periods within those years, which for the Company was the first quarter of fiscal 2010. The Company s adoption of the provisions of ASC 820 for non-financial assets and non-financial liabilities in the first quarter of fiscal 2010 had no impact on its consolidated financial statements.

In December 2007, the FASB issued ASC 805, Business Combinations (ASC 805). ASC 805 establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. ASC 805 also provides guidance for recognizing and measuring the goodwill acquired in the business combination or a gain from a bargain purchase and determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of the business combination. ASC 805 applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which for the Company was the first quarter of fiscal 2010. ASC 805 will impact the Company s consolidated financial statements for business combinations with an acquisition date on or after adoption in the first quarter of fiscal 2010. The Company s adoption of ASC 805 in the first quarter of fiscal 2010 had no impact on its consolidated financial statements.

In April 2008, the FASB issued ASC 350-30-65-1, General Intangibles Other than Goodwill Transition and Open Effective Date Information (ASC 350-30-65-1), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under ASC 350, Intangibles Goodwill and Other. ASC 350-30-65-1 is effective for fiscal years beginning on or after December 15, 2008, which for the Company was the first quarter of fiscal year 2010. The Company s adoption of ASC 350-30-65-1 in the first quarter of fiscal 2010 had no impact on its consolidated financial statements.

In April 2009, the FASB issued ASC 825-10-65-1, Financial Instruments Transition and Open Effective Date Information (ASC 825-10-65-1), which amends ASC 825, Financial Instruments, and ASC 270, Interim Financial Reporting, to require disclosures about fair value of financial instruments in interim and annual reporting periods. The Company s adoption of ASC 825-10-65-1 in the first quarter of fiscal 2010 did not have a material impact on its consolidated financial statements.

In September 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13), and ASU 2009-14, Certain Revenue Arrangements That Include Software Elements (ASU 2009-14). ASU 2009-13 amends the revenue guidance under Subtopic 605-25, Multiple Element Arrangements , and addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration shall be measured and allocated to the separate units of accounting in the arrangement. ASU 2009-14 excludes tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of Subtopic 985-605, Revenue Recognition. ASU 2009-13 and ASU 2009-14 are effective for periods beginning after December 15, 2009 with earlier adoption permitted. The Company is currently evaluating the timing of its adoption of ASU 2009-13 and ASU 2009-14 and the impact that these new accounting standards will have on its consolidated financial statements.

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

This information should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended July 3, 2009.

Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters. As used herein, the terms we, us, our, the Company and WD refer to Western Digital Corporation and subsidiaries.

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, would, 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:

- *demand for hard drives and solid-state drives in the various markets and factors contributing to such demand;*
- *our plans to continue to develop new products and expand into new storage markets and into emerging economic markets;*
- *emergence of new storage markets for hard drives;*
- *emergence of competing storage technologies;*
- *traditional seasonal demand and pricing trends;*
- *our beliefs regarding the adequacy of our facilities and fabrication capacity;*
- *our share repurchase plans;*
- *our stock price volatility;*
- *expectations regarding the outcome of legal proceedings in which we are involved;*
- *the timing of future payments, if any, relating to unrecognized tax benefits;*

expectations regarding industry conditions and our financial results for the third quarter of fiscal 2010;

expectations regarding our capital expenditure plans and our depreciation and amortization expense in fiscal 2010; and

beliefs regarding the sufficiency of our cash and cash equivalents to meet our working capital and capital expenditure needs.

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 Part II, Item 1A of this Quarterly Report on Form 10-Q, and any of those made in our other reports filed with the Securities and Exchange Commission (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 (magnetic media) 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 manufacturers (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 finished enclosures, embedding application software and offering the products as WD®-branded external storage appliances for personal data backup and portable or expanded storage of digital music, photographs, video, and other digital 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 80 gigabytes (GB) to 2 terabytes (TB), nominal rotation speeds up to 10,000 revolutions per minute (RPM), and offer interfaces including Enhanced Integrated Drive Electronics (EIDE), Serial Advanced Technology Attachment (SATA) and Serial Attached SCSI (Small Computer System Interface) (SAS). We also embed our hard drives into WD®-branded external storage appliances using interfaces such as Universal Serial Bus (USB) 2.0, USB 3.0, external SATA, FireWire and Ethernet network connections with capacities of 160 GB up to 8 TB. In addition, we offer a family of hard drives specifically designed to consume substantially less power than standard drives, utilizing our WD GreenPower Technology .

We also design, develop, manufacture and sell solid-state drives and media players. A solid-state drive is a storage device that uses semiconductor, non-volatile media, rather than magnetic disks and magnetic heads, to store and allow fast access to data. We sell our solid-state drives worldwide to OEMs and distributors for use in the embedded systems market which includes network-communications, industrial, embedded-computing, medical, military, aerospace, media-appliance and data-streaming applications. A media player is a device that connects to a user s television, the Internet or home theater system and plays digital movies, music and photos from any of our WD®-branded external hard drives, other USB mass storage devices or content services accessed over the Internet. We sell our media players worldwide to resellers and retailers under the WD® brand.

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 disks, optical hard drives and tapes, and they are more cost effective than semiconductor technology.

All of our hard drive products employ similar technology. The main components of the hard drive are a Head-Disk-Assembly (HDA) and a Printed Circuit Board Assembly (PCBA). The HDA includes heads, magnetic media (disks), head positioning mechanism (actuator) and spindle motor. A rigid base and top cover contain these components in a contamination-controlled environment. The PCBA includes both standard and custom integrated circuits, an interface connector to the host computer and a power connector.

Industry-standard interfaces allow the hard drive to communicate with the computer. Currently, the primary interfaces for PCs are EIDE (also known as Parallel Advanced Technology Attachment, or PATA) and SATA. The primary interfaces for enterprise systems are SATA and the following, which we refer to as traditional enterprise: Small Computer System Interface, or SCSI ; Serial Attached SCSI, or SAS ; and Fibre Channel-Arbitrated Loop, or FC-AL. 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 and SAS, to facilitate the higher data transfer rates. We currently offer the SATA interface on our WD Caviar®, WD Scorpio®, WD® RE, WD VelociRaptor™ and WD® AV hard drive families; the EIDE (PATA) interface on WD Caviar®, WD Scorpio® and WD®AV hard drive families; and the SAS interface on the WD S25 hard drive family.

The number of disks and each disk s areal density (track density multiplied by bit density), which is a measure of the amount of data that can be stored on the recording surface of the disk per unit area, 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 and heads as the areal density increases, potentially reducing product costs over time through reduced component requirements. In July 2009, we began shipping our WD Scorpio® Blue™ 2.5-inch 1 TB drives at 333 GB per platter (approximately 525 gigabits per square inch) areal density. In September 2009, we began shipping our WD Caviar® Black ™ 3.5-inch 2 TB drives at 500 GB per platter (approximately 380 gigabits per square inch) areal density.

In November 2009, we entered the traditional enterprise market by shipping our WD S25, 2.5-inch, SAS interface hard drives. The WD S25 drive provides up to 300 GB of storage suitable for both mission-critical enterprise server and enterprise storage applications, as well as data centers and large data arrays.

Second Quarter Overview

For the third consecutive quarter, demand for hard drives was at the high end of expectations as the positive industry conditions that first materialized in the June quarter continued throughout the second half of the calendar year. In the December quarter, demand strength continued to be primarily consumer driven though we also saw some signs of recovery in the commercial sector. We believe that overall hard drive industry shipments in the December quarter totaled 160 million units, up 29% on the year-ago quarter and up 5% sequentially from the September quarter.

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

	THREE MONTHS ENDED				**SIX MONTHS ENDED**			
	Jan. 1, 2010		Dec. 26, 2008		**Jan. 1, 2010**		Dec. 26, 2008	
Net revenue	**$2,619**	**100.0%**	$1,823	100.0%	**$4,827**	**100.0%**	$3,933	100.0%
Gross margin	**687**	**26.2**	290	15.9	**1,201**	**24.9**	714	18.2
Total operating expenses	**214**	**8.2**	274	15.0	**409**	**8.5**	464	11.8
Operating income	**473**	**18.1**	16	0.9	**792**	**16.4**	250	6.4
Net income	**429**	**16.4**	14	0.8	**717**	**14.9**	225	5.7

Table of Contents

The following is a summary of our financial performance for the second quarter of 2010:

Consolidated net revenue totaled $2.6 billion.

