

WESTERN DIGITAL CORP

Form 10-K

August 14, 2009

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

FORM 10-K

(Mark One)

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

For the fiscal year ended July 3, 2009

or

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

For the transition period from to

Commission file number 1-8703

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

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

33-0956711
(I.R.S. Employer
Identification No.)

20511 Lake Forest Drive
Lake Forest, California
(Address of principal executive offices)

92630
(Zip Code)

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

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

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

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

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

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

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

Indicate by checkmark 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 ☐ No ☐

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

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 ☒ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐
(Do not check if a smaller reporting company)

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant on December 26, 2008, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$2.5 billion, based on the closing sale price as reported on the New York Stock Exchange.

As of the close of business on August 6, 2009, 224,685,608 shares of common stock, par value \$.01 per share, were outstanding.

Documents Incorporated by Reference

Part III incorporates by reference certain information from the registrant's definitive proxy statement (the "Proxy Statement") for the 2009 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of the 2009 fiscal year. Except with respect to information specifically incorporated by reference in this Form 10-K, the Proxy Statement is not deemed to be filed as part hereof.

WESTERN DIGITAL CORPORATION

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For the Fiscal Year Ended July 3, 2009**

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Typically, our fiscal year ends on the Friday nearest to June 30 and consists of 52 weeks. However, approximately every five years, we report a 53-week fiscal year to align our fiscal quarters. The 2009 fiscal year, which ended on

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July 3, 2009, consisted of 53 weeks. The 2008 and 2007 fiscal years, which ended on June 27, 2008 and June 29, 2007, respectively, consisted of 52 weeks each. Unless otherwise indicated, references herein to specific years and quarters are to our fiscal years and fiscal quarters, and references to financial information are on a consolidated basis. As used herein, the terms we, us, our and WD refer to Western Digital Corporation and its subsidiaries.

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

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

Western Digital, WD, the WD logo, WD Caviar, WD VelociRaptor, WD Scorpio, WD Elements, My Passport, My Book, My DVR Expander, WD GreenPower Technology, WD TV, ShareSpace, SiliconDrive, PowerArmor,

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SiSMART, SolidStor, and SiSecure are trademarks of Western Digital Technologies, Inc. and/or its affiliates. All other trademarks mentioned are the property of their respective owners.

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;

the impact of our acquisition of SiliconSystems, Inc. on SiliconSystems' existing markets and on our development of future products for emerging opportunities in our existing markets;

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 growth in the first 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, cash equivalents and short-term investments to meet our working capital 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 I, Item 1A of this Annual Report on Form 10-K, 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.

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PART I

Item 1. *Business*

General

We design, develop, manufacture and sell hard drives. A hard drive is a device that uses one or more rotating magnetic disks (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 40 gigabytes (GB) to 2 terabytes (TB), nominal rotation speeds up to 10,000 revolutions per minute (RPM), and offer interfaces including both Enhanced Integrated Drive Electronics (EIDE) and Serial Advanced Technology Attachment (SATA). We also embed our hard drives into WD®-branded external storage appliances using interfaces such as USB 2.0, 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™.

In the second quarter of 2009, we began to design, develop, manufacture and sell media players. A media player is a device that connects to a user's television or home theater system and plays digital movies, music and photos from any of our WD®-branded external hard drives or other USB mass storage devices. We sell our media players worldwide to resellers and retailers under our WD® brand.

In the third quarter of 2009, with the acquisition of SiliconSystems, Inc. (SiliconSystems), we began to design, develop, manufacture and sell solid-state drives. 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.

Business Strategy

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

distinguishes us in the dynamic and competitive hard drive industry;

provides great value to our customers;

allows us to better achieve consistent financial performance, including strong returns on invested capital; and

provides continued diversification of our hard drive product set and entry into additional markets such as solid-state drives and media players.

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

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Industry

We design, develop and manufacture hard drives for the desktop and mobile PC, enterprise, CE and branded product retail markets. We believe that growth in the sales of hard drives has continued to outpace the growth in the sales of all PCs as there were approximately 84% more hard drives sold in the market than PCs in calendar 2008, based on industry data. We believe the following factors continue to drive this accelerating growth of hard drive sales in addition to PC applications:

consumer use of hard drives for the playing, retention and creation of digital content for personal use in the rapidly growing CE market;

growth of the external hard drive or branded products market, permitting the easy storage, portability and backup of digital data such as music, photographs or video;

increased use of multiple hard drives in PCs for data backup and expanded storage capacity; and

increased use of multiple cost-optimized high performance hard drives in data-intensive applications such as Internet search engines and in hard drive intensive hosts for handheld computing devices.

Additionally, we believe that the demand for 2.5-inch hard drives has grown from approximately 16% of the overall hard drive market in calendar 2003 to 41% of the overall hard drive market in calendar 2008, driven by the fast-growing markets for notebook and netbook computers, game consoles and external storage.

