ADAPTEC INC
Form 10-Q/A
January 15, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended September 30, 2002 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 0-15071

ADAPTEC, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**94-2748530**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
691 S. MILPITAS BLVD., MILPITAS, CALIFORNIA	**95035**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code **(408) 945-8600**

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 ý No o

The number of shares outstanding of Adaptec's common stock as of November 1, 2002 was 107,215,438.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
	(in thousands, except per share amounts)			
Net revenues	$ 85,709	$ 95,305	$ 193,555	$ 205,488
Cost of revenues	39,519	48,831	86,803	107,083
Gross profit	46,190	46,474	106,752	98,405
Operating expenses:				
Research and development	29,403	23,970	60,619	50,211
Selling, marketing and administrative	23,389	22,323	47,799	48,693
Amortization of goodwill and intangible assets	3,743	14,024	7,487	27,603
Write-off of acquired in-process technology		53,370		53,370
Restructuring charges	7,139		7,139	6,912
Other charges	528		528	4,092
Total operating expenses	64,202	113,687	123,572	190,881

	Three Month Period Ended		Six Month Period Ended	
Loss from operations	(18,012)	(67,213)	(16,820)	(92,476)
Interest and other income	9,784	8,889	18,976	19,437
Interest expense	(4,011)	(3,058)	(9,185)	(6,071)
Loss from continuing operations before provision for (benefit from) income taxes	(12,239)	(61,382)	(7,029)	(79,110)
Provision for (benefit from) income taxes	(1,419)	1,481	1,237	2,256
Net loss from continuing operations	(10,820)	(62,863)	(8,266)	(81,366)
Net income from discontinued operations, net of taxes				495
Net loss	$ (10,820)	$ (62,863)	$ (8,266)	$ (80,871)
Net income (loss) per share:				
Basic:				
Continuing operations	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Discontinued operations	$	$	$	$ 0.00
Net loss	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Diluted:				
Continuing operations	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Discontinued operations	$	$	$	$ 0.00
Net loss	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Shares used in computing net income (loss) per share:				
Basic	106,550	100,895	106,264	99,992
Diluted	106,550	100,895	106,264	99,992

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADAPTEC, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)

	September 30, 2002	March 31, 2002
	(in thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 157,002	$ 331,324
Marketable securities	550,147	472,335
Restricted marketable securities	7,441	7,387
Accounts receivable, net	47,474	44,790
Inventories	32,419	30,172
Deferred income taxes	24,798	26,442
Prepaid expenses	15,106	18,383

	September 30, 2002	March 31, 2002
Other current assets	14,685	15,965
Total current assets	849,072	946,798
Property and equipment, net	84,609	94,833
Restricted marketable securities, less current portion	10,897	13,825
Goodwill	53,854	45,684
Intangible assets	56,747	73,902
Other long-term assets	27,799	32,919
Total assets	$ 1,082,978	$ 1,207,961
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 24,054	$ 18,458
Accrued liabilities	121,774	134,947
Total current liabilities	145,828	153,405
$4^3/_4$% Convertible Subordinated Notes	82,445	202,860
3% Convertible Subordinated Notes	250,000	250,000
Other long-term liabilities	2,755	4,765
Contingencies (Note 10)		
Stockholders' equity:		
Common stock	107	106
Additional paid-in capital	174,423	171,374
Deferred stock-based compensation	(13,520)	(21,131)
Accumulated other comprehensive income, net of tax	5,367	2,743
Retained earnings	435,573	443,839
Total stockholders' equity	601,950	596,931
Total liabilities and stockholders' equity	$ 1,082,978	$ 1,207,961

See accompanying Notes to Condensed Consolidated Financial Statements.

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

	Six Month Period Ended	
	September 30, 2002	**September 30, 2001**
	(in thousands)	

	Six Month Period Ended	
Net Cash Provided by Operating Activities	$ 29,121	$ 8,249
Cash Flows From Investing Activities:		
Payment of general holdback in connection with acquisition of Platys	(10,640)	
Purchases of certain net assets in connection with acquisition of Platys, net of cash acquired		(35,861)
Purchases of other investments	(1,000)	
Purchases of property and equipment	(5,016)	(5,858)
Net proceeds from sales of properties		942
Purchases of marketable securities	(355,757)	(239,462)
Sales of marketable securities	227,422	181,218
Maturities of marketable securities	52,800	61,218
Net Cash Used for Investing Activities	(92,191)	(37,803)
Cash Flows From Financing Activities:		
Proceeds from issuance of common stock	5,061	4,078
Repurchases of long-term debt	(116,313)	
Net Cash Provided by (Used for) Financing Activities	(111,252)	4,078
Net Cash Used for Discontinued Operations		(30,703)
Net Decrease in Cash and Cash Equivalents	(174,322)	(56,179)
Cash and Cash Equivalents at Beginning of Period	331,324	207,644
Cash and Cash Equivalents at End of Period	$ 157,002	$ 151,465

See accompanying Notes to Condensed Consolidated Financial Statements.

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ADAPTEC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated interim financial statements of Adaptec, Inc. and its wholly-owned subsidiaries (collectively the "Company") have been prepared on a consistent basis with the March 31, 2002 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, except as described in Notes 3, 7, 12 and 13, necessary to provide a fair statement of the results for the interim periods presented. These unaudited condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2002. The second quarters of fiscal 2003 and fiscal 2002 ended September 27, 2002 and September 28, 2001, respectively. For presentation purposes, the accompanying financial statements have been shown as ending on the last day of the calendar month. The results of operations for the second quarter and first half of fiscal 2003 are not necessarily indicative of the results to be expected for the entire fiscal year.

On April 12, 2001, the Company's Board of Directors formally approved a plan to spin-off the Software segment, Roxio, Inc., ("Roxio") into a fully independent and separate company. The Company effected the spin-off after the close of business on May 11, 2001 by issuing a dividend of Roxio common stock to the Company's stockholders of record as of April 30, 2001. As a result of the spin-off, the Company's historical condensed consolidated financial statements have been restated to account for Roxio as discontinued operations for all periods presented in accordance with Accounting Principles Board ("APB") Opinion No. 30, "Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Unless otherwise indicated, the Notes to Unaudited Condensed Consolidated Financial Statements ("Notes") relate to the discussion of the Company's continuing operations.

The Company adopted Emerging Issues Task Force ("EITF") Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" in January 2002. As a result, certain consideration paid to distributors is now classified as an offset to revenue rather than an operating expense. Prior period financial statements have been reclassified to conform to this presentation.

2. Recent Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 146, "Accounting for Exit or Disposal Activities." SFAS No. 146 addresses significant issues regarding the recognition, measurement and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the EITF has set forth in Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The scope of SFAS No. 146 also includes (1) costs related to terminating a contract that is not a capital lease and (2) termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred compensation contract. SFAS No. 146 will be effective for fiscal years beginning after December 31, 2002. The Company will adopt SFAS No. 146 on April 1, 2003 and the Company has not yet determined the impact of SFAS No. 146 on its results of operations or financial position.

In May 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 eliminates Statement No. 4 (and Statement No. 64, as it amends Statement No. 4), which requires gains and losses from extinguishments of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result, the criteria in APB Opinion No. 30 will now be used to classify those gains and losses. SFAS No. 145 amends FASB Statement No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions are accounted for in the same manner as sale-leaseback transactions. This amendment is consistent with the FASB's goal of requiring similar accounting treatment for transactions that have similar economic effects. In addition, SFAS No. 145 makes technical corrections to existing pronouncements. While those corrections are not substantive in nature, in some instances, they may change accounting practice. This statement is effective for fiscal years beginning after May 2002 for the provisions related to the rescission of Statements Nos. 4 and 64, and for all transactions entered into beginning May 2002 for the provision related to the amendment of Statement No. 13 although early adoption is permitted. The Company elected to adopt SFAS No. 145 effective fiscal 2002, and as a result, the Company has included the gain on extinguishment of debt of $2.2 million (net of unamortized debt issuance costs of $0.5 million) in "Interest and Other Income" for the second quarter of fiscal 2003 and the gain on extinguishment of debt of $3.3 million (net of unamortized debt issuance costs of $0.8 million) in "Interest and Other Income" for the first half of fiscal 2003.