66% of our hard drive revenue was derived from non-desktop markets, including notebook computers, CE products, enterprise applications and WD-branded product sales, as compared to 65% in the prior-year period.

Hard drive unit shipments increased by 39% over the prior-year period to 49.5 million units.

Gross margin increased to 26.2%, compared to 15.9% for the prior-year period.

Operating income was $473 million, an increase of $457 million over the prior-year period. The prior-year period included a restructuring charge of $113 million.

We generated $557 million in cash flow from operations in the second quarter of 2010, and we finished the quarter with $2.4 billion in cash and cash equivalents.

Historically, March quarter industry unit demand has been down sequentially in a range from 5% to 7% from the December quarter. However, we believe that true demand in the December quarter was not entirely satisfied, and this coupled with an expectation of continuing strong demand for digital storage leads us to expect a sequential decline of 1% to 5% in the March quarter. Therefore, we expect our revenue in the March quarter to slightly decrease from the December quarter. Operating expenses for the March quarter are expected to slightly increase from the December quarter as we continue to invest in new products and technology.

Results of Operations

Net Revenue

	THREE MONTHS ENDED			SIX MONTHS ENDED		
(in millions, except percentages and ASP)	**Jan. 1, 2010**	**Dec. 26, 2008**	**Percentage Change**	**Jan. 1, 2010**	**Dec. 26, 2008**	**Percentage Change**
Net revenue	**$2,619**	$1,823	44%	**$4,827**	$3,933	23%
Unit shipments*	**49.5**	35.5	39	**93.6**	74.9	25
ASP (per unit)*	**$ 52**	$ 51	2	**$ 51**	$ 52	(2)
Revenues by Geography (%)						
Americas	**25%**	23%		**23%**	23%	
Europe, Middle East and Africa	**25**	29		**24**	29	
Asia	**50**	48		**53**	48	
Revenues by Channel (%)						
OEM	**48%**	57%		**50%**	57%	
Distributors	**30**	21		**30**	23	
Retailers	**22**	22		**20**	20	
Revenues by Product (%)						
Non-desktop sources	**66%**	65%		**65%**	63%	
Desktop hard drives	**34**	35		**35**	37	

* Based on sales of hard drive units only.

Non-hard drive units were not material.

For the quarter ended January 1, 2010, net revenue was $2.6 billion, an increase of 44% over the quarter ended December 26, 2008. Total hard drive shipments increased to 49.5 million units for the second quarter of 2010 as compared to 35.5 million units for the second quarter of 2009. For the six months ended January 1, 2010, net revenue was $4.8 billion, an increase of 23% over the six months ended December 26, 2008. Total hard drive shipments increased to 93.6 million for the six months ended January 1, 2010, as compared to 74.9 million for the six months ended December 26, 2008. The increase in revenue resulted from the strong demand for hard drives. For example, we shipped 21.2 million and 40.3 million mobile drives in the three and six months ended January 1, 2010, respectively. This compares to 13.8 million and 28.4 million units in the three and six months ended December 26, 2008, respectively. The average selling price (ASP) for hard drives in the second quarter of 2010 was $52, an increase of $1 from the prior-year quarter.

Changes in revenue by geography and by channel generally reflected normal fluctuations in market demand and competitive dynamics, as well as demand strength in Asia, which continues to be driven by the concentration of global manufacturing in that region. For the three months ended January 1, 2010, Hewlett-Packard Company accounted for 10%, or more, of our revenue. For the six months ended January 1, 2010, Dell Inc. and Hewlett-Packard Company each accounted for 10%, or more, of our revenue.

We have sales incentive and marketing programs that provide customers with price protection and other incentives or reimbursements that are recorded as a reduction to gross revenue. For the three and six months ended January 1, 2010, these programs represented 7% of gross revenues compared to 12% in the comparative prior-year periods. These amounts generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product.

Gross Margin

	THREE MONTHS ENDED			**SIX MONTHS ENDED**		
(in millions, except percentages)	**Jan. 1, 2010**	**Dec. 26, 2008**	**Percentage Change**	**Jan. 1, 2010**	**Dec. 26, 2008**	**Percentage Change**
Net revenue	**$2,619**	$1,823	44%	**$4,827**	$3,933	23%
Gross margin	**687**	290	137	**1,201**	714	68
Gross margin %	**26.2%**	15.9%		**24.9%**	18.2%	

For the three months ended January 1, 2010, gross margin as a percentage of revenue increased to 26.2% as compared to 15.9% for the prior-year period. For the six months ended January 1, 2010, gross margin as a percentage of revenue increased to 24.9% as compared to 18.2% for the prior-year period. These increases were primarily due to lower costs, a favorable product mix and moderate price declines.

Operating Expenses

	THREE MONTHS ENDED			**SIX MONTHS ENDED**		
(in millions, except percentages)	**Jan. 1, 2010**	**Dec. 26, 2008**	**Percentage Change**	**Jan. 1, 2010**	**Dec. 26, 2008**	**Percentage Change**
R&D expense	**$ 154**	$ 119	29%	**$ 296**	$ 252	17%
SG&A expense	**60**	42	43	**113**	99	14
Restructuring		113			113	
Total operating expenses	**$ 214**	$ 274		**$ 409**	$ 464	

Research and development (R&D) expense was $154 million for the three months ended January 1, 2010, an increase of $35 million over the prior-year period. This increase was primarily due to an increase in variable incentive compensation. For the six months ended January 1, 2010, R&D expense was $296 million, an increase of $44 million over the prior-year period. This increase was primarily due to an increase in variable incentive compensation and the investment in product development to support new programs.

Selling, general and administrative (SG&A) expense was $60 million for the three months ended January 1, 2010, an increase of $18 million over the prior-year period. This increase was primarily due to an increase in variable incentive compensation and the expansion of sales and marketing to support new products and growing markets. For the six months ended January 1, 2010, SG&A expense was $113 million, an increase of $14 million over the prior-year period. This increase was primarily due to an increase in variable incentive compensation.

Table of Contents

During the three months ended December 26, 2008, we recorded a $113 million restructuring charge related to our restructuring plan to realign our cost structure as a result of a softer demand environment. The restructuring plan was completed in fiscal 2009.

Other Income (Expense)

Interest income for the three and six months ended January 1, 2010 decreased $1 million and $4 million, respectively, as compared to the prior-year periods primarily due to a decrease in the rates of return on our investments. Interest and other expense for the three and six months ended January 1, 2010 decreased $8 million and $13 million, respectively, as compared to the prior-year periods. These decreases were primarily due to other-than-temporary impairment charges on our auction-rate securities of $6 million and $9 million in the three and six months ended December 26, 2008, respectively, and a decrease in the interest rate on a lower amount of debt.

Income Tax Provision

Our income tax provision for the three months ended January 1, 2010 was $42 million as compared to a $7 million benefit in the prior-year period. Our income tax provision for the six months ended January 1, 2010 was $71 million compared to $12 million in the prior-year period. Differences between the effective tax rate and the U.S. Federal statutory rate are primarily due to tax holidays in Malaysia and Thailand that expire at various dates through 2022 and the current year generation of income tax credits.