We design, develop and manufacture solid-state drives for the embedded systems market which includes network-communications, industrial, embedded-computing, medical, military, aerospace, media appliance and data streaming applications. We believe that the growth rate of solid-state drives will be significant over the next four years, with particular opportunities for growth in the enterprise storage, netbooks, and embedded systems markets.

We also design, develop and manufacture WD®-branded media players for the retail market. We believe there is a growing need for consumers to play their stored digital content on their television or home theater system in connection with the growing trend in the digitization of rich content and data.

These factors and our product expansion strategy have gradually increased our percentage of revenue derived from non-desktop sources. In 2009, 62% of our revenue was from non-desktop sources compared to 56% in 2008.

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

Desktop PC Market

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

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

the overall growth of desktop computer sales;

the increasing needs of businesses and individuals for increased storage capacity on their desktop computers;

the continuing development of software applications to manage multimedia content; and

the increasing use of broadband Internet, including content downloaded from the Internet onto desktop computer hard drives.

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

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Mobile PC Market

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

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

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

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

Enterprise Market

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

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

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

growing portion of the highest capacity hard drives in the next three years.

SAS is the next generation SCSI technology and has been replacing SCSI drives over the past few years. SATA technology is compatible with SAS technology, enabling customers the flexibility of incorporating SATA hard drives in SAS storage systems. We believe the market transition from SCSI to SAS has added to the growth of the enterprise-class SATA market, which currently is estimated to be approximately 47% of the enterprise hard drive market.

High-performance server applications, including blade servers, are increasingly using 2.5-inch form factor hard drives, supplanting traditional 3.5-inch drives. Smaller form factors enable more drives per physical space for increased

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performance, higher capacity per square foot and lower power consumption. This trend demonstrates the fragmentation of the enterprise hard drive market and the need for application-specific enterprise-class hard drives.

Consumer Electronics Market

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

video content in applications such as DVRs;

audio and video content in applications such as consumer handheld devices, including MP3 players; and

hard drives in game consoles.

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

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

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

External Hard Drive Market

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

Solid-State Drive Market

The solid-state drive market consists primarily of solid-state drives constructed with semiconductor, non-volatile media that retains data even when power is not applied using either single-level cell or multilevel cell NAND media. Our solid-state drive products are currently used in the embedded systems market which includes network-communications, industrial, embedded-computing, medical, military, aerospace, media appliance and data streaming applications.

We believe that the demand for solid-state drives in certain markets has grown in part due to:

the increasing performance, measured by input/output per second, in enterprise applications;

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- the increasing low entry cost applications in the netbook markets;
- the increasing premium performance applications in the desktop and notebook markets; and
- the increasing requirements of the embedded systems market for high durability and long life cycles.

We expect the solid-state drive market to grow faster on a compounded annual growth rate basis than the hard drive market over the next four years.

Other Market Opportunities

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

Products

We offer a broad line of hard drives designed for various markets. We market our hard drives under brand names including WD Caviar, WD RE, WD VelociRaptor, WD Scorpio, WD Elements, WD AV, My Passport, My Book, My DVR Expander and WD GreenPower Technology. These hard drives service the desktop, mobile, enterprise, CE and branded products markets, and can be found in products including desktop computers, notebook computers, enterprise storage, workstations, video surveillance equipment, networking products, DVRs, STBs and external storage appliances. We also offer a line of WD®-branded media players under the WD TV™ brand name, as well as a line of solid-state drives under the SiliconDrive® brand name.

Desktop Hard Drive Products

The hard drives we design for the desktop PC market currently consist of 3.5-inch form factor products with capacities ranging from 40 GB to 2 TB. These products utilize either the EIDE or SATA interfaces, providing high performance while retaining ease of use and overall low cost of connection. The type of EIDE interface currently used in our hard drives is ATA/100, which signifies a burst data transfer rate of 100 megabytes per second, which is the maximum specified data transition that can be sustained under ideal conditions. The SATA interface available in the majority of our hard drives enables burst transfer rates of up to 3 gigabits (Gb) per second.

Mobile Hard Drive Products

Our hard drives used in mobile products typically include 2.5-inch form factor drives for notebook computers. Although the desktop PC market still accounts for a majority of hard drive sales, unit shipments of hard drives for notebook computers represent a growing share of the total. We entered the 2.5-inch mobile market in September 2004. We are now shipping our seventh generation of the WD Scorpio® product family, offering up to 1 TB of capacity. Our product expansion, including a high-performance hard drive spinning at 7,200 RPM and producing ultra-high capacities for specific applications with a three platter platform, has enabled us to provide customers with a full-line of 2.5-inch mobile drives and helped us enhance our market position in this fast-growing market.