3. Business Combination

In August 2001, the Company purchased Platys Communications, Inc. ("Platys"), a developer of Internet Protocol ("IP") storage solutions. The acquisition was accounted for under SFAS No. 141 and certain specified provisions of SFAS No. 142. The results of operations of Platys were included in the Company's Unaudited Condensed Consolidated Statements of Operations for the second quarter and first half of fiscal 2003. If the Company had acquired Platys at the beginning of the second quarter and first half of fiscal 2002, the Company's unaudited pro forma net revenues, net loss and net loss per share from continuing operations would have been as follows:

	Three Month Period Ended September 30, 2001	Six Month Period Ended September 30, 2001

		Three Month Period Ended September 30, 2001		Six Month Period Ended September 30, 2001
		(in thousands, except per share amounts)		
Net revenues	$	95,315	$	205,608
Net loss	$	(66,912)	$	(88,505)
Net loss per share:				
Basic	$	(0.65)	$	(0.85)
Diluted	$	(0.65)	$	(0.85)

As part of the purchase agreement, $15.0 million of the cash payment was held back (the "General Holdback") for unknown liabilities that may have existed as of the acquisition date. The General Holdback, which was included as part of the purchase price, was included in accrued liabilities as of March 31, 2002. As of September 30, 2002, the Company paid $10.6 million of the General Holdback to the former Platys stockholders. The remaining $4.4 million has been retained as the Company submitted a written notice of claim to the Representative of the Platys shareholders in August 2002. While the Company believes that its claims are meritorious, the Company cannot predict with certainty how the matter will be resolved.

4. Balance Sheets Details

Inventories are stated at the lower of cost (first-in, first-out) or market. The components of net inventories were as follows:

		September 30, 2002		March 31, 2002
		(in thousands)		
Raw materials	$	7,667	$	8,760
Work-in-process		8,168		4,088
Finished goods		16,584		17,324
Total	$	32,419	$	30,172

5. Line of Credit

In May 2001, the Company obtained an unsecured $20.0 million revolving line of credit. The line of credit has a term, as amended, through August 2003 and bears interest at a "Prime Rate" in effect or at a "Fixed Term Rate" as elected by the Company. Prime Rate refers to the rate of interest as established by the line of credit provider while the Fixed Term Rate is determined in relation to the LIBOR. In addition, the Company is charged a fee equal to 0.15% per annum on the average daily unused amount of the line of credit. Under the terms of the line of credit, the Company is required to maintain certain financial ratios, among other restrictive covenants. As of September 30, 2002, the Company was in compliance with all such covenants. No borrowings were made under the line of credit during the first half of fiscal 2003.

6. Long-Term Liability

During the first half of fiscal 2003, the Company repurchased $4^3/_4$% Convertible Subordinated Notes with a book value of $120.4 million in principal amount for an aggregate price of $116.3 million, resulting in a gain on extinguishment of debt of $3.3 million (net of unamortized debt issuance costs of $0.8 million). The Company elected to adopt SFAS No. 145 effective fiscal 2002, and as a result, the gain on extinguishment of debt has been included in "Interest and Other Income" (Note 11).

7. Accounting Change

Effective April 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach, whereby goodwill will be evaluated annually and whenever events or circumstances occur which indicate that goodwill might be impaired. In accordance with SFAS No. 142, the Company discontinued amortizing the remaining goodwill balances as of the beginning of fiscal 2003. All remaining and future acquired goodwill will be subject to annual impairment tests, or earlier if indicators of potential impairment exist, using a fair-value-based approach. All other intangible assets will continue to be amortized over their estimated useful lives and assessed for impairment under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company has completed the transitional impairment test required upon the adoption of SFAS No. 142. As of September 30, 2002, no impairment of goodwill and intangible assets has been recognized. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

Upon adoption of SFAS No. 142, distribution network, acquired employees and original equipment manufactures ("OEM") relationships no longer meet the definition of identifiable intangible assets. As a result, the net balance of $8.2 million has been reclassified to goodwill (Note 8 and 9).

The following table discloses the effect on net loss and basic and diluted net loss per share as if the Company accounted for its goodwill (including distribution networks, acquired employees and OEM relationships) under SFAS No. 142 for all periods presented:

	Three Month Period Ended		**Six Month Period Ended**	
	September 30, 2002	**September 30, 2001**	**September 30, 2002**	**September 30, 2001**
	(in thousands, except per share amounts)			
Reported net loss	$ (10,820)	$ (62,863)	$ (8,266)	$ (80,871)
Add: Amortization of goodwill, net of tax		10,115		20,229
Adjusted net loss	$ (10,820)	$ (52,748)	$ (8,266)	$ (60,642)
Basic net loss per share:				
Reported net loss per share	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Add: Amortization of goodwill, net of tax	$	$ 0.10	$	$ 0.20
Adjusted net loss per share	$ (0.10)	$ (0.52)	$ (0.08)	$ (0.61)
Diluted net loss per share:				
Reported net loss per share	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Add: Amortization of goodwill, net of tax	$	$ 0.10	$	$ 0.20
Adjusted net loss per share	$ (0.10)	$ (0.52)	$ (0.08)	$ (0.61)

8. Goodwill

Goodwill by operating segments is as follows:

	September 30, 2002	**March 31, 2002**
	(in thousands)	
Segments:		
SSG	$ 8,187	$
DSG		
SNG	45,667	45,684
Other		
Total	$ 53,854	$ 45,684

	September 30, 2002	March 31, 2002

During the second quarter and first half of fiscal 2003, no goodwill was acquired, impaired or written off.

9. Intangible Assets

All intangible assets are being amortized using the straight-line method over their estimated useful lives ranging from 3-5 years. The components of intangible assets are as follows:

	September 30, 2002		March 31, 2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in thousands)			
Acquisition related intangible assets:				
Patents and core technology	$ 53,654	$ (30,808)	$ 53,654	$ (24,099)
Covenants-not-to-compete	4,670	(1,686)	4,670	(908)
Distribution network			8,849	(5,280)
Acquired employees			6,507	(3,882)
OEM relationships			4,943	(2,950)
Subtotal	58,324	(32,494)	78,623	(37,119)
Intellectual property	42,192	(11,275)	42,192	(9,794)
Total	$ 100,516	$ (43,769)	$ 120,815	$ (46,913)

Amortization of acquisition related intangible assets is included in "Amortization of goodwill and intangible assets" in the Statement of Operations. Amortization of acquisition-related intangible assets was $3.7 million and $4.8 million for the second quarter of fiscal 2003 and 2002, respectively. Amortization of acquisition-related intangible assets was $7.5 million and $9.1 million for the first half of fiscal 2003 and 2002, respectively. Amortization of intellectual property is reflected in the Company's "Gross profit" in the Statement of Operations. Amortization of intellectual property was $1.2 million and $0.3 million for the second quarter of fiscal 2003 and 2002, respectively. Amortization of intellectual property was $1.5 million and $0.7 million for the first half of fiscal 2003 and 2002, respectively.

During the second quarter and first half of fiscal 2003, no intangible assets were acquired, impaired or written off. Based on the Company's intangible assets at September 30, 2002, the annual amortization expense is expected to be as follows:

	Estimated Amortization Expense	
	Acquisition-related intangibles	Intellectual property
	(in thousands)	
Fiscal Years:		
2003 (remaining six months)	$ 7,485	$ 3,281
2004	12,372	6,561
2005	4,407	6,438

	Estimated Amortization Expense	
2006	1,566	6,316
2007		6,316
Total	$ 25,830	$ 28,912

10. Contingencies

In December 1999, the Company purchased Distributed Processing Technology Corp. ("DPT") and as part of the purchase agreement, $18.5 million of the purchase price was held back, (the "Holdback Amount") from former DPT stockholders, for unknown liabilities that may have existed as of the acquisition date. For accounting purposes, the Holdback Amount was included as part of the acquisition purchase price. Subsequent to the date of purchase, the Company determined that certain representations and warranties made by the DPT stockholders were incomplete or inaccurate, which resulted in a loss of revenues and additional expenses to the Company. In addition, certain DPT products were found to be defective. In December 2000, the Company filed a claim against the DPT stockholders for the entire Holdback Amount of $18.5 million. In January 2001, the DPT stockholders notified the Company as to their objection to the Company's claim. Under the terms of the purchase agreement, the Company's claim has been submitted to arbitration. The arbitration hearings began in October 2002. While the Company believes that its claims are meritorious, the Company cannot predict with certainty how the matter will be resolved.

On June 27, 2000, the Company received a statutory notice of deficiency from the IRS with respect to its federal income tax returns for fiscal 1994 to 1996. The Company filed a Petition with the United States Tax Court on September 25, 2000, contesting the asserted deficiencies. In December 2001, settlement agreements were filed with the U.S. Tax Court reflecting a total of $9.0 million of adjustments and an allowance of $0.5 million in additional tax credits. Only procedural matters remain to complete the tax audit for these years. The outcome did not have a material effect on the Company's financial position or results of operations, as a sufficient tax provision had been made.