Liquidity and Capital Resources

We ended the second quarter of fiscal 2010 with total cash and cash equivalents of $2.4 billion. The following table summarizes our statements of cash flows for the six months ended January 1, 2010 and December 26, 2008 (in millions):

	SIX MONTHS ENDED	
	Jan. 1, 2010	**Dec. 26, 2008**
Net cash flow provided by (used in):		
Operating activities	**$ 991**	$ 601
Investing activities	**(372)**	(301)
Financing activities	**22**	(28)
Net increase in cash and cash equivalents	**$ 641**	$ 272

Our investment policy is to manage our investment portfolio to preserve principal and liquidity while maximizing return through the full investment of available funds. We believe our current cash, cash equivalents and cash generated from operations will be sufficient to meet our working capital and capital expenditure needs through the foreseeable future. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

Operating Activities

Net cash provided by operating activities during the six months ended January 1, 2010 was $991 million as compared to $601 million during the six months ended December 26, 2008. Cash flow from operating activities consists of net income, adjusted for non-cash charges, plus or minus working capital changes. This represents our principal source of cash. Net cash provided by working capital changes was $5 million for the six months ended January 1, 2010 as compared to $34 million for the prior-year period.

Our working capital requirements primarily depend on the effective management of our cash conversion cycle, which measures how quickly we can convert our products into cash through sales. The cash conversion cycles for the three months ended January 1, 2010 and December 26, 2008 were as follows:

	THREE MONTHS ENDED	
	Jan. 1, 2010	**Dec. 26, 2008**
Days sales outstanding	**47**	46
Days in inventory	**21**	27
Days payables outstanding	**(71)**	(64)
Cash conversion cycle	**(3)**	9

For the three months ended January 1, 2010, our days sales outstanding (DSOs) increased by 1 day, days in inventory (DIOs) decreased by 6 days, and days payable outstanding (DPOs) increased by 7 days as compared to the prior-year period. The decrease in DIOs and the increase in DPOs was primarily the result of the strong demand environment that continued through the end of the quarter. From time to time, we modify the timing of payments to our vendors. We make 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 our vendors or by granting to, or receiving from, our vendors payment term accommodations.

Investing Activities

Net cash used in investing activities for the six months ended January 1, 2010 was $372 million as compared to $301 million for the six months ended December 26, 2008. Investing activities for the six months ended January 1, 2010 consisted of capital expenditures of $375 million, offset by $3 million from the sale of investments. Investing activities for the six months ended December 26, 2008 consisted primarily of capital expenditures of $302 million.

We believe that demand for digital storage will continue to be strong throughout fiscal 2010. Consequently, we are increasing our capital expenditure forecast for fiscal 2010 to between $650 million and $750 million, compared with our previous projection of $650 million. Depreciation and amortization for fiscal 2010 is now expected to be about $550 million, as compared to our previous estimate of $540 million.

Our cash equivalents are invested primarily in readily accessible, AAA rated institutional money market funds which are invested in U.S. Treasury securities, U.S. Treasury bills and U.S. Government agency securities. We also have auction-rate securities that are classified as long-term investments as they are expected to be held until secondary markets become available. These investments are currently accounted for as available-for-sale securities and recorded at fair value within other non-current assets in the condensed consolidated balance sheet. The estimated market values of these investments are subject to fluctuation. During the three months ended January 1, 2010, we sold $3 million of auction-rate securities, reducing the carrying value of these investments to $15 million.

Financing Activities

Net cash provided by financing activities for the six months ended January 1, 2010 was $22 million as compared to net cash used in financing activities of $28 million in the prior-year period. Net cash provided by financing activities for the six months ended January 1, 2010 consisted of $47 million provided by the issuance of stock under employee stock plans and a $20 million increase in excess tax benefits from employee stock plans, offset by $38 million used to repay long-term debt and $7 million in tax withholding obligations paid in connection with the vesting of stock awards under employee stock plans. Net cash used in financing activities for the six months ended December 26, 2008 resulted from $36 million used to repurchase our common stock and $5 million in debt repayments offset by $13 million related to employee stock plans.

Off-Balance Sheet Arrangements

Other than facility and equipment lease commitments incurred in the normal course of business and certain indemnification provisions (see Contractual Obligations and 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 our unaudited condensed consolidated financial statements.

Additionally, we do not have an interest in, or relationships with, any special-purpose entities.

Table of Contents

Contractual Obligations and Commitments

Credit Facility In February 2008, Western Digital Technologies, Inc. (WDTI), a wholly-owned subsidiary of the Company, entered into a five-year Credit Agreement (Credit Facility) that provides for a $750 million unsecured loan consisting of a $500 million term loan facility and a $250 million revolving credit facility. The revolving credit facility includes borrowing capacity available for letters of credit and for short-term borrowings referred to as swingline. In addition, WDTI may elect to expand the Credit Facility by up to $250 million if existing or new lenders provide additional term or revolving commitments. The $500 million term loan had a variable interest rate of 1.50% as of January 1, 2010 and requires sixteen quarterly principal payments, that began in June 2009, of approximately $19 million, $25 million, $31 million and $50 million per quarter for each four quarter increment. As of January 1, 2010, WDTI had $250 million available for future borrowings on the revolving credit facility and was in compliance with all covenants.

Purchase Orders In the normal course of business, we enter into purchase orders with 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 also enter into purchase orders with suppliers for capital equipment that are recorded as a liability upon receipt of the equipment. Our ability to change or cancel a capital equipment purchase order without penalty depends on the nature of the equipment being ordered. In some cases, 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 of components or capital equipment.

We have entered into long-term purchase agreements with various component suppliers, which contain minimum quantity requirements. However, the dollar amount of the purchases may depend on the specific products ordered, achievement of pre-defined quantity or quality specifications or future price negotiations. We have also entered into long-term purchase agreements with various component suppliers that carry fixed volumes and pricing which obligate us to make certain future purchases, contingent on certain conditions of performance, quality and technology of the vendor s components.

We enter into, from time to time, 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.

See Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations and Commitments in our Annual Report on Form 10-K for the year ended July 3, 2009, for further discussion of our purchase orders and purchase agreements and the associated dollar amounts. See Part II, Item 1A of this Quarterly Report on Form 10-Q for a discussion of the risks associated with these commitments.

Foreign Exchange Contracts We purchase short-term, forward exchange contracts to hedge the impact of foreign currency fluctuations on certain underlying assets, revenue, liabilities and commitments for operating expenses and product costs denominated in foreign currencies. See Part I, Item 3, of this Quarterly Report on Form 10-Q under the heading Disclosure About Foreign Currency Risk, for a description of our current forward exchange contract commitments and Note 9 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

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, products or 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 previously authorized us to repurchase $750 million of our common stock in open market transactions under a program through March 31, 2013. Since the inception of this stock repurchase program in 2005, through January 1, 2010, we have repurchased 18 million shares for a total cost of $284 million (including commissions). We expect stock repurchases to be funded principally by operating cash flows. We may continue to repurchase our stock as we deem appropriate and market conditions allow. We did not make any repurchases of our common stock during the six months ended January 1, 2010.

Unrecognized Tax Benefits As of January 1, 2010, our total cash liability representing unrecognized tax benefits was $84 million. We estimate the timing of the future payments of these liabilities to be within the next five to seven years. See Part I, Item 1, Note 7 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for information regarding our tax liability for unrecognized tax benefits.

Critical Accounting Policies and Estimates

We have prepared the accompanying unaudited condensed consolidated financial statements in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP). The preparation of the financial statements requires the use of judgments 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 provide resellers with limited price protection for inventories held by resellers at the time of published list price reductions, and we provide resellers and OEMs with other sales incentive programs. At the time we recognize revenue to resellers and OEMs, we record a reduction of revenue for estimated price protection until the resellers sell such inventory to their customers and we also record a reduction of revenue for the other programs in effect. We base these adjustments on several factors including anticipated price decreases during the reseller holding period, reseller s sell-through and inventory levels, estimated amounts to be reimbursed to qualifying customers, historical pricing information and customer claim processing. If customer demand for hard drives or market conditions differ from our expectations, our operating results could be affected. We also have programs under which we reimburse qualified distributors and retailers for certain marketing expenditures which are recorded as a reduction of revenue. Sales incentive and marketing programs are recorded as a reduction of revenue. These amounts generally vary according to several factors including industry conditions, seasonal demand, competitor actions, channel mix and overall availability of product. Since the first quarter of fiscal 2009, total sales incentive and marketing programs have ranged from 7% to 12% of gross revenues per quarter. Changes in future customer demand and market conditions may require us to increase our incentive programs as a percentage of gross revenue from the current range. Adjustments to revenues due to changes in accruals for these programs related to revenues reported in prior periods have averaged 0.2% of quarterly gross revenue since the first quarter of fiscal 2009.

