

ADAPTEC INC  
Form 10-Q  
February 07, 2005

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended December 31, 2004 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 0-15071

ADAPTEC, INC.

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of incorporation or organization)

**691 S. MILPITAS BLVD., MILPITAS,  
CALIFORNIA**

(Address of principal executive offices)

**94-2748530**

(I.R.S. Employer Identification No.)

**95035**

(Zip Code)

**(408) 945-8600**

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act)

Yes  No

The number of shares outstanding of Adaptec's common stock as of January 31, 2005 was 111,577,536.



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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

ADAPTEC, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (unaudited)

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2004	December 31, 2003	December 31, 2004	December 31, 2003
	(in thousands, except per share amounts)			
Net revenues	\$ 126,548	\$ 115,143	\$ 363,750	\$ 331,628
Cost of revenues	83,657	68,575	217,065	192,849
Gross profit	42,891	46,568	146,685	138,779
Operating expenses:				
Research and development	29,970	25,103	87,374	76,487
Selling, marketing and administrative	21,260	19,745	63,325	59,583
Amortization of acquisition-related intangible assets	5,095	4,530	13,205	14,067
Write-off of acquired in-process technology			5,200	3,649
Restructuring charges	2,228	878	4,975	2,704
Other charges	(2,755 )		(2,755 )	
Total operating expenses	55,798	50,256	171,324	156,490
Loss from operations	(12,907 )	(3,688 )	(24,639 )	(17,711 )
Interest and other income	3,097	3,369	8,599	64,491
Interest expense	(1,083 )	(2,322 )	(3,350 )	(8,010 )
Income (loss) before income taxes	(10,893 )	(2,641 )	(19,390 )	38,770
Provision for (benefit from) income taxes	(33,382 )	372	(33,826 )	720
Net income (loss)	\$ 22,489	\$ (3,013 )	\$ 14,436	\$ 38,050
Net income (loss) per share:				
Basic	\$ 0.20	\$ (0.03 )	\$ 0.13	\$ 0.35
Diluted	\$ 0.17	\$ (0.03 )	\$ 0.12	\$ 0.33
Shares used in computing net income (loss) per share:				
Basic	111,136	108,858	110,429	108,408
Diluted	134,517	108,858	131,607	126,578

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

ADAPTEC, INC.  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(unaudited)

	December 31, 2004		March 31, 2004	
	(in thousands)			
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$	92,728	\$	119,113
Marketable securities		424,448		544,741
Restricted cash and marketable securities		2,283		2,815
Accounts receivable, net		87,488		51,562
Inventories		56,650		48,888
Deferred income taxes		58,355		55,678
Prepaid expenses		22,684		14,761
Other current assets		9,367		20,031
Total current assets		754,003		857,589
Property and equipment, net		61,036		58,435
Restricted marketable securities, less current portion		4,648		6,346
Goodwill		159,632		68,492
Other intangible assets, net		87,086		48,902
Other long-term assets		50,079		11,340
Total assets	\$	1,116,484	\$	1,051,104
<b>Liabilities and Stockholders Equity</b>				
Current liabilities:				
Accounts payable	\$	53,803	\$	35,969
Accrued liabilities		111,149		106,392
Total current liabilities		164,952		142,361
¾% Convertible Senior Subordinated Notes		225,000		225,000
3% Convertible Subordinated Notes		35,190		35,190
Other long-term liabilities		16,059		3,662
Deferred tax liabilities		9,215		
Commitments and contingencies (Note 16)				
Stockholders equity:				
Common stock		112		110
Additional paid-in capital		163,636		153,174
Deferred stock-based compensation		(3,517)		(2,713)
Accumulated other comprehensive income, net of taxes		81		3,000
Retained earnings		505,756		491,320
Total stockholders equity		666,068		644,891
Total liabilities and stockholders equity	\$	1,116,484	\$	1,051,104

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

ADAPTEC, INC.  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(unaudited)