On December 15, 2000, the Company received a statutory notice of deficiency from the IRS with respect to its federal income tax return for fiscal 1997. The Company filed a Petition with the United States Tax Court on March 14, 2001, contesting the asserted deficiencies. Settlement agreements have been filed with the U.S. Tax Court on all but one issue. The Company believes that the final outcome of all issues will not have a material effect on the Company's financial position or results of operations, as it believes that it has made sufficient tax provisions. However, the Company cannot predict with certainty how these matters will be resolved and whether it will be required to make additional payments.

In addition, the IRS is currently auditing the Company's federal income tax returns for fiscal 1998 and 1999. The Company believes that it has provided sufficient taxes for these years and the ultimate outcome of the IRS audits will not have a material adverse impact on its financial position or results of operations. However, the Company cannot predict with certainty how these matters will be resolved and whether it will be required to make additional payments.

The Company is a party to other litigation matters and claims which are normal in the course of its operations, and while the results of such litigation matters and claims cannot be predicted with certainty, the Company believes that the final outcome of such matters will not have a material adverse impact on its financial position or results of operations.

11. Statements of Operations Details

The components of interest and other income for the second quarter and first half of fiscal 2003 and 2002, were as follows:

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
	(in thousands)			

	Three Month Period Ended		Six Month Period Ended	
Interest income	$ 7,587	$ 8,889	$ 15,679	$ 19,437
Gain on extinguishment of debt	2,197		3,297	
Total	$ 9,784	$ 8,889	$ 18,976	$ 19,437

12. Restructuring Charges

Second Quarter of Fiscal 2003 Restructuring Plan: In July 2002, the Company announced a restructuring program to reduce expenses and streamline operations in each of its segments and recorded a restructuring charge of $6.2 million. The restructuring charge included $4.0 million for severance and benefits related to the involuntary termination of approximately 170 employees. These terminated employees were primarily in the manufacturing, administrative, sales and marketing and engineering functions. Approximately 73%, 24%, 2% and 1% were based in the United States, Singapore, Europe and Japan, respectively. The Company recorded $0.5 million pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities in New Hampshire and Colorado. The Company wrote-off leasehold improvements, furniture and fixtures and equipment with a net book value of $1.7 million. These assets were taken out of service, as they were deemed unnecessary due to the reductions in workforce.

The following table sets forth an analysis of the components of the second quarter of fiscal 2003 restructuring charge and payments made against the reserve through September 30, 2002:

	Severance And Benefits	Asset Write-offs	Other Charges	Total
	(in thousands)			
Restructuring provision:				
Severance and benefits	$ 3,965	$	$	$ 3,965
Accrued lease costs			459	459
Property and equipment write-off		1,681		1,681
Other charges			50	50
Total	3,965	1,681	509	6,155
Cash paid	(1,968)		(58)	(2,026)
Non-cash charges		(1,681)		(1,681)
Reserve balance at September 30, 2002	$ 1,997	$	$ 451	$ 2,448

The Company anticipates that the remaining restructuring reserve balance of $2.4 million will be substantially paid out by the second quarter of fiscal 2004. The longer term payments relate to lease obligations.

Fourth Quarter of Fiscal 2002 Restructuring Plan: In March 2002, the Company announced a series of actions to reduce costs and tailor the Company's expenses to current revenues for each of its segments.

The Company recorded a restructuring charge of $3.8 million consisting of $2.7 million for severance and benefits related to the involuntary termination of approximately 70 employees, $0.4 million related to the termination of operating leases for facilities and equipment, $0.5 million accrual for legal, accounting and other similar costs and write-down of $0.2 million of leasehold improvements, furniture and fixtures and equipment. The terminated employees were primarily in the manufacturing, administrative, sales and marketing and engineering functions. Approximately 67% of these terminated employees were based in the United States and approximately 33% were based in Belgium. The assets were taken out of service as they were deemed unnecessary due to the reductions in workforce.

The following table sets forth an analysis of the components of the fourth quarter of fiscal 2002 restructuring charge and the payments made against the reserve through September 30, 2002:

	Severance And Benefits	Asset Write-offs	Other Charges	Total
		(in thousands)		
Restructuring provision:				
Severance and benefits	$ 2,723	$	$	$ 2,723
Accrued lease costs			425	425
Property and equipment write-off		220		220
Other charges			465	465
Total	2,723	220	890	3,833
Cash paid	(324)			(324)
Non-cash charges		(220)		(220)
Reserve balance at March 31, 2002	2,399		890	3,289
Cash paid	(1,656)		(103)	(1,759)
Reserve balance at June 30, 2002	743		787	1,530
Cash paid	(359)		(91)	(450)
Reserve balance at September 30, 2002	$ 384	$	$ 696	$ 1,080

The Company anticipates that the remaining restructuring reserve balance of $1.1 million will be substantially paid out by the third quarter of fiscal 2004. The longer term payments relate to lease obligations.

First Quarter of Fiscal 2002 Restructuring Plan: In response to the economic slowdown, the Company implemented a restructuring plan in the first quarter of fiscal 2002 and recorded a restructuring charge of $6.2 million. The goal of the restructuring plan was to reduce costs and improve operating efficiencies in each of its segments in order to match the current business environment. The restructuring charge consisted of severance and benefits of $5.2 million related to the involuntary termination of approximately 325 employees. These terminated employees were primarily in the manufacturing, administrative, sales and marketing and engineering functions. Approximately 53% of these terminated employees were based in the United States, 43% in Singapore and 4% in other locations. Additionally, the Company accrued for lease costs of $0.2 million pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities in Florida that were vacated due to the reductions in workforce. The Company also wrote off leasehold improvements with a net book value of $0.4 million and production-related machinery and equipment with a net book value of $0.4 million. The assets were taken out of service as they were deemed unnecessary due to the reductions in workforce. The Company recorded a reduction to the fiscal

2002 first quarter restructuring provision of $0.4 million in the third quarter of fiscal 2002, as actual costs for severance and benefits were lower than originally anticipated.

In the second quarter of fiscal 2003, the Company recorded an additional $0.3 million charge consisting of accrued lease costs to the first quarter of fiscal 2002 restructuring provision.

The following table sets forth an analysis of the components of the first quarter of fiscal 2002 restructuring charge and the provision adjustments and payments made against the reserve through September 30, 2002:

	Severance And Benefits	Asset Write-offs	Other Charges	Total

	Severance And Benefits	Asset Write-offs	Other Charges	Total
		(in thousands)		
Restructuring provision:				
Severance and benefits	$ 5,174	$	$	$ 5,174
Accrued lease costs			219	219
Property and equipment write-off		811		811
Other charges			25	25
Total	5,174	811	244	6,229
Provision adjustment	(387)			(387)
Cash paid	(4,787)		(40)	(4,827)
Non-cash charges		(811)		(811)
Reserve balance at March 31, 2002			204	204
Cash paid			(116)	(116)
Reserve balance at June 30, 2002			88	88
Provision adjustment			347	347
Cash paid			(126)	(126)
Reserve balance at September 30, 2002	$	$	$ 309	$ 309

The Company anticipates that the remaining restructuring reserve balance relating to lease obligations of $0.3 million will be substantially paid out by the second quarter of fiscal 2004.

Fourth Quarter of Fiscal 2001 Restructuring Plan: In response to the economic slowdown, the Company's management implemented a restructuring plan in the fourth quarter of fiscal 2001 to reduce costs and improve operating efficiencies across each of the Company's segments, and the Company recorded a restructuring charge of $9.9 million. The restructuring charge consisted primarily of severance and benefits of $6.1 million related to the involuntary termination of approximately 275 employees. These employees were primarily in manufacturing and engineering functions, of which approximately 78% were based in the United States, 19% were based in Singapore and 3% were based in Belgium. Additionally, the Company accrued for lease costs of $1.4 million pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities in California, New Hampshire, Florida and Belgium that were vacated due to the reductions in workforce. The Company wrote off leasehold improvements, furniture and fixtures, and production-related machinery and equipment with net book values of $1.2 million, $0.4 million and $0.3 million, respectively. The assets were taken out of service as they were deemed unnecessary due to the reductions in workforce. In addition, the Company wrote down certain manufacturing equipment by $0.3 million to its estimated realizable value of $0.5 million. The manufacturing equipment was taken out of service and is expected to be sold in fiscal 2003. The Company accrued for legal, accounting and consulting costs of $0.2 million related to the restructuring.

In the first quarter of fiscal 2002, the Company recorded an additional $0.7 million charge to the fiscal 2001 restructuring provision. The adjustments included accrued lease costs of $0.5 million, and the Company wrote down an additional $0.3 million of the estimated realizable value of certain manufacturing equipment identified in the fourth quarter of fiscal 2001 restructuring provision. These adjustments were offset by a decrease in severance and benefits of $0.1 million as actual costs were lower than originally anticipated. In the third quarter of fiscal 2002, the Company recorded a net reduction to the fourth quarter of fiscal 2001 restructuring provision of $0.4 million. The third quarter adjustment included a $0.6 million reduction in the restructuring provision as actual severance and benefit costs were lower than originally anticipated as well as an additional $0.2 million charge for the estimated realizable value of certain manufacturing equipment.