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 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 prepare our estimates and assist us in exercising 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 I, Item 1, Note 2 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

Inventory

We value inventories at the lower of cost (first-in, first-out and weighted average methods) or net realizable value. We use the first-in, first-out method to value the cost of the majority of our inventories, while we use the weighted-average method to value precious metal inventories. Weighted-average cost is calculated based upon the cost of precious metals at the time they are received by us. We have determined that it is not practicable to assign specific costs to individual units of precious metals and, as such, we relieve our precious metals inventory based on the weighted-average cost of the inventory at the time the inventory is used in production. The weighted average method of valuing precious metals does not materially differ from a first-in, first-out method. 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 a write down of inventory that could negatively affect operating results.

Litigation and Other Contingencies

We disclose material 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 I, Item 1, Note 6 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q). The ability to predict the ultimate outcome of such matters involves judgments, estimates and inherent uncertainties. The actual outcome of such matters could differ materially from management s estimates.

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 when it is more likely than not that the deferred tax assets will not be realized. Each quarter 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 recognize liabilities for uncertain tax positions based on a two-step process. To the extent a tax position does not meet a more-likely-than-not level of certainty, no benefit is recognized in the financial statements. If a position meets the more-likely-than-not level of certainty, it is recognized in the financial statements at the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. Interest and penalties related to unrecognized tax benefits are recognized on liabilities recorded for uncertain tax positions and are recorded in our provision for income taxes. The actual liability for unrealized tax benefit in any such contingency may be materially different from our estimates, which could result in the need to record additional liabilities for unrecognized tax benefits or potentially adjust previously-recorded liabilities for unrealized tax benefits.

Stock-Based Compensation

We account for all stock-based compensation at fair value. 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. The fair values of all stock options granted are estimated using a binomial model, and the fair values of all Employee Stock Purchase Plan (ESPP) purchase rights are 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. 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.

Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued ASC 820, Fair Value Measurements and Disclosures (ASC 820), which establishes a framework for measuring fair value under U.S. GAAP and expands disclosures about fair value measurement. In February 2008, FASB issued ASC 820-10-65-1, Fair Value Measurements and Disclosures Transition and Open Effective Date Information, which delayed the effective date of ASC 820 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal years beginning after November 15, 2008 and interim periods within those years, which for us was the first quarter of fiscal 2010. Our adoption of the provisions of ASC 820 for non-financial assets and non-financial liabilities in the first quarter of fiscal 2010 had no impact on our consolidated financial statements.

In December 2007, the FASB issued ASC 805, Business Combinations (ASC 805). ASC 805 establishes principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. ASC 805 also provides guidance for recognizing and measuring the goodwill acquired in the business combination or a gain from a bargain purchase and determines what information to disclose to enable users of financial statements to evaluate the nature and financial effects of the business combination. ASC 805 applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, which for us was the first quarter of fiscal 2010. ASC 805 will impact our consolidated financial statements for business combinations with an acquisition date on or after adoption in the first quarter of fiscal 2010. Our adoption of ASC 805 in the first quarter of fiscal 2010 had no impact on our consolidated financial statements.

In April 2008, the FASB issued ASC 350-30-65-1, General Intangibles Other than Goodwill Transition and Open Effective Date Information (ASC 350-30-65-1), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under ASC 350, Intangibles Goodwill and Other. ASC 350-30-65-1 is effective for fiscal years beginning on or after December 15, 2008, which for us was the first quarter of fiscal year 2010. Our adoption of ASC 350-30-65-1 in the first quarter of fiscal 2010 had no impact on our consolidated financial statements.

In April 2009, the FASB issued ASC 825-10-65-1, Financial Instruments Transition and Open Effective Date Information (ASC 825-10-65-1), which amends ASC 825, Financial Instruments, and ASC 270, Interim Financial Reporting, to require disclosures about fair value of financial instruments in interim and annual reporting periods. Our adoption of ASC 825-10-65-1 in the first quarter of fiscal 2010 did not have a material impact on our consolidated financial statements.

Table of Contents

In September 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13), and ASU 2009-14, Certain Revenue Arrangements That Include Software Elements (ASU 2009-14). ASU 2009-13 amends the revenue guidance under Subtopic 605-25, Multiple Element Arrangements , and addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration shall be measured and allocated to the separate units of accounting in the arrangement. ASU 2009-14 excludes tangible products containing software components and non-software components that function together to deliver the product s essential functionality from the scope of Subtopic 985-605, Revenue Recognition. ASU 2009-13 and ASU 2009-14 are effective for periods beginning after December 15, 2009 with earlier adoption permitted. We are currently evaluating the timing of our adoption of ASU 2009-13 and ASU 2009-14 and the impact that these new accounting standards will have on our consolidated financial statements.

Item 3. ***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, foreign exchange contracts to hedge the impact of foreign currency exchange fluctuations on certain underlying assets, revenue, 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 12 months. We do not purchase forward exchange contracts for trading purposes. Currently, we focus on hedging our foreign currency risk related to the Thai Baht, Malaysian Ringgit, Euro and British Pound Sterling. Malaysian Ringgit contracts are designated as cash flow hedges. Euro and British Pound Sterling contracts are designated as fair value hedges. Thai Baht contracts are designated as either cash flow or fair value hedges. See Part II, Item 8, Note 1 in the Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended July 3, 2009 and Note 9 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

As of January 1, 2010, we had outstanding the following purchased foreign exchange contracts (in millions, except weighted average contract rate):

	Contract Amount	Weighted Average Contract Rate*	Unrealized Gain
Foreign exchange contracts:			
Thai Baht cash flow hedges	$873	33.57	$ 3
Thai Baht fair value hedges	$234	33.32	
Malaysian Ringgit cash flow hedges	$209	3.47	$ 1
Euro fair value hedges	$ 19	0.70	
British Pound Sterling fair value hedges	$ 7	0.62	

* Expressed in units of foreign currency per U.S. dollar.

During the three and six month periods ended January 1, 2010 and December 26, 2008, total net realized transaction and forward exchange contract currency gains and losses were not material to the condensed consolidated financial statements.

Disclosure About Other Market Risks

Variable Interest Rate Risk

Borrowings under the Credit Facility bear interest at a rate equal to, at the option of WDTI, either (a) a LIBOR rate determined by reference to the cost of funds for Eurodollar deposits for the interest period relevant to such borrowing, adjusted for certain additional costs (the Eurocurrency Rate) or (b) a base rate determined by reference to the higher of

(i) the federal funds rate plus 0.50% and (ii) the prime rate as announced by JPMorgan Chase Bank, N.A. (the Base Rate); in each case plus an applicable margin. The applicable margin for borrowings under the term loan facility ranges from 1.25% to 1.50% with respect to borrowings at the Eurocurrency Rate and 0.0% to

0.125% with respect to borrowings at the Base Rate. The applicable margin for revolving loan borrowings under the revolving credit facility ranges from 0.8% to 1.125% with respect to borrowings at the Eurocurrency Rate and 0.0% to 0.125% with respect to borrowings at the Base Rate. The applicable margins for borrowings under the Credit Facility are determined based upon a leverage ratio of the Company and its subsidiaries calculated on a consolidated basis. If the federal funds rate, prime rate or LIBOR rate increase, our interest payments could also increase. A one percent increase in the variable rate of interest on the Credit Facility would increase interest expense by approximately $4 million annually.