Enterprise Hard Drive Products

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

the WD VelociRaptor™ drive, which is a 300 GB, 10,000 RPM, 2.5-inch enterprise-class drive with the SATA interface for enterprise applications requiring high performance and high reliability;

the WD® RE family of drives, with capacities ranging from 160 GB to 2 TB. The WD® RE family serves the SATA market and has enhanced reliability features and ratings when contrasted to our desktop products; and

low-power versions of the WD® RE family of drives featuring WD GreenPower Technology™, which reduces power consumption as much as 40 percent compared with standard hard drives. Lower power consumption

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reduces total cost of ownership for our customers by cutting energy costs and lowering operating temperatures, which contributes to longer reliability.

Both WD VelociRaptor™ and WD® RE drives may be used in, but are not limited to, applications such as databases, e-commerce and super computing in life science, oil and gas and similar industries, business records management, e-mail, file serving, web serving, near-line storage, medical records, engineering data management, video broadcasting and video security. The WD VelociRaptor™ also has been popular for use in the high-end desktop PC market for applications including gaming and advanced CAD/CAM (computer aided design/computer-aided manufacturing) systems.

Consumer Electronics Products

We offer a line of hard drives under the WD® AV brand that are designed for use in products such as DVRs, STBs, karaoke systems, multi-function printers and gaming systems. WD® AV drives deliver the characteristics CE manufacturers seek most, which are quiet operation, low operating temperature, low power consumption specifications, high reliability and optimized streaming capabilities. We also offer low-power WD® AV drive models that feature the WD GreenPower Technology™. Lower power consumption in our WD® AV drives results in cooler operation, which enhances long-term reliability. Our WD GreenPower Technology™ also quiets drive operation, which is an important attribute for our consumer electronics customers.

Branded Products

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

the 3.5-inch hard drive-based My Book® family of storage appliances, which are designed to reside on desktops as PC peripherals, as well as be connected to networks, and to simplify storage for mainstream consumers, and offer from 160 GB to 4 TB of capacity;

the 3.5-inch My DVR Expander™ series of external SATA (eSATA) and USB 2.0 storage appliances, which adds recording time to STBs with DVR capability;

the WD ShareSpace™ network-attached storage system, which offers capacities as high as 8 TB for home office or small office applications;

the 2.5-inch hard drive-based My Passport™ Portable series of USB 2.0 and FireWire™ storage devices, which, weighing less than one-half of a pound, offer from 160 GB to 1 TB of portable storage capacity; and

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

We also sell a line of WD®-branded media players which are devices that enable users to play digital movies, music and photos from any of our WD® branded external hard drives or other USB mass storage devices on a television or home theater system, independent of the PC. Our media players provide rich high definition playback and navigation up to 1080p, multiple ports to connect to multiple mass storage devices and access them simultaneously, high-definition multimedia interface ports to connect to the highest quality HDTV or home theater system and

composite outputs to ensure compatibility with virtually all television sets.

Solid-State Drive Products

We offer a line of solid-state drives under the SiliconDrive® brand that provides advanced storage technologies for the embedded systems market which includes network-communications, industrial, medical, military, aerospace, media appliance and data streaming applications. We are now shipping three generations of the SiliconDrive® product family in 2.5-inch, 1.8-inch, CF and other small form factors, with capacities ranging from 32 MB to 120 GB, interfaces that include SATA, PATA/EIDE/CF and USB 2.0 and read/write speeds of up to 100/80 MB per second. These drives also

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address the stringent embedded systems market requirements to ensure data integrity, eliminate unscheduled downtime, protect application data and software and provide for data security and protection through our patented and patent-pending PowerArmor®, SiSMART®, SolidStor® and SiSecure™ technologies.

Research and Development

We devote substantial resources to development of new products and improvement of existing products. We focus our engineering efforts on coordinating our product design and manufacturing processes to bring our products to market in a cost-effective and timely manner. Research and development expenses totaled \$509 million, \$464 million and \$306 million in 2009, 2008 and 2007, respectively.

Fiscal 2009 represented the eighth consecutive year of substantial growth in our research and development spending to support our significant broadening of our product and technology portfolios. Over that eight-year period, we grew our research and development spending 350% from \$113 million in fiscal 2001 to \$509 million in fiscal 2009. As a result of this investment activity, we continue to expand our business beyond the desktop PC market into newer markets or markets in which we have not previously participated. Such investments have allowed us to execute against our strategic objective of revenue diversification to address the growth of new applications for hard drives and fast-growing new market opportunities.

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

Technology and Product Development

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

Acoustics which is the sound power emitted during hard drive operation, commonly expressed in decibels, and perceived loudness due to sound pressure, commonly expressed in sones.

Data transfer rate which is the sustained rate of data transfer to and from the disk, commonly expressed in gigabits per second. One gigabit equals one billion bits.