In the second quarter of fiscal 2003, the Company recorded an additional $0.6 million charge to the fourth quarter of fiscal 2001 restructuring provision. The adjustments included accrued lease costs of $0.4 million and the Company wrote down an additional $0.2 million of the estimated realizable value of certain manufacturing equipment that is being held for sale. The Company subleased a facility in California through April 2008. The estimated future sublease income will not be sufficient to cover the estimated future obligations for the non-cancelable lease payments. The Company accrued $0.4 million associated with the estimated loss through the end of the lease term.

The following table sets forth an analysis of the components of the fourth quarter of fiscal 2001 restructuring charge and the provision adjustments and payments made against the reserve through September 30, 2002:

	Severance And Benefits	Asset Write-offs	Other Charges	Total
		(in thousands)		
Restructuring provision:				
Severance and benefits	$ 6,083	$	$	$ 6,083
Accrued lease costs			1,407	1,407
Property and equipment write-off		2,169		2,169
Other charges			245	245
Total	6,083	2,169	1,652	9,904
Cash paid	(2,264)		(48)	(2,312)
Non-cash charges		(2,169)		(2,169)
Reserve balance at March 31, 2001	3,819		1,604	5,423
Provision adjustment	(680)	464	506	290
Cash paid	(3,139)		(1,359)	(4,498)
Non-cash charges		(464)		(464)
Reserve balance at March 31, 2002			751	751
Cash paid			(191)	(191)
Reserve balance at June 30, 2002			560	560
Provision adjustment		170	468	638
Cash paid			(81)	(81)
Non-cash charges		(170)		(170)
Reserve balance at September 30, 2002	$	$	$ 947	$ 947

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The Company anticipates that the remaining restructuring reserve balance relating to lease obligations of $0.9 million will be substantially paid out by the first quarter of fiscal 2009.

13. Other Charges

Other charges consisted of asset impairment charges. The Company holds minority investments in certain non-public companies. The Company regularly monitors these minority investments for impairment and records reductions in the carrying values when necessary. Circumstances that indicate an other than temporary decline include subsequent "down" financing rounds, decreases in quoted market prices and declines in operations of the issuer. In the second quarter of fiscal 2003, the Company recorded an impairment charge of $0.5 million related to a decline in the value of a minority investment deemed to be other than temporary. In the first half of fiscal 2002, the Company recorded an impairment charge of $4.1 million related to a decline in the value of a minority investment deemed to be other than temporary.

14. Income Taxes

Income tax provisions for interim periods were based on the Company's estimated annual income tax rate. In the second quarter of fiscal 2003, the Company recorded an income tax benefit of $1.4 million on a pretax loss of $12.2 million, resulting in an effective income tax rate of approximately 12%. The tax rate for the second quarter of 2003 differs from the combined U.S. Federal and state statutory income tax rate of 40%, primarily due to the amortization of non-goodwill acquisition related intangibles that are not fully deductible for tax purposes.

15. Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share gives effect to all potentially dilutive common shares outstanding during the period. In computing diluted net income

(loss) per share, the average stock price for the period is used in determining the number of shares assumed to be purchased upon the exercise of stock options.

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	**September 30, 2001**	**September 30, 2002**	**September 30, 2001**
	(in thousands, except per share amounts)			
Numerators:				
Net loss from continuing operations	$ (10,820)	$ (62,863)	$ (8,266)	$ (81,366)
Net income from discontinued operations				495
Net loss	$ (10,820)	$ (62,863)	$ (8,266)	$ (80,871)
Denominators:				
Weighted average shares outstanding basic	106,550	100,895	106,264	99,992
Effect of dilutive securities:				
Employee stock options and other				
Weighted average shares and potentially dilutive common shares outstanding diluted	106,550	100,895	106,264	99,992
Basic net income (loss) per share:				
Continuing operations	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Discontinued operations	$	$	$	$ 0.00
Net loss	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Diluted net income (loss) per share:				
Continuing operations	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)
Discontinued operations	$	$	$	$ 0.00
Net loss	$ (0.10)	$ (0.62)	$ (0.08)	$ (0.81)

Certain instruments potentially convertible into common stock were not included in the computation of diluted net income (loss) per share because they were anti-dilutive, as the Company was in a net loss position in all periods presented. The items excluded for the second quarter and first half of fiscal 2003 and 2002 were as follows:

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	**September 30, 2001**	**September 30, 2002**	**September 30, 2001**

	Three Month Period Ended		Six Month Period Ended	
Outstanding employee stock options	18,441,000	10,368,000	18,791,000	9,803,000
Warrants	1,310,000	1,160,000	1,310,000	1,160,000
$4^3/_4$% Convertible Subordinated Notes	3,022,000	6,033,000	3,552,000	6,033,000
3% Convertible Subordinated Notes	16,327,000		16,327,000	

16. Comprehensive Loss

The Company's comprehensive loss consisted of net loss and the changes in net unrealized gains on available-for-sale securities, net of tax.

The components of comprehensive loss, net of tax, for the second quarter and first half of fiscal 2003 and 2002, were as follows:

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
	(in thousands)			
Net loss	$ (10,820)	$ (62,863)	$ (8,266)	$ (80,871)
Increase in net unrealized gains on available-for-sale securities, net of tax	1,968	3,301	2,624	2,960
Comprehensive loss	$ (8,852)	$ (59,562)	$ (5,642)	$ (77,911)

Accumulated other comprehensive income presented in the accompanying Unaudited Condensed Consolidated Balance Sheets represents the net unrealized gains on available-for-sale securities, net of tax. The realization of these gains is dependent on the market value of the securities, which is subject to fluctuation. There can be no assurance if and when these gains will be realized.

17. Segment Reporting

The Company operates in three reportable segments: Storage Solutions Group ("SSG"), Desktop Solutions Group ("DSG") and Storage Networking Group ("SNG").

Storage Solutions Group ("SSG"): SSG's interface products enable the movement, storage and protection of data across a range of server platforms, direct attached storage servers, storage area network based servers, network attached storage ("NAS") devices and storage subsystems. These products bring Host Input/Output ("I/O"), including small computer system interface ("SCSI"), technology and redundant array of independent disks ("RAID") solutions to storage applications.

Desktop Solutions Group ("DSG"): DSG provides high-performance I/O, connectivity solutions for personal computing platforms, including notebook and desktop computers and consumer electronic devices. These products provide USB 2.0, FireWire/1394, and SCSI connectivity.

Storage Networking Group ("SNG"): SNG provides storage connectivity solutions for servers, storage devices, fabric switches and NAS devices. These products incorporate Internet Protocol SCSI ("iSCSI"), TCP/IP offload engine ("TOE") functionality, fibre channel and multi-port ethernet technologies. The Company is currently providing evaluation units of iSCSI and TOE products to OEM customers for integration and testing.

Other revenues and expenses: This includes unallocated corporate expenses, write-off of acquired in process technology, restructuring charges, other charges, interest and other income, and interest expense.

Summarized financial information on the Company's reportable segments is shown in the following table. There were no inter-segment revenues for the periods shown below. The Company does not separately track assets or depreciation by operating segments nor are the segments evaluated under these criteria.

	SSG	DSG	SNG	Other	Total
			(in thousands)		
Three Month Period Ended September 30, 2002:					
Net revenues	$ 70,939	$ 12,082	$ 2,688	$	$ 85,709
Segment income (loss)	7,471	(2,128)	(16,292)	(1,290)	(12,239)
Three Month Period Ended September 30, 2001:					
Net revenues	$ 80,818	$ 11,697	$ 2,790	$	$ 95,305
Segment loss	(4,279)	(762)	(9,681)	(46,660)	(61,382)
Six Month Period Ended September 30, 2002:					
Net revenues	$ 158,713	$ 28,426	$ 6,416	$	$ 193,555
Segment income (loss)	24,694	(1,581)	(33,167)	3,025	(7,029)
Six Month Period Ended September 30, 2001:					
Net revenues	$ 169,037	$ 30,503	$ 5,948	$	$ 205,488
Segment income (loss)	(12,142)	1,334	(18,695)	(49,607)	(79,110)

The following table presents the details of other expenses for the second quarter and first half of fiscal 2003 and 2002:

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
		(in thousands)		
Unallocated corporate expenses, net	$ 604	$ 879	$ 901	$ 1,401
Write-off of acquired in-process technology		(53,370)		(53,370)
Restructuring charges	(7,139)		(7,139)	(6,912)
Other charges	(528)		(528)	(4,092)
Interest and other income	9,784	8,889	18,976	19,437
Interest expense	(4,011)	(3,058)	(9,185)	(6,071)
Total	$ (1,290)	$ (46,660)	$ 3,025	$ (49,607)

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q/A contains forward-looking statements that involve risks and uncertainties. The statements contained in this document that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including, without limitation, statements regarding our expectations, beliefs, intentions or strategies regarding our business. We may identify these statements by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "might," "plan," "potential," "predict," "project," "should," "will," "would" and other similar expressions. All forward-looking statements included in this document are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements, except as may otherwise be required by law.

Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth in the "Risk Factors" section and elsewhere in this document. In evaluating our business, prospective investors should consider carefully these factors in addition to the other information set forth in this document.

While management believes that the discussion and analysis in this report is adequate for a fair presentation of the information presented, we recommend that you read this discussion and analysis in conjunction with our Annual Report on Form 10-K for the year ended March 31, 2002.

As discussed further in the "Roxio Spin-Off" section below, we successfully completed the spin-off of our Software segment, Roxio, Inc., or Roxio, into a fully independent and separate company in the first quarter of fiscal 2002. Unless otherwise indicated, the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section relates to our continuing operations.

Roxio Spin-Off

On April 12, 2001, our Board of Directors formally approved a plan to spin off our Software segment, Roxio, into a fully independent and separate company. Roxio is a provider of digital media software solutions that enable individuals to create, manage and move music, photos, video and data onto recordable CDs. Our Board of Directors declared a dividend of Roxio common stock to our stockholders of record on April 30, 2001. The dividend was distributed after the close of business on May 11, 2001, in the amount of 0.1646 shares of Roxio's common stock for each outstanding share of our common stock. We distributed all of the shares of Roxio's common stock, except for 190,936 shares that are retained by us for issuance upon the potential exercise of the warrants held by Agilent Technologies, Inc., or Agilent, to purchase shares of our common stock that were issued in connection with our development and marketing agreement with them which has since been terminated. The distribution of the shares of Roxio's common stock was intended to be tax-free to us and to our stockholders. The distribution of the Roxio common stock dividend on May 11, 2001 resulted in the elimination of our net assets of discontinued operations and a $74.5 million reduction of our retained earnings. Of this amount, $33.2 million represents the initial long-term funding we contributed to Roxio at the date of distribution.

As a result of the spin-off, our historical consolidated financial statements have been restated to account for Roxio as discontinued operations for all periods presented in accordance with Accounting Principles Board, or APB, Opinion No. 30, "Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions."

Under the Master Transitional Services Agreement we entered into with Roxio, we agreed to provide Roxio certain corporate support services, including information technology systems, supply chain, human resources administration, product order administration, customer service, buildings and facilities, and legal, finance and accounting services. Our fees for providing these services were typically the cost of

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providing the services, plus five percent. These transitional service arrangements generally had a term of one year following the legal separation other than a five-year facility lease for Roxio's corporate headquarters. Effective May 2002, Roxio vacated the facilities leased to them pursuant to an early termination right in the lease and occupancy license agreement. We no longer provide such transitional services to Roxio other than certain technical support functions.

In addition, we also entered into a Tax Sharing Agreement, or TSA, with Roxio for tax matters. The TSA provides for the allocation of income, losses, credits and other tax attributes prior to the distribution of the shares of Roxio common stock to our stockholders, and assigns certain responsibilities for administrative matters such as the filing of returns, payment of taxes due, retention of records and conducts of audits, examinations or similar proceedings. The TSA provides that we retain the risk of any modification of tax liabilities for periods prior to the distribution date. In addition, the TSA requires Roxio to indemnify us for certain taxes and similar obligations that we could incur if the distribution does not qualify for tax-free treatment due to certain events, such as an acquisition of a controlling interest in Roxio's common stock after the distribution, Roxio's failure to continue its business after the distribution or a repurchase of Roxio's common stock.

Results of Operations

The following table sets forth the items in the Condensed Consolidated Statements of Operations as a percentage of net revenues:

	Three Month Period Ended	Six Month Period Ended

	Three Month Period Ended		Six Month Period Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Net revenues (1)	100%	100%	100%	100%
Cost of revenues	46	51	45	52
Gross margin	54	49	55	48
Operating expenses:				
Research and development	34	25	31	24
Selling, marketing and administrative (1)	28	24	25	24
Amortization of goodwill and intangible assets	4	14	4	14
Write-off of acquired in-process technology		56		26
Restructuring charges	8		4	3
Other charges	1		0	2
Total operating expenses	75	119	64	93
Loss from operations	(21)	(70)	(9)	(45)
Interest and other income	11	9	10	10
Interest expense	(5)	(3)	(5)	(3)
Loss from continuing operations before provision for (benefit from) income taxes	(15)	(64)	(4)	(38)
Provision for (benefit from) income taxes	(2)	2	0	1
Net loss from continuing operations	(13)	(66)	(4)	(39)
Net income from discontinued operations, net		0		0
Net loss	(13)%	(66)%	(4)%	(39)%

Notes:

(1) We adopted EITF Issue No. 01-09, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" in January 2002. As a result, certain consideration

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paid to distributors is now classified as an offset to revenue rather than an operating expense. Prior period financial statements have been reclassified to conform to this presentation.

Business Segments. Our current reportable business segments are Storage Solutions Group, or SSG, Desktop Solutions Group, or DSG, and Storage Networking Group, or SNG. See "Item 1. Business" in Part I of our Annual Report on Form 10-K for the year ended March 31, 2002 and Note 17 to Notes to Condensed Consolidated Financial Statements included herein, for a detailed discussion of our reportable business segments.

Net Revenues. Net revenues were $85.7 million for the second quarter of fiscal 2003, a decrease of 10% from net revenues of $95.3 million for the second quarter of fiscal 2002. Net revenues were $193.6 million for the first half of fiscal 2003, a decrease of 6% from net revenues of $205.5 million for the first half of fiscal 2002.

Net revenues for the second quarter of fiscal 2003, were comprised of $70.9 million from the SSG segment, a decrease of 12% from the second quarter of fiscal 2002, $12.1 million from the DSG segment, an increase of 3% from the second quarter of fiscal 2002, and $2.7 million from the SNG segment, a decrease of 4% from the second quarter of fiscal 2002. Net revenues for the first half of fiscal 2003, were comprised of $158.7 million from the SSG segment, a decrease of 6% from the first half of fiscal 2002, $28.4 million from the DSG segment, a decrease of 7% from the first half of fiscal 2002, and $6.4 million from the SNG segment, an increase of 8% from the first half of fiscal 2002. Distributor owned inventories decreased by approximately 18% in the second quarter of fiscal 2003 from the first quarter of fiscal 2003 and increased by approximately 6% in the second quarter of fiscal 2003 as compared to the second quarter of fiscal 2002.

Net revenues from the SSG segment decreased for both the second quarter and first half of fiscal 2003, as compared to the corresponding periods of fiscal 2002, due to a decline in sales of our small computer system interface, or SCSI, products, which was partially offset by an increase in sales of our redundant array of independent disks, or RAID, and external storage products. Net revenues from our SCSI products declined due to a decline in sales volumes resulting from the continuing industry-wide slow down in capital spending. This slow down resulted in reduced end-user demand for servers and storage systems and caused our original equipment manufacturers, or OEM, and channel distributor customers to focus on reducing their inventories on hand. Net revenues from our RAID products increased primarily due to sales of our ServeRAID products to International Business Machines Corporation, or IBM, that began in the second quarter of fiscal 2003 following our entry into the ServeRAID agreement with IBM in the fourth quarter of fiscal 2002. In addition, we are transitioning from our Ultra 160 family of products, the major product family of our SSG segment, to our new family of Ultra 320 products. As part of this transition, we are beginning to see a shift in our product mix towards sales of a greater portion of RAID products as compared to SCSI products. We expect that this Ultra 320 transition will occur over a period of several quarters. Our future revenues will, over time, be significantly influenced by the extent to which we are successful in achieving design wins for, and ultimately selling, our Ultra 320 products to our current customers, and to new customers.

Net revenues from the DSG segment increased slightly for the second quarter of fiscal 2003, as compared to the second quarter of fiscal 2002, due to increased sales of our USB2.0 host-bus adapters and FireWire/1394 solutions. In addition, current quarter sales also included our analog video hardware/software products launched in the second quarter of fiscal 2003 and our Hubs product line launched in the third quarter of fiscal 2002. However, the increase in net revenues was partially offset by a decline in sales volumes of our SCSI-based desktop computer solutions due to continued decline in demand resulting from the penetration of other lower cost solutions. Net revenues from the DSG segment decreased for the first half of fiscal 2003 as compared with the first half of fiscal 2002 reflecting the continued decline in demand for our SCSI-based desktop computer solutions. The decline was partially offset by increased sales of our USB2.0 host-bus adapters, FireWire/1394 solutions and new product launches.