Credit Market Risk

Our long-term investments consist of auction-rate securities totaling $15 million as of January 1, 2010. The negative conditions in the global credit markets have prevented us from liquidating some of our holdings of auction-rate securities because the amount of securities submitted for sale has exceeded the amount of purchase orders for such securities. If the credit markets do not improve, auctions for our invested amounts may continue to fail. If this occurs, we may be unable to liquidate some or all of our auction-rate securities at par should we need or desire to access the funds invested in those securities prior to maturity of the underlying assets. In the event we need or desire to access these funds, we will not be able to do so until a future auction on these investments is successful or a buyer is found outside the auction process. If a buyer is found but is unwilling to purchase the investments at par, we may incur a loss. The market values of some of the auction-rate securities we owned were impacted by the macroeconomic credit market conditions. Rating downgrades of the security issuer or the third-parties insuring such investments may require us to adjust the carrying value of these investments through an impairment charge. Based on our ability to access our cash, cash equivalents and cash generated from operations, we do not anticipate these investments will affect our ability to execute our current business plan.

Item 4. *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 such term is defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective. There has been no change in our internal control over financial reporting during the quarter ended January 1, 2010, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *LEGAL PROCEEDINGS*

For a description of our legal proceedings, see Note 6 of the Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q, which is incorporated by reference in response to this item.

Item 1A. *RISK FACTORS*

We have updated a number of the risk factors affecting our business since those presented in our Annual Report on Form 10-K, Part I, Item 1A, for the fiscal year ended July 3, 2009. Except for revisions to the first nine risk factors below and the deletion of a risk factor regarding our auction-rate securities, there have been no material changes in our assessment of our risk factors from those set forth in our Annual Report on Form 10-K for the fiscal year ended July 3, 2009. All of our risk factors are included below.

If the pace of the recovery in our industry slows significantly as a result of negative global economic conditions or otherwise, we may have to take steps to align our cost structure with demand, which could result in impairment charges and have a negative impact on our operating results.

Demand for our products and the systems containing our products has improved from the lows experienced in the second and third quarters of fiscal 2009, and we have increased capital expenditures, resources and capacity to meet this increase. If the pace of the recovery in our industry, which has exceeded the pace of the recovery in the overall economy, slows significantly as a result of a deterioration in global economic conditions or otherwise, we may need to execute restructuring activities to realign our cost structure with softening demand. The occurrence of restructuring activities could result in impairment charges and other expenses, which could adversely impact our results of operations or financial condition.

Our customers demand for storage capacity may not continue to grow at current industry estimates, which may lower the prices our customers are willing to pay for new products or put us at a disadvantage to competing technologies.

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, the emergence of processes such as cloud computing, data deduplication and storage virtualization, or otherwise. These factors could lead to our customers storage capacity needs being satisfied at lower prices with lower capacity hard drives or solid-state storage products that we do not offer, thereby decreasing our revenue or putting us at a disadvantage to competing storage technologies. As a result, even with increasing aggregate demand for storage capacity, our ASPs could decline, which could adversely affect our operating results.

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

Selling branded products is an important part of our business, and as our branded products revenue increases as a portion of our overall revenue, our success in the retail market becomes increasingly important to our operating results. If consumer spending decreases as a result of the recent uncertainty and volatility in global economic conditions, our operating results could suffer because of the increased importance of our branded products business.

We sell our branded products directly to a select group of major retailers, such as 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 U.S., 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 are unable to maintain effective working relationships with major retailers and online resellers, or if we fail to successfully expand into multiple channels, our competitive position in the branded product market may suffer and our operating results may be adversely affected.

Our success in the retail market also depends on our ability to maintain our brand image and corporate reputation. Adverse publicity, whether or not justified, or allegations of product quality issues, even if false or unfounded, could tarnish our reputation and cause our customers to choose products offered by our competitors. In addition, the proliferation of new methods of mass communication facilitated by the Internet make it easier for false or unfounded allegations to adversely affect our brand image and reputation. If customers no longer maintain a preference for WD®-brand products, our operating results may be adversely affected.

Additionally, 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. For example, several additional hard drive manufacturers have recently disclosed plans to expand into the external storage market. As these companies attempt to gain market share, we may have difficulty in maintaining or growing our market share and there may be increased downward pressure on pricing. There can be no assurance that any new products we introduce into the retail market will gain market acceptance, and if they do not, our operating results could suffer.

Shortages of commodity materials or commodity components, price volatility, or use by other industries of materials and components used in the hard drive industry, may negatively impact our operating results.

Increases in the cost for certain commodity materials or commodity components may increase our costs of manufacturing and transporting hard drives and key components. Shortages of commodity components such as DRAM and NAND flash, or commodity materials such as glass substrates, stainless steel, aluminum, nickel, neodymium, ruthenium or platinum, may increase our costs and may result in lower operating margins if we are unable to find ways to mitigate these increased costs. Furthermore, if other high volume industries increase their demand for materials or components such as these, our costs may further increase, which could have an adverse effect on our operating margins. In addition, shortages in other commodity components and materials used in our customers products could result in a decrease in demand for our products, which would negatively impact our operating results. The volatility in the cost of oil also affects our transportation costs and may result in lower operating margins if we are unable to pass these increased costs through to our customers.

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

Our future operating results may depend substantially on our suppliers ability to timely qualify their components in our programs, and their ability to supply us with these components in sufficient 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 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, if 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. 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.

Each of the following could also significantly harm our operating results:

- an unwillingness of a supplier to supply such components or equipment to us;

- consolidation of key suppliers, such as the acquisition of Brilliant Manufacturing Limited by Nidec Corporation, the acquisition of Agere Systems Inc. by LSI Corporation, the acquisition of Infineon Technologies hard drive semiconductor business by LSI Corporation, the acquisition of Alps Electric Co. Ltd. s magnetic device division s assets and related intellectual property by TDK Corp, and the acquisition of Magnecomp Precision Technology Public Company Limited by TDK Corp;

- failure of a key supplier s business process;

- a key supplier s or sub-supplier s inability to access credit necessary to operate its business; or

- failure of a key supplier to remain in business, to remain an independent merchant supplier, or to adjust to market conditions.

Our manufacturing operations are concentrated in a small number of large, purpose-built facilities, which subjects us to substantial risk of damage or loss if operations at any of these facilities are disrupted.

As a result of our cost structure and strategy of vertical integration, we conduct our manufacturing operations at large, high volume, purpose-built facilities. For example, approximately 80% of our requirement for heads is satisfied by wafers fabricated in our Fremont, California facility. Also, we manufacture the majority of our substrates for magnetic media in our Johor, Malaysia facility, and we finish a majority of our magnetic media in two facilities in Penang, Malaysia. A majority of our high volume hard drive manufacturing operations are conducted in

28

two facilities in Thailand, with the balance conducted in our Kuala Lumpur, Malaysia facility. The manufacturing facilities of many of our suppliers are also in Asia near our facilities. A fire, flood, earthquake or other disaster, condition or event such as political instability, civil unrest or a power outage that adversely affects any of these facilities would significantly affect 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. Similarly, a localized health risk affecting our employees at these facilities or the staff of our suppliers, such as the spread of the Influenza A (H1N1) or a new pandemic influenza, could impair the total volume of hard drives that we are able to manufacture, which would result in substantial harm to our operating results.

If we fail to identify, manage, complete and integrate acquisitions, investment opportunities or other significant transactions, it may adversely affect our future results.

As part of our growth strategy, we may pursue acquisitions of, investment opportunities in or other significant transactions with companies that are complementary to our business. In order to pursue this strategy successfully, we must identify attractive acquisition or investment opportunities, successfully complete the transaction, some of which may be large and complex, and manage post-closing issues such as integration of the acquired company or employees. We may not be able to identify or complete appealing acquisition or investment opportunities given the intense competition for these transactions. Even if we identify and complete suitable corporate transactions, we may not be able to successfully address any integration challenges in a timely manner, or at all. If we fail to successfully integrate an acquisition, we may not realize all or any of the anticipated benefits of the acquisition, and our future results of operations could be adversely affected.

The costs of compliance with state, federal and international legal and regulatory requirements, such as environmental, labor, trade and tax regulations, and customers standards of corporate citizenship could cause an increase in our operating costs.