	Nine-Month Period Ended			
	December 31, 2004		December 31, 2003	
	(in thousands)			
<b>Cash Flows From Operating Activities:</b>				
Net income	\$	14,436	\$	38,050
Adjustments to reconcile net income to net cash provided by operating activities:				
Non-cash restructuring charges		109		105
Write-off of acquired in-process technology		5,200		3,649
Stock-based compensation		2,807		3,259
Non-cash effect of tax settlement		(26,009)		
Loss on extinguishment of debt				3,734
Non-cash portion of DPT settlement gain				(18,256)
Gain on sale of long-lived assets		(2,755)		
Depreciation and amortization		34,987		40,431
Deferred income taxes		(40)		(5,895)
Other non-cash items		(12)		551
Changes in operating assets and liabilities (net of acquired businesses):		(44,673)		3,006
<b>Net Cash Provided by (Used for) Operating Activities</b>	\$	(15,950)	\$	68,634
<b>Cash Flows From Investing Activities:</b>				
Payment of general holdback in connection with acquisition of Platys				(195)
Payment of holdback in connection with acquisition of Eurologic		(2,279)		
Purchases of businesses, net of cash acquired		(123,978)		(29,884)
Purchases of restricted marketable securities				(7,915)
Maturities of restricted marketable securities		2,213		3,750
Purchases of property and equipment		(12,553)		(5,859)
Proceeds from sale of long-lived assets		9,577		
Purchases of marketable securities		(252,649)		(530,390)
Sales of marketable securities		297,424		455,145
Maturities of marketable securities		65,541		78,918
<b>Net Cash Used for Investing Activities</b>		(16,704)		(36,430)
<b>Cash Flows From Financing Activities:</b>				
Proceeds from the issuance of ¾% Convertible Senior Subordinated Notes, net of issuance costs of \$6,750				218,250
Repurchases and redemption of long-term debt				(207,243)
Purchase of convertible bond hedge				(64,140)
Proceeds from issuance of warrant				30,390
Proceeds from issuance of common stock		5,446		4,130
Installment payment on acquisition of software licenses				(3,633)
<b>Net Cash Provided by (Used for) Financing Activities</b>		5,446		(22,246)
<b>Effect of Foreign Currency Translation on Cash and Cash Equivalents</b>		823		911
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>		(26,385)		10,869
<b>Cash and Cash Equivalents at Beginning of Period</b>		119,113		149,373
<b>Cash and Cash Equivalents at End of Period</b>	\$	92,728	\$	160,242

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.



**ADAPTEC, INC.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Basis of Presentation**

In the opinion of management, the accompanying Unaudited Condensed Consolidated Interim Financial Statements ( financial statements ) of Adaptec, Inc. and its wholly-owned subsidiaries (collectively, the Company ) have been prepared on a consistent basis with the March 31, 2004 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly present the information set forth therein. The financial statements have been prepared in accordance with the regulations of the SEC, and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended March 31, 2004, which were included in the Company s Current Report on Form 8-K, which was filed with the SEC on December 7, 2004. The third quarters of fiscal 2005 and 2004 ended December 31, 2004 and December 26, 2003, respectively. For presentation purposes, the accompanying financial statements have been shown as ending on the last day of the calendar month. Certain amounts reported in previous periods have been reclassified to conform to the current period presentation. The results of operations for the third quarter and first nine months of fiscal 2005 are not necessarily indicative of the results to be expected for the entire fiscal year. In the first and second quarters of fiscal 2005, the Company reorganized its reportable segments, as described more fully in Note 18.

In the third quarter of fiscal 2005, the Company adopted EITF 04-08 which required restatement of previously reported earnings per share as further discussed in Note 13.

The glossary of acronyms and accounting rules and regulations referred to within this Quarterly Report on Form 10-Q is listed in alphabetical order in Note 21.

**2. Recent Accounting Pronouncements**

In December 2004, the FASB issued SFAS No. 123(R). This statement replaces SFAS No. 123, amends SFAS No. 95 and supersedes APB Opinion No. 25. SFAS No. 123(R) requires companies to apply a fair-value based measurement method in accounting for share-based payment transactions with employees and to record compensation expense for all stock awards granted, and to awards modified, repurchased or cancelled after the required effective date. In addition, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. SFAS No. 123(R) will be effective for quarterly periods beginning after June 15, 2005, which is the Company s second quarter of fiscal 2006. This statement will have a significant impact on the Company s results of operations as the Company will be required to record compensation expense rather than disclose the impact on the Company s results of operations within its footnotes (see Note 3 below).

At its March 2004 meeting, the EITF reached a consensus on recognition and measurement guidance previously discussed under EITF 03-01. The consensus clarified the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under SFAS No. 115 and to investments accounted for under the cost method or the equity method. In September 2004, the FASB delayed the recognition and measurement guidance to be applied to



## ADAPTEC, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)  
(unaudited)

## 2. Recent Accounting Pronouncements (Continued)

other-than-temporary impairment evaluations. The FASB expects to issue additional implementation guidance with respect to debt securities that are impaired solely due to interest rates and/or sector spreads.

## 3. Stock-Based Compensation

The Company accounts for stock-based compensation using the intrinsic-value-based method, which is in accordance with APB Opinion No. 25 as interpreted by FIN 44, and complies with the disclosure provisions of SFAS No. 148, an amendment of SFAS No. 123. The following table illustrates the effect on net income (loss) and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to employee and director stock option plans, including shares issued under the Company's ESPP, collectively called "options," for all periods presented:

	Three-Month Period Ended				Nine-Month Period Ended						
	December 31, 2004		December 31, 2003		December 31, 2004		December 31, 2003				
	(in thousands, except per share amounts)										
Net income (loss), as reported	\$	22,489		\$	(3,013)		\$	14,436		\$	38,050
Add: Deferred stock-based compensation expense included in reported net income (loss)		775			892			2,453			2,991
Deduct: Total stock-based compensation expense determined under the fair value-based method, net of tax		(3,837)			(6,025)			(9,923)			(21,186)
Pro forma net income (loss)	\$	19,427		\$	(8,146)		\$	6,966		\$	19,855
Basic net income (loss) per share:											
As reported	\$	0.20		\$	(0.03)		\$	0.13		\$	0.35
Pro forma	\$	0.17		\$	(0.07)						