Net revenues from the SNG segment decreased slightly for the second quarter of fiscal 2003 as compared with the second quarter of fiscal 2002, primarily as a result of a decline in sales volumes of our fibre channel products to OEMs. Net revenues from the SNG segment increased for the first half of fiscal 2003 as compared with the first half of fiscal 2002 as a result of increased sales volumes of our network interface cards, or NICs, in the first quarter of fiscal 2003. However, increased net revenues from our NICs for the first half of fiscal 2003 are not necessarily indicative of results to be expected in the future.

Gross Margin. As a percentage of net revenues, gross margin was 54% and 55% for the second quarter and first half of fiscal 2003, respectively, compared to 49% and 48% for the corresponding periods of fiscal 2002, respectively. Gross margins improved year-over-year primarily as a result of additional cost of sales charges recorded in the preceding periods. Gross margins for the second quarter and first half of fiscal 2002 were unfavorably impacted by excess inventory charges, primarily due to customers delaying shipments or canceling orders as a result of the slowdown in their capital expenditures. We also recorded $1.6 million in minimum royalty fees payable to Agilent in the first half of fiscal 2002 in connection with the termination of our development and marketing agreement with them. Gross margins in the second quarter and first half of fiscal 2003 were favorably impacted by manufacturing-related cost reductions resulting from restructuring plans implemented in fiscal 2002. However, the favorable cost reductions were partially offset by $0.9 million of amortization expenses associated with the ServeRAID agreement with IBM. Our RAID products generally carry lower margins than our SCSI products, and to the extent that the revenues from our RAID products increase relative to revenues from our SCSI products, we would expect our margins to be impacted accordingly. In addition, we will continue to amortize expenses associated with the ServeRAID agreement with IBM for the next 4.5 years and our margins on the ServeRAID products are considerably lower than our other RAID products.

Research and Development Expenses. Research and development expenses were $29.4 million for the second quarter of fiscal 2003 compared to $24.0 million for the second quarter of fiscal 2002. As a percentage of net revenues, research and development expenses were 34% for the second quarter of 2003 compared to 25% for the second quarter of fiscal 2002. The increase in research and development expenses was due to the acquisition of Platys Communications, Inc., or Platys, in the second quarter of fiscal 2002. For the second quarter of fiscal 2003, we recorded three months of amortization of deferred compensation and three months of costs associated with the Platys workforce acquired, whereas for the second quarter of fiscal 2002, we incurred only one month of deferred compensation and costs associated with the acquired workforce. Secondarily, the increase was attributed to expenses associated with the ServeRAID agreement with IBM and our continued investment in Internet Protocol SCSI, or iSCSI, technology. Excluding the Platys deferred compensation charges, research and development expenses as a percentage of net revenues were 31% for the second quarter of fiscal 2003 and 24% for the second quarter of fiscal 2002. Research and development expenses were $60.6 million for the first half of fiscal 2003 compared to $50.2 million for the first half of fiscal 2002. As a percentage of net revenues, research and development expenses were 31% for the first half of 2003 compared to 24% for the first half of fiscal 2002. The increase in research and development expenses was due to five months of additional expenses associated with the Platys acquisition, including deferred compensation, as described above. Excluding the Platys deferred compensation charges, research and development expenses as a percentage of net revenues were 28% for the first half of fiscal 2003 and 24% for the first half of fiscal 2002. We remain committed to significant levels of research and development in order to enhance technological investments in our solutions. Our investment in research and development primarily focuses on developing new products for the Internet Protocol, or IP storage, RAID, SCSI and desktop computer markets.

Selling, Marketing and Administrative Expenses. Selling, marketing and administrative expenses were $23.4 million for the second quarter of fiscal 2003, compared to $22.3 million for the second quarter of fiscal 2002. As a percentage of net revenues, selling, marketing and administrative expenses were 28% for the second quarter of 2003, compared to 24% for the second quarter of 2002. The increase in selling, marketing and administrative expenses for the second quarter of fiscal 2003 was attributable to the Platys

acquisition. For the second quarter of fiscal 2003, we recorded three months of amortization of deferred compensation and three months of costs associated with the Platys workforce acquired, whereas for the second quarter of fiscal 2002, we incurred only one month of deferred compensation and costs associated with the acquired workforce. Excluding the Platys deferred compensation charges, selling, marketing and administrative expenses as a percentage of net revenues were 26% for the second quarter of fiscal 2003 and 23% for the second quarter of fiscal 2002. The increase in selling, marketing and administrative expenses for the second quarter of fiscal 2003 was partially offset by approximately $1.2 million of savings from reductions in our workforce, resulting from the restructuring plans implemented in the fourth quarter of fiscal 2002 and the second quarter of 2003. Selling, marketing and administrative expenses were $47.8 million for the first half of fiscal 2003 compared to $48.7 million for the first half of fiscal 2002. As a percentage of net revenues, selling, marketing and administrative expenses were 25% for the first half of fiscal 2003 compared to 24% for the first half of fiscal 2002. The decrease in selling, marketing and administrative, was attributable to approximately $2.9 million of savings from reductions in our workforce, resulting from restructuring plans implemented in the first and fourth quarter of fiscal 2002 and the second quarter of fiscal 2003. The decrease was partially offset by additional expenses, including deferred compensation, associated with the Platys acquisition described above. Excluding the Platys deferred compensation charges, selling, marketing and administrative expenses as a percentage of net revenues were 24% for both the first half of fiscal 2003 and 2002.

Amortization of Goodwill and Other Acquisition-Related Intangibles. Effective April 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach, whereby goodwill will be evaluated annually and whenever events or circumstances occur which indicate that goodwill might be impaired. In accordance with SFAS No. 142, the Company discontinued amortizing the remaining balances of goodwill as of the beginning of fiscal 2003. All remaining and future acquired goodwill will be subject to annual impairment tests, or earlier if indicators of potential impairment exist, using a fair-value-based approach. All other intangible assets will continue to be amortized over their estimated useful lives and assessed for impairment under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Company has completed the transitional impairment test required upon the adoption of SFAS No. 142. As of September 30, 2002, no impairment of goodwill and intangible assets has been recognized. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

Amortization of intangible assets was $3.7 million for the second quarter of fiscal 2003 and amortization of goodwill and intangible assets was $14.0 million for the second quarter of fiscal 2002, consisting of $9.2 million of amortization of goodwill and $4.8 million of amortization of intangible assets. Amortization of intangible assets was $7.5 million for the first half of fiscal 2003 and amortization of goodwill and intangible assets was $27.6 million for the first half of fiscal 2002, consisting of $18.5 million of amortization of goodwill and $9.1 million of amortization of intangibles. The decrease for both the second quarter and the first half of fiscal 2003 was attributable to the adoption of SFAS No. 142 as discussed above, partially offset by additional amortization of intangible assets recorded in connection with the acquisition of Platys of $0.9 million and $2.2 million in the second quarter and first half of fiscal 2003, respectively.

Write-off of Acquired In-Process Technology. In connection with our acquisition of Platys, approximately $53.4 million of the purchase price was allocated to the acquired in-process technology and written off in the second quarter of fiscal 2002. We identified research projects of Platys in areas for which technological feasibility had not been established and no alternative future uses existed. We acquired certain application specific integrated circuits, or ASIC, -based iSCSI technology for the Internet Protocol, or IP, storage solutions market. The value was determined by estimating the expected cash flows from the products once commercially viable, discounting the net cash flows to their present value, and then applying a percentage of completion to the calculated value as defined below.

Net Cash Flows. The net cash flows from the identified projects were based on estimates of revenues, cost of revenues, research and development expenses, selling, general and administrative expenses, royalty expenses and income taxes from the projects. We believe the assumptions used in the valuation as described below were reasonable at the time of the acquisition. The research and development expenses excluded costs to bring the projects to technological feasibility.

Net Revenues. The estimated net revenues were based on management projections of the projects. The business projections were compared with and found to be in line with industry analysts' forecasts of growth in substantially all of the relevant markets. Estimated total net revenues from the projects were expected to grow and peak after fiscal 2006, and decline thereafter as other new products are expected to become available. These projections were based on estimates of market size and growth, expected trends in technology, and the nature and expected timing of our new product introductions and our competitors.

Gross Margins. Projected gross margins were based on Platys' historical margins, which were in line with our SNG segment that acquired Platys.