We may be subject to various state, federal and international laws and regulations governing our environmental, labor, trade and tax practices. These laws and regulations, particularly those applicable to our international operations, are complex, extensive and subject to change. 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. For example, the European Union (EU) has enacted the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive, which prohibits the use of certain substances in electronic equipment, and the Waste Electrical and Electronic Equipment (WEEE) directive, which 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. Similar legislation may be enacted in other locations where we manufacture or sell our products. If we or our component suppliers 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 operating results.

In connection with our compliance with such environmental laws and regulations, as well as our compliance with industry environmental initiatives, the standards of business conduct required by some of our customers, and our commitment to sound corporate citizenship in all aspects of our business, we could incur substantial compliance and operating costs and be subject to disruptions to our operations and logistics. In addition, if we were found to be in violation of these laws or noncompliant with these initiatives or standards of conduct, we could be subject to governmental fines, liability to our customers and damage to our reputation and corporate brand which could cause our financial condition or operating results to suffer.

From time to time we may become subject to income tax audits or similar proceedings, and as a result we may incur additional costs and expenses or owe additional taxes, interest and penalties that may negatively impact our operating results.

We are subject to income taxes in the U.S. and certain foreign jurisdictions, and our determination of our tax liability is subject to review by applicable domestic and foreign tax authorities. For example, as we have previously disclosed, we are under examination of certain of our fiscal years by the U.S. Internal Revenue Service (the IRS). Although we believe our tax positions are reasonable, the outcomes and timing of these audits are subject to

Table of Contents

significant uncertainty and could result in our having to pay amounts to the applicable tax authority in order to resolve examination of our tax positions, which could result in an increase or decrease of our current estimate of unrecognized tax benefits and may negatively impact our financial position, results of operations, net income or cash flows.

Negative or uncertain global economic conditions could result in a decrease in our sales and revenue and an increase in our operating costs, which could continue to adversely affect our business and operating results.

If the recent uncertainty and volatility in global economic conditions were to continue or if the emerging economic recovery is not sustained, many of our direct and indirect customers may delay or reduce their purchases of our products and systems containing our products. In addition, many of our customers in each of the OEM, distribution and retail channels rely on credit financing in order to purchase our products. If negative conditions in the global credit markets prevent our customers access to credit, product orders in these channels may decrease, which could result in lower revenue. Likewise, if our suppliers face challenges in obtaining credit, in selling their products or otherwise in operating their businesses, they may be unable to offer the materials we use to manufacture our products. These actions could result in reductions in our revenue, increased price competition and increased operating costs, which could adversely affect our business, results of operations and financial condition.

Negative or uncertain global economic conditions increase the risk that we could suffer unrecoverable losses on our customers accounts receivable, which would adversely affect our financial results.

We extend credit and payment terms to some of our customers. In addition to ongoing credit evaluations of our customers financial condition, we traditionally seek to mitigate our credit risk by purchasing credit insurance on certain of our accounts receivable balances; however, as a result of the recent uncertainty and volatility in global economic conditions, we may find it increasingly difficult to be able to insure these accounts receivable. We could suffer significant losses if a customer whose accounts receivable we have not insured, or have underinsured, fails and is unable to pay us. Additionally, if global economic conditions worsen or if the emerging economic recovery is not sustained, the risk increases that if a customer whose accounts receivable we have insured fails, the financial condition of the insurance carrier for such customer account may have also deteriorated such that it cannot cover our loss. A significant loss of an accounts receivable that we cannot recover through credit insurance would have a negative impact on our financial results.

If our long-lived assets or goodwill become impaired, it may adversely affect our operating results.

If global economic conditions worsen or if the emerging economic recovery is not sustained, it could result in circumstances, such as a sustained decline in our stock price and market capitalization or a decrease in our forecasted cash flows such that they are insufficient, indicating that the carrying value of our long-lived assets or goodwill may be impaired. If we are required to record a significant charge to earnings in our consolidated financial statements because an impairment of our long-lived assets or goodwill is determined, our results of operations will be adversely affected.

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

Historically, the hard drive industry 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. When ASPs in the hard drive industry decline, our ASPs are also likely to decline, which adversely affects 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.

During past economic downturns, as well as over the past few years, the consumer market for computers has shifted significantly towards lower priced systems, and we therefore expect this trend to continue in light of current global economic conditions. 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 may be found in many products other than computers, such as various CE devices. Accurately forecasting for future requirements of these new markets remains 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 and therefore greater market differentiation, may require attributes not currently offered in our products, resulting in a need to develop new interfaces, form factors, technical specifications or product 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 emerging markets such as the 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 or operating efficiencies.

The data storage industry faces difficulties in accurately forecasting market and customer demand for its products. Accurately forecasting demand has become increasingly difficult for us, our customers and our suppliers in light of the recent uncertainty and volatility in global economic conditions. 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, or if market demand increases significantly beyond our forecasts or beyond our ability to add manufacturing capacity, 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.

Although we receive forecasts from our customers, they are not generally obligated to purchase the forecasted amounts. Sales volumes in the distribution and retail channels 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.

In order to efficiently and timely meet the demands of many of our OEM customers, we position our products in multiple strategic locations based on the amounts forecasted by such customers. If an OEM customer s actual product demands decrease significantly from its forecast, then we may incur additional costs in relocating the products that have not been purchased by the OEM. This could result in a delay in our product sales and an increase in our operating costs, which may negatively impact our operating results.

Our entry into additional storage markets increases the complexity of our business, and if we are unable to successfully adapt our business processes as required by these new markets, we will be at a competitive disadvantage and our ability to grow will be adversely affected.

As we expand our product line to sell into additional storage markets, the overall complexity of our business increases at an accelerated rate and we must make necessary adaptations to our business model to address these complexities. For example, as we have previously disclosed, we entered the traditional enterprise market in November 2009. In addition to requiring significant capital expenditures, our entry into the traditional enterprise market adds complexity to our business that requires us to effectively adapt our business and management processes to address the unique challenges and different requirements of the traditional enterprise market, while maintaining a competitive operating cost model. If we fail to gain market acceptance in the traditional enterprise storage market, we will remain at a competitive disadvantage to the companies that succeed in this market and our ability to continue our growth will be negatively affected.

Expansion into new hard drive markets may cause our capital expenditures to increase, and if we do not successfully expand into 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 or 2.5-inch hard drives for the desktop, mobile, enterprise, CE and external storage markets. However, demand for hard drives may shift to products in form factors or with interfaces that our competitors offer but which we do not. Expansion into other hard drive markets and resulting increases in manufacturing capacity requirements may require us to make substantial additional investments in part because our operations are largely vertically integrated now that we manufacture heads and magnetic media for use in many of the hard drives we manufacture. If we fail to successfully expand into new hard drive markets with products that we do not currently offer, we may lose business to our competitors who offer these products.

If we fail to successfully manage our new product development or new market expansion, or if we fail to anticipate the issues associated with such development or expansion, our business may suffer.

While we continue to develop new products and look to expand into new markets, the success of our new product introductions depends 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; and
- quality problems or other defects in the early stages of new product introduction that were not anticipated in the design of those products.

Further, we need to identify how any of the new markets into which we are expanding may have different characteristics from the markets in which we currently exist and properly address these differences. These characteristics may include:

- demand volume requirements;
- demand seasonality;
- product generation development rates;
- customer concentrations;
- warranty expectations and product return policies; and
- cost, performance and compatibility requirements.

Our business may suffer if we fail to successfully anticipate and manage these issues associated with our product development and market expansion. For example, our branded products are designed to attach to and interoperate with a wide variety of PC and CE devices, and therefore their functionality relies on the manufacturer of such devices, or the associated operating systems, enabling the manufacturer s devices to operate with our branded products. If our branded products are not compatible with a wide variety of devices, or if device manufacturers design their devices so that our branded products cannot operate with them, and we cannot quickly and efficiently adapt our branded products to address these compatibility issues, our business could suffer.

Table of Contents

Expanding into new 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 our branded products are individual consumers, this market has historically experienced a dramatic increase in demand during the winter holiday season. If we do not properly adjust our supply to these new demand cycles, we risk having excess inventory during periods of low demand and insufficient inventory during periods of high demand, which could adversely affect our operating results.