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

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

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

Power Consumption which is the amount of electricity required to operate the drive, measured in watts.

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.

HDA: One or more disks positioned around a motor-driven spindle hub that rotates the disks comprise the disk-pack assembly. The disk is made up of a smooth substrate on which thin layers of magnetic materials are deposited. The head stack assembly (HSA) is comprised of a magnetic positioner, a pivot-arm module, on which the individual heads

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are mounted. Each disk has a head suspended directly above it, which can read data from or write data to the spinning disk.

PCBA: The integrated circuits on the printed circuit board typically include a drive interface and a controller. The drive interface receives instructions from the host computer, while the controller directs the flow of data to or from the disks and controls the heads. The location of data on each disk is logically maintained in concentric tracks divided into sectors. The host computer sends instructions to the controller to read data from or write data to the disks, based on logical track and sector locations. Guided by instructions from the controller, the HSA pivots in an arc, across the disk until it reaches the selected track of a disk, where the data is recorded or retrieved.

Industry-standard interfaces allow the hard drive to communicate with the computer. Currently, the primary interfaces for PCs are EIDE (Parallel Advanced Technology Attachment, or PATA) and SATA, and the primary interfaces for enterprise systems are SATA, SCSI, SAS, and 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; and EIDE (PATA) on WD Caviar®, WD Scorpio® and WD®AV families.

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 January 2009, we began shipping our WD Caviar® 3.5-inch family of drives at 500 GB per platter (approximately 400 gigabits per square inch) areal density. 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.

Head technology is one of the key components affecting areal density. Historically, there have been rapid technological changes resulting in several generations of head technology in a relatively short time. However, in recent years the time has lengthened between changes in generations of head technology. The hard drive industry has transitioned from the use of longitudinal magnetic recording (LMR) head technology for the head writer function to perpendicular magnetic recording (PMR) technology, which allows for significantly higher storage capacities. In addition, the industry has made the transition to tunnel-junction magneto resistive (TMR) technology for the head reader function. We have completed the transition to PMR and TMR across all of our product platforms.

With the transition to PMR, magnetic media plays a much more important role in achieving higher areal density. PMR demands a much tighter interaction and matching between head and magnetic media designs. We are vertically integrated in the two most important technology components of hard drives (heads and magnetic media), which has enabled us to achieve a more optimum design and utilization of these components.

We invest considerable resources in research and development, manufacturing infrastructure and capital equipment of head and magnetic media components, in order to secure our competitive position and cost structure.

Solid-state drives record, store and retrieve digital data without any moving parts. Attributes, such as fast read/write speeds, low power consumption and robust durability offer greater performance than hard drives in some storage applications but are currently much more costly per gigabyte and are available in much lower capacity points than hard drives. The main components of a solid-state drive are the system-on-chip and semiconductor media. The capacity, measured in megabytes or gigabytes, of a solid-state drive is based on the total number of megabits or gigabits of semiconductor media in the solid-state drive. Industry-standard storage interface protocols, such as SATA,

PATA/EIDE/CF and USB 2.0, allow the solid-state drive to communicate with the host system.

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

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

Sales and Distribution

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

Original Equipment Manufacturers

Sales to OEMs, which include sales through ODMs, accounted for 54%, 51% and 48% of our net revenue in 2009, 2008 and 2007, respectively. For 2009 and 2007, sales to Dell Inc. accounted for 10% of our net revenue. For 2008, no single customer accounted for 10%, or more, of our net revenue. We believe that our success depends on our ability to maintain and improve our strong relationships with the leading OEMs.

OEMs evaluate and select their hard drive and solid-state drive suppliers based on a number of factors, including quality and reliability, storage capacities, performance characteristics, price, service and support, ease of doing business, and the supplier's long-term financial stability. They typically seek to qualify two or more providers for each generation of products, and once an OEM has chosen its qualified vendors for a given product, it generally will purchase products from those vendors for the life of that product. To achieve success with OEM qualifications, a supplier must consistently offer products featuring leading technology, quality and reliability at acceptable capacity. Suppliers must quickly achieve volume production of each new generation of high quality and reliable hard drives or solid-state drives, requiring access to flexible, high-capacity, high-quality manufacturing capabilities.

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

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

Distributors

We use a broad group of distributors to sell our products to non-direct customers such as small computer and CE manufacturers, dealers, systems integrators, online retailers and other resellers. Distributors accounted for approximately 26%, 31% and 36% of our net revenue for 2009, 2008 and 2007, respectively. Distributors generally enter into non-exclusive agreements for specific territories with us for the purchase and redistribution of our products in those territories. We grant our distributors limited price protection rights.

Retailers

We sell our branded products directly to a select group of major retailers such as computer superstores, warehouse clubs, online retailers, and computer electronics stores, and authorize sales through distributors to smaller retailers. Retailers accounted for approximately 20%, 18% a