Operating Expenses. Estimated operating expenses used in the valuation analysis of Platys included research and development expenses and selling, marketing and administrative expenses. In developing future expense estimates and evaluation of Platys' overall business model, an assessment of specific project results including both historical and expected direct expense levels and general industry metrics was conducted.

Research and Development Expenses. Estimated research and development expenses consist of the costs associated with activities undertaken to correct errors or keep products updated with current information (also referred to as "maintenance" research and development) after a product is available for general release to customers. These activities include routine changes and additions. The estimated maintenance research and development expense was 1.25% of net revenues for the in-process technologies throughout the estimation period.

Selling, Marketing and Administrative Expenses. Estimated selling, marketing and administrative expenses were consistent with Platys' historical cost structure in the first year net revenues were generated and decreased in later years to account for economies of scale as total net revenues increased.

Effective Tax Rate. The effective tax rate utilized in the analysis of the in-process technologies reflects a combined historical industry average for the United States Federal and state statutory income tax rates.

Royalty Rate. We applied a royalty charge of approximately 8% of the estimated net revenues for each in-process project to attribute value for dependency on existing technology.

Discount Rate. The cost of capital reflects the estimated time to complete and the level of risk involved. The cost of capital used in discounting the net cash flows ranged from approximately 40% to 60% for each of the projects.

Percentage of Completion. The percentage of completion was determined using costs incurred by Platys prior to the acquisition date compared to the estimated remaining research and development to be completed to bring the projects to technological feasibility. We estimated, as of the acquisition date, project completion ranged from 25% to 90%.

We expect to complete the initial projects and begin shipping products by the first half of fiscal 2004 with completion and commercialization of products from all of the in-process projects to occur by the end of fiscal 2004. The completion of all in-process projects will occur six months to one year after the estimated completion dates used for valuation of the assets acquired. The longer development period is due to customers requesting increased functionality be incorporated into the initial product. These additional functionalities have significantly increased the complexity and added to the development costs

of each of the in-process projects. We expect the costs to bring all of the various in-process projects to completion to be approximately $37.0 million. Development of these projects remains a significant risk to us due to the remaining effort to achieve technological feasibility, rapidly changing customer markets and significant competition. Failure to bring these products to market in a timely manner could adversely impact our sales, profitability and our future growth.

Restructuring Charges.

Second Quarter of Fiscal 2003 Restructuring Plan

In July 2002, we announced a restructuring program to reduce expenses and streamline operations in each of our segments and recorded restructuring charges of $6.2 million. The restructuring charge included $4.0 million for severance and benefits related to the involuntary termination of approximately 170 employees. These terminated employees were primarily in the manufacturing, administrative, sales and marketing and engineering functions. Approximately 73%, 24%, 2% and 1% were based in the United States, Singapore, Europe and Japan, respectively. We recorded $0.5 million pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities in New Hampshire and Colorado. We wrote-off leasehold improvements, furniture and fixtures and equipment with a net book value of $1.7 million. These assets were taken out of service, as they were deemed unnecessary due to the reductions in workforce.

In the second quarter of fiscal 2003, we recorded an additional $0.3 million charge consisting of accrued lease costs to the first quarter of fiscal 2002 restructuring provision. We also recorded an additional $0.6 million charge to the fourth quarter of fiscal 2001 restructuring provision. The adjustments included accrued lease costs of $0.4 million and we wrote down an additional $0.2 million of the estimated realizable value of certain manufacturing equipment that is being held for sale. The Company subleased a facility in California through April 2008. The estimated future sublease income will not be sufficient to cover the estimated future obligations for the non-cancelable lease payments. The Company accrued $0.4 million associated with the estimated loss through the end of the lease term.

As a result of our second quarter fiscal 2003 restructuring plan, we estimate that we will reduce our annual infrastructure spending by approximately $16.0 million, of which approximately 10%, 25% and 65% will be reflected as a reduction in cost of revenues, research and development expenses, and selling, marketing and administrative expenses, respectively.

Fourth Quarter of Fiscal 2002 Restructuring Plan

In March 2002, we announced a series of actions to reduce costs and tailor our expenses to current revenues for each of our segments. We recorded a restructuring charge of $3.8 million consisting of $2.7 million for severance and benefits related to the involuntary termination of approximately 70 employees, $0.4 million in losses on termination of operating leases for facilities and equipment, $0.5 million accrual for legal, accounting and other similar costs and write-down of $0.2 million of leasehold improvements, furniture and fixtures and equipment. The terminated employees were primarily in the manufacturing, administrative, sales, marketing and engineering functions. Approximately 67% of these terminated employees were based in the United States and approximately 33% were based in Belgium. The assets were taken out of service as they were deemed unnecessary due to the reductions in workforce.

First Quarter of Fiscal 2002 Restructuring Plan

In response to the continuing economic slowdown, we implemented a restructuring plan in the first quarter of fiscal 2002 and recorded a restructuring charge of $6.2 million. The goal of the restructuring plan was to reduce costs and improve operating efficiencies in each of our segments in order to match the current business environment. The restructuring charge consisted of severance and benefits of $5.2 million related to the involuntary termination of approximately 325 employees. These terminated employees were

primarily in the manufacturing, administrative, sales, marketing and engineering functions. Approximately 53% of these terminated employees were based in the United States, 43% in Singapore and 4% in other locations. Additionally, we accrued for lease costs of $0.2 million pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities in Florida that were vacated due to the reductions in workforce. We also wrote off leasehold improvements with a net book value of $0.4 million and production-related machinery and equipment with a net book value of $0.4 million. The assets were taken out of service as they were deemed unnecessary due to the reductions in workforce. We recorded a reduction to the fiscal 2002 first quarter restructuring provision of $0.4 million in the third quarter of fiscal 2002, as actual costs for severance and benefits were lower than originally anticipated.

As a result of our fiscal 2002 restructuring plans, we estimate that we reduced our annual infrastructure spending by approximately $20 to $25 million, of which approximately 30%, 35% and 35% will be reflected as a reduction in cost of revenues, research and development expenses, and selling, marketing and administrative expenses, respectively.

Fourth Quarter of Fiscal 2001 Restructuring Plan

In response to the economic slowdown, our management implemented a restructuring plan in the fourth quarter of fiscal 2001 to reduce costs and improve operating efficiencies across each of our segments, and we recorded a restructuring charge of $9.9 million. The restructuring charge consisted primarily of severance and benefits of $6.1 million related to the involuntary termination of approximately 275 employees. These employees were primarily in manufacturing and engineering functions, of which approximately 78% were based in the United States, 19% were based in Singapore and 3% were based in Belgium. Additionally, we accrued for lease costs of $1.4 million pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities in California, New Hampshire, Florida and Belgium that were vacated due to the reductions in workforce. We wrote off leasehold improvements, furniture and fixtures, and production-related machinery and equipment with net book values of $1.2 million, $0.4 million and $0.3 million, respectively. The assets were taken out of service as they were deemed unnecessary due to the reductions in workforce. In addition, we wrote down certain manufacturing equipment by $0.3 million to its estimated realizable value of $0.5 million. The manufacturing equipment was taken out of service and is expected to be sold in fiscal 2003. The Company accrued for legal, accounting and consulting costs of $0.2 million related to the restructuring.

In the first quarter of fiscal 2002, we recorded an additional $0.7 million charge to the fiscal 2001 restructuring provision. The adjustments included accrued lease costs of $0.5 million, and we also wrote down an additional $0.3 million of the estimated realizable value of certain manufacturing equipment identified in the fourth quarter of fiscal 2001 restructuring provision. These adjustments were offset by a decrease in severance and benefits of $0.1 million, as actual costs were lower than originally anticipated. In the third quarter of fiscal 2002, we recorded a net reduction to the fourth quarter of fiscal 2001 restructuring provision of $0.4 million. The third quarter adjustment included a $0.6 million reduction in the restructuring provision as actual severance and benefit costs were lower than originally anticipated as well as an additional $0.2 million charge for the estimated realizable value of certain manufacturing equipment.

Other Charges. Our other charges consisted of asset impairment charges. We hold minority investments in certain non-public companies. We regularly monitor these minority investments for impairment and record reductions in the carrying values when necessary. Circumstances that indicate an other than temporary decline include subsequent "down" financing rounds, decreases in quoted market prices and declines in operations of the issuer. In the second quarter of fiscal 2003, we recorded an impairment charge of $0.5 million related to a decline in the value of a minority investment deemed to be other than temporary. In the first half of fiscal 2002, we recorded an impairment charge of $4.1 million related to a decline in the value of a minority investment deemed to be other than temporary.