Loss of market share with or by a key customer, or consolidation among our customer base, could harm our operating results.

During the quarter ended January 1, 2010, a large percentage of our revenue, 55%, came from sales to our top 10 customers. 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 is not generally 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, our operating results would likely be harmed.

Additionally, if there is consolidation among our customer base, our customers may be able to command increased leverage in negotiating prices and other terms of sale, which could adversely affect our profitability. In addition, if, as a result of increased leverage, 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. Consolidation among our customer base may also lead to reduced demand for our products, replacement of our products by the combined entity with those of our competitors and cancellations of orders, each of which could harm our operating results.

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. We may be at a competitive disadvantage to any companies that are able to gain these advantages.

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. Additionally, if the distribution market weakens as a result of a slowing PC growth rate, technology transitions or a significant change in consumer buying preference, or if 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. 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 may over extended periods of time sell hard 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 may sell hard drives at lower prices and operate their hard drive business unit at a loss over an extended period of time while still remaining profitable overall. In 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 lower prices. Our operating results may be adversely affected if we cannot successfully compete with the pricing by these companies.

If we fail to qualify our products with our customers or if product life cycles lengthen, it may have a significant adverse impact on our sales and margins.

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 delayed or reduced product sales, reduced product margins caused by having to continue to offer a more costly current generation product, or lost 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 storage markets. Likewise, 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 reduce our profits because we expect declining gross margins on our current generation products as a result of competitive pressures.

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 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 operating results.

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

A competitive 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 that we are unable to match, we could be at a competitive disadvantage to those competitors.

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.

We make most of our own heads and magnetic media for some of our product families; however, we do not manufacture many of the component parts used in our hard drives. As a result, the success of our products depends on our ability to gain access to and integrate parts 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 magnetic media components. For example, 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.

Violation of labor or environmental laws and practices by our suppliers or sub-suppliers could harm our business.

We expect our suppliers to operate in compliance with applicable laws and regulations, including labor and environmental laws, and to otherwise meet our required supplier standards of conduct. While our internal operating guidelines promote ethical business practices, we do not control our suppliers or sub-suppliers or their labor or environmental practices. The violation of labor, environmental or other laws by any of our suppliers or sub-suppliers, or divergence of a supplier s or sub-supplier s labor or environmental practices from those generally accepted as ethical in the U.S., could harm our business by:

- interrupting or otherwise disrupting the shipment of our product components;
- damaging our reputation;
- forcing us to find alternate component sources;
- reducing demand for our products (for example, through a consumer boycott); or
- exposing us to potential liability for our supplier s or sub-supplier s wrongdoings.

Contractual commitments with component suppliers may result in us paying increased charges and cash advances for such components or may cause us to have inadequate or excess component inventory.

To reduce the risk of component shortages, we attempt to provide significant lead times when buying components, which may subject us to cancellation charges if we cancel orders as a result of technology transitions or changes in our component needs. In addition, we may from time to time enter into contractual commitments with 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 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. Furthermore, as a result of the current global economic conditions, our ability to forecast our requirements for these components has become increasingly difficult, therefore increasing the risk that our contractual commitments may not meet our actual supply requirements, which could cause us to have inadequate or excess component inventory and adversely affect our operating results and increase our operating costs.

Failure by certain suppliers to effectively and efficiently develop and manufacture components, technology or production equipment 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. Likewise, we rely on suppliers for certain technology and equipment necessary for advanced development technology for future products. Some of these components, and most of this technology and production equipment, must be specifically designed to be compatible for use in our products or for developing and manufacturing our future products, and are only available from a limited number of suppliers, some of with whom we are sole sourced. We are therefore dependent on these suppliers to be able and willing to dedicate adequate engineering resources to develop components that can be successfully integrated with our products, and technology and production equipment that can be used to develop and manufacture our next-generation products efficiently. The failure of these suppliers to effectively and efficiently develop and manufacture components that can be integrated into our products or technology and production equipment that can be used to develop or manufacture next generation products may cause us to experience inability or delay in our manufacturing and shipment of hard drive products, our expansion into new technology and markets, or our ability to remain competitive with alternative storage technologies, therefore adversely affecting our business and financial results.

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 and magnetic media manufacturing resulted in a fundamental change in our operating structure, as we now manufacture heads and magnetic media for use in many of the hard drives we manufacture. Consequently, we make more capital investments and carry a higher percentage of fixed costs than we would if we were not vertically integrated. 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 magnetic media manufacturing assets may face under-utilization that may impact our operating results. 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:

- failure to continue to leverage the integration of our magnetic media technology with our head technology;

- insufficient third party sources to satisfy our needs if we are unable to manufacture a sufficient supply of heads or magnetic media;

- third party head or magnetic 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 magnetic media may infringe certain intellectual property rights of other companies; and

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

If we do not adequately address the challenges related to our head or magnetic 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.

If we are unable to timely and cost-effectively develop heads and magnetic media 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 and magnetic media used in 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 and magnetic media technologies developed by other manufacturers. Technology transition for head and magnetic media designs is critical to increasing our volume production of heads and magnetic media. There can be no assurance, however, that we will be successful in timely and cost-effectively developing and manufacturing heads or magnetic media for products using future technologies. We also may not effectively transition our head or magnetic 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 or magnetic media we manufacture. In addition, we may not have access to external sources of supply without incurring substantial costs which would negatively impact our business and financial results.

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

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. If product life cycles shorten, it 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. In addition, shortening of product life cycles also makes it 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 magnetic media technology to be improved or new technologies developed to accommodate more data on a single disk. In addition, our introduction of new products during a technology transition increases the likelihood of unexpected quality concerns. Our failure to bring high quality new products to market on time and at acceptable costs may put us at a competitive disadvantage to companies that achieve these results.

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

Historically, when the industry experiences a fundamental change in technology, any manufacturer that fails to successfully and timely adjust its designs and processes to accommodate the new technology fails to remain competitive. There are some technologies, such as current-perpendicular-to-plane (CPP), energy assisted magnetic recording, patterned magnetic media, advanced signal processing, advanced format technology and other similar potentially breakthrough technologies, that will represent revolutionary recording technologies if they can be implemented by a competitor on a commercially viable basis ahead of the industry, which 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, magnetic 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 heads and magnetic media, which may cause longer production times and reduce the overall availability of magnetic media in the industry. Additionally, the new technology requires a greater degree of integration between heads and magnetic 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, technology and production equipment that accommodate the new technology. For example, advanced wafer and magnetic media manufacturing technologies have historically been developed for use in the semiconductor industry prior to the hard drive industry. However, successful implementation of the use of patterned magnetic media with hard drive magnetic media currently presents a significant technical challenge facing the hard drive industry but not the semiconductor industry. Therefore, our suppliers may not be willing to dedicate adequate engineering resources to develop manufacturing equipment for patterned magnetic media prior to a need for the equipment in the semiconductor industry. We believe that if patterned magnetic media technology is not successfully implemented in the hard drive industry, then alternative

Table of Contents

storage technologies like solid-state storage may more rapidly overtake hard drives as the preferred storage solution for higher capacity storage needs. This result would put us at a competitive disadvantage and 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 do not properly manage the technology transitions of our products, our competitiveness and operating results may be negatively affected.

The storage markets in which we offer our products continuously undergo technology transitions which we must anticipate and adapt our products to address in a timely manner. For example, serial interfaces normally go through cycles in which their maximum speeds double. We must effectively manage the transition of the features of our products to address these faster interface speeds in a timely manner in order to remain competitive and cost effective. If we fail to successfully and timely manage the transition to faster interface speeds, we may be at a competitive disadvantage to other companies that have successfully adapted their products in a timely manner and our operating results may suffer.

If we fail to develop and introduce new hard drives that are competitive against alternative storage technologies, our business may suffer.

Our success depends in part on our ability to develop and introduce new products in a timely manner in order to keep pace with competing technologies. Alternative storage technologies like solid-state storage and flash memory technology have successfully served digital entertainment markets for products such as digital cameras, MP3 players, USB flash drives and mobile phones that require a relatively low amount of storage capacity that cannot be economically serviced using hard drive technology. Typically, storage needs for higher capacity and performance, with lower cost-per-gigabyte, have been better served by hard drives. However, advances in semiconductor technology have resulted in solid-state storage emerging as a technology that is competitive with hard drives for niche high performance needs in advanced digital computing markets such as enterprise servers and storage, in spite of the associated challenges in the attributes of cost, capacity and reliability. Additionally, solid-state storage is produced by large semiconductor companies who can sell their products at lower prices and operate their solid-state storage business unit at a loss while still remaining profitable overall in an attempt to gain market share. There can be no assurance that we will be successful in anticipating and developing new products for the desktop, mobile, enterprise, CE and external storage markets in response to solid-state storage, as well as other competing technologies. If our hard drive technology fails to offer higher capacity, performance and reliability with lower cost-per-gigabyte than solid-state storage for the desktop, mobile, enterprise, CE and external storage markets, we will be at a competitive disadvantage to companies using semiconductor technology to serve these markets and our business will suffer.

Spending to improve our technology and develop new technology to remain competitive may negatively impact our financial results.

In attempting to remain competitive, we may need to increase our capital expenditures and expenses above our historical run-rate model in order to attempt to improve our existing technology and develop new technology.

Table of Contents

Increased investments in technology could cause our cost structure to fall out of alignment with demand for our products which would have a negative impact on our financial 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. Our operating results will be adversely affected if we fail to:

- maintain overall quality of products in 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;
- obtain customer qualification of these products 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; or
- 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.

Manufacturing and marketing our products globally subjects us to numerous risks.

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

- obtaining requisite U.S. 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;
- copyright levies or similar fees or taxes imposed in European and other countries;
- 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.

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 a portion of 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 are vulnerable to system failures, which could harm our business.

We are heavily dependent on our technology infrastructure, among other functions, to operate our factories, sell our products, fulfill orders, manage inventory and bill, collect and make payments. Our systems are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, computer viruses, computer denial-of-service attacks and other events. Our business is also subject to break-ins, sabotage and intentional acts of vandalism by third parties as well as employees. Despite any precautions we may take, such problems could result in, among other consequences, interruptions in our business, which could harm our reputation and financial condition.

If we are unable to retain or hire key staff and skilled employees our business results may suffer.

Our success depends upon the continued contributions of our key staff and skilled employees, many of whom would be extremely difficult to replace. Global competition for skilled employees in the data storage industry is intense and, as we attempt to move to a position of technology leadership in the storage industry, our business success becomes increasingly dependent on our ability to retain our key staff and skilled employees as well as attract, integrate and retain new skilled employees. Volatility or lack of positive performance in our stock price and the overall markets may adversely affect our ability to retain key staff or skilled employees who have received equity compensation. Additionally, because a substantial portion of our key employees compensation is placed at risk and linked to the performance of our business, when our operating results are negatively impacted by global economic conditions, we are at a competitive disadvantage for retaining and hiring key staff and skilled employees versus other companies that pay a relatively higher fixed salary. 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.

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

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

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.

Table of Contents

Our success depends, in significant part, on the proprietary nature of our technology, including non-patentable intellectual property such as our process technology. If a competitor is able to reproduce or otherwise capitalize on our technology despite the safeguards we have in place, 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 U.S. laws. 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.

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. 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.

Additionally, we negotiate and procure some of our component requirements in U.S. dollars from Japanese and other non-U.S. based vendors. If the U.S. dollar continues to weaken against other foreign currencies, some of our component suppliers may increase the price they charge for their components in order to maintain an equivalent profit margin. If this occurs, it would have a negative impact on our operating results.

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 assess 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;

Table of Contents

- 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:

- price protection adjustments and other sales promotions and allowances on products sold to retailers, resellers and distributors;
- inventory adjustments for write-down of inventories to lower of cost or market value (net realizable value);
- reserves for doubtful accounts;
- accruals for product returns;
- accruals for warranty costs related to product defects;
- accruals for litigation and other contingencies; and
- liabilities for unrecognized tax benefits.

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;

- contraction in our operating results or growth rates that are lower than our previous high growth-rate periods;
- changes in financial estimates by securities analysts relating specifically to us or the hard drive industry in general; and
- macroeconomic conditions that affect the market generally.

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.

Current economic conditions have caused us difficulty in adequately protecting our increased cash, cash equivalents and short-term investments from financial institution failures.

The uncertain global economic conditions and volatile investment markets have caused us to hold more cash, cash equivalents and short-term investments than we would hold under normal circumstances. Since there has been an overall increase in demand for low-risk, U.S. government backed securities with a limited supply in the financial marketplace, we face increased difficulty in adequately protecting our increased cash and short-term investments from possible sudden and unforeseeable failures by banks and other financial institutions. A failure of any of these financial institutions in which deposits exceed FDIC limits could have an adverse impact on our financial position.

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 July 3, 2009, in compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our internal control over financial reporting was effective. We believe that we currently have adequate internal control procedures in place for future periods; however, if our internal control over financial reporting is found to be ineffective or if we identify a material weakness or significant deficiency in our financial reporting, investors may lose confidence in the reliability of our financial statements, which may adversely affect our financial results or our stock price.

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

1. The 2009 annual meeting of stockholders was held on November 11, 2009. The stockholders elected the following ten directors to hold office until the next annual meeting and until their successors are elected and qualified:

	FOR	AGAINST	ABSTAIN
Peter D. Behrendt	178,210,660	18,492,387	541,021
Kathleen A. Cote	182,557,951	14,479,120	206,998
John F. Coyne	180,844,522	16,239,578	159,968
Henry T. DeNero	182,368,125	14,519,711	356,168
William L. Kimsey	182,531,706	14,487,378	224,921
Michael D. Lambert	180,926,849	16,105,832	211,324
Matthew E. Massengill	180,333,197	16,630,436	280,371
Roger H. Moore	180,743,365	16,158,448	342,191
Thomas E. Pardun	177,871,363	19,084,416	288,225
Arif Shakeel	180,547,797	16,390,647	305,559

Table of Contents

2. In addition, the stockholders approved the following matters:

	FOR	AGAINST	ABSTAIN	BROKER NON-VOTE
To approve an amendment and restatement of the Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan	148,139,067	30,909,451	356,952	17,838,599
To ratify the appointment of KPMG LLP as the Company s independent registered public accounting firm for the fiscal year ending July 2, 2010	190,599,657	6,451,060	168,505	

Item 6. *EXHIBITS*

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of Western Digital Corporation, as amended to date (Incorporated by reference to the Company s Quarterly Report on Form 10-Q (File No. 1-08703), as filed with the Securities and Exchange Commission on February 8, 2006)
3.2	Amended and Restated Bylaws of Western Digital Corporation, as amended effective as of November 5, 2007 (Incorporated by reference to the Company s Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on November 8, 2007)
10.1	Western Digital Corporation Amended and Restated 2004 Performance Incentive Plan, amended and restated as of August 12, 2009 (Incorporated by reference to the Company s Current Report on Form 8-K (File No. 1-08703), as filed with the Securities and Exchange Commission on November 16, 2009)*
10.7	Western Digital Corporation Summary of Compensation Arrangements for Named Executive Officers and Directors *
31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema Document**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document**

Exhibit filed with this Report.

* Management contract or compensatory plan or

arrangement required to be filed as an exhibit pursuant to applicable rules of the Securities and Exchange Commission.

** Furnished herewith on a voluntary basis in advance of the XBRL phase-in schedule applicable to the registrant. In accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, except as expressly set forth by specific reference in such filing.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned thereunto duly authorized.

WESTERN DIGITAL CORPORATION
Registrant

/s/ Timothy M. Leyden

Timothy M. Leyden
Executive Vice President and Chief Financial Officer (Principal Financial Officer)

/s/ Joseph R. Carrillo

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

Date: January 29, 2010

Table of Contents

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