Interest and Other Income. Interest and other income was $9.8 million for the second quarter of fiscal 2003 compared to $8.9 million for the second quarter of fiscal 2002. The increase in interest and other income was due to gains of $2.2 million (net of unamortized debt issuance costs of $0.5 million) related to the repurchase of $73.0 million in principal amount of our $4^3/_4$% Convertible Subordinated Notes was partially offset by lower yields received on our marketable securities during the second quarter of fiscal 2003 as compared to the corresponding period of fiscal 2002. Interest and other income was $19.0 million for the first half of fiscal 2003 compared to $19.4 million for the first half of fiscal 2002. The decrease in interest and other income was primarily attributable to lower yields received on our marketable securities during the first half of fiscal 2003 as compared to the corresponding period of fiscal 2002. The decrease was partially offset by gains of $3.3 million (net of unamortized debt issuance costs of $0.8 million) related to the repurchase of $120.4 million in principal amount of our $4^3/_4$% Convertible Subordinated Notes for the first half of fiscal 2003. See Recent Accounting Pronouncements section below for a description of the impact of our adoption of SFAS No. 145 on interest and other income as a result of the repurchase of the Notes.

Interest Expense. Interest expense was $4.0 million and $9.2 million for the second quarter and first half of fiscal 2003, respectively compared to $3.1 million and $6.1 million for the corresponding periods of fiscal 2002. The increase in interest expense for the second quarter and first half of fiscal 2003 was attributable to interest 3% Convertible Subordinated Notes issued in March 2002, partially offset by less interest expense from our $4^3/_4$% Convertible Subordinated Notes due to the repurchase of $120.4 million in principal amount.

Income Taxes. Our income tax benefit was $1.4 million in the second quarter of fiscal 2003 and our income tax provision was $1.5 million in the second quarter of fiscal 2002. Our income tax provisions were $1.2 million and $2.3 million in the first half of fiscal 2003 and 2002, respectively. Income tax provisions and benefits for interim periods are based on our estimated annual effective income tax. The tax benefit derived from our effective income tax rate for the second quarter of 2003 is lower than the combined U.S. Federal and state statutory income tax rate of 40%, primarily due to amortization of non-goodwill acquisition related intangibles that are not fully deductible for tax purposes.

Liquidity and Capital Resources

Operating Activities: Net cash provided by operating activities for the first half of fiscal 2003 was $29.1 million. Operating cash primarily resulted from our net loss of $8.3 million, adjusted for non-cash items including depreciation and amortization, restructuring and other charges, amortization of deferred stock-based compensation and other intangibles and our gain on the repurchase of a portion of our $4^3/_4$% Convertible Subordinated Notes, as well as the decrease in our other long-term assets and increase in accounts payable.

Investing Activities: Net cash used for investing activities for the first half of fiscal 2003 was $92.2 million. The use of cash for investing activities was primarily a result of the purchase of marketable securities, primarily corporate securities and U.S. government bonds, of $355.8 million, which was partially offset by the sale and maturities of marketable securities of $280.2 million. In addition, we made a partial payment of the General Holdback of $10.6 million associated with our acquisition of Platys, and purchased $5.0 million of property and equipment.

Financing Activities: Net cash used for financing activities for the first half of fiscal 2003 was $111.3 million. The use of cash for financing activities was primarily due to the repurchase of a portion of our $4^{3}/_{4}$% Convertible Subordinated Notes with an aggregate price of $116.3 million, partially offset by proceeds received from the issuance of common stock for the exercise of employee stock options.

Liquidity. As of September 30, 2002, we had $707.1 million of cash, cash equivalents and marketable securities, of which approximately $523.7 was held by our Singapore subsidiary. Although we do not have

any current plans to repatriate cash from our Singapore subsidiary to our U.S. parent company, if we were to do so, additional income taxes at the combined United States Federal and state statutory rate of approximately 40% may be incurred from the repatriation. In addition, we had $18.3 million of restricted marketable securities that are held as security for the next five scheduled interest payments on our 3% Convertible Subordinated Notes. In May 2001 we obtained a revolving line of credit of $20.0 million that expires, as amended, in August 2003. We believe our existing working capital, together with expected cash flows from operations and available sources of bank, equity and equipment financing, will be sufficient to support our operations through fiscal 2003.

The following table summarizes our contractual obligations at September 30, 2002 and the effect these obligations are expected to have on our liquidity and cash flow in future periods.

Contractual obligations by Year (in thousands)	**Remaining Six Months of Fiscal 2003**	**Fiscal 2004**	**Fiscal 2005**	**Fiscal 2006**	**Fiscal 2007**	**Thereafter**	**Total**
$4^{3}/_{4}$% Convertible Subordinated Notes	$	$ 82,445	$	$	$	$	$ 82,445
3% Convertible Subordinated Notes					250,000		250,000
Operating leases	3,984	6,868	6,359	5,150	4,755	5,185	32,301
Total	$ 3,984	$ 89,313	$ 6,359	$ 5,150	$ 254,755	$ 5,185	$ 364,746

At September 30, 2002 and 2001, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Accordingly, we are not exposed to the type of financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

In June 2002, the Financial Accounting Standards Board, or FASB, issued SFAS No. 146, "Accounting for Exit or Disposal Activities." SFAS No. 146 addresses significant issues regarding the recognition, measurement and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force, or EITF, has set forth in the EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The scope of SFAS No. 146 also includes (1) costs related to terminating a contract that is not a capital lease and (2) termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred compensation contract. SFAS No. 146 will be effective for fiscal years beginning after December 31, 2002. We will adopt SFAS No. 146 on April 1, 2003 and we have not yet determined the impact of SFAS No. 146 on our results of operations or financial position.

In May 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145 eliminates Statement No. 4 (and Statement No. 64, as it amends Statement No. 4), which requires gains and losses from extinguishments of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result, the criteria in APB Opinion No. 30 will now be used to classify those gains and losses. SFAS No. 145 amends FASB Statement No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions are accounted for in the same manner as sale-leaseback transactions. This amendment is consistent with the FASB's goal of requiring similar accounting treatment for transactions that have similar economic effects. In addition, SFAS No. 145 makes technical corrections to existing pronouncements. While those corrections are not substantive in nature, in some instances, they may change accounting practice. This statement is effective for fiscal years beginning after May 2002 for the provisions related to the rescission of Statements Nos. 4 and 64, and for all transactions entered into beginning May 2002 for the provision related to the amendment of Statement No. 13 although early adoption is permitted. We elected to adopt SFAS No. 145 effective fiscal 2002, and as a result, we have included the gain on extinguishment of debt of $2.2 million (net of unamortized debt issuance costs of $0.5 million) in "Interest and Other Income" for the second quarter of fiscal 2003 and the gain on extinguishment of debt of $3.3 million (net of unamortized debt issuance costs of $0.8 million) in "Interest and Other Income" for the first half of fiscal 2003.

RISK FACTORS

Our business faces significant risks. The risks described below may not be the only risks we face. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following risks actually occur, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

Our future operating results are subject to fluctuation.

Our operating results may fluctuate as a result of a wide variety of factors, including, but not limited to, the following:

- cancellations or postponements of orders;
- shifts in the mix of our products and sales channels;
- changes in pricing policies by our suppliers;
- shortages of components or wafer fabrication capacity affecting us, our customers or our suppliers;
- market acceptance of new and enhanced versions of our products;
- product obsolescence;
- shortage of skilled labor;
- future accounting pronouncements and changes in accounting policies;
- timing of acquisitions, integration of acquired businesses and any associated charges;
- restructuring actions or other involuntary terminations;
- general economic trends;
- international political instability; and
- pending legal proceedings.

Operating results for the first half of fiscal 2003 were materially affected by unusual charges, including deferred compensation in connection with our Platys acquisition and restructuring charges.

Operating results for fiscal 2002 were materially affected by unusual charges, including the following:

asset impairment charges;

deferred compensation in connection with our Platys acquisition;

write-off of acquired in-process technology from Platys;

excess inventory charges due to the economic slowdown; and

restructuring charges.

Fiscal 2001 operating results were materially affected by unusual charges, including the following:

accrued minimum royalty fees to Agilent;

excess inventory charges due to the economic slowdown;

restructuring charges; and

asset impairment charge.

Fluctuations in our operating results may adversely affect the trading price of our common stock.

Our sales have been negatively affected by the current economic slowdown, and if these conditions persist or deteriorate, they may continue to adversely affect our results of operations and financial position. Since the second half of fiscal 2001, our operating results have been significantly affected by the continuing slowdown in information technology investments and consumer spending. Many of our customers have announced workforce reductions and delayed capital spending in response to the economic slowdown. In addition, recent international terrorist activities have further dampened the economic recovery. If current global economic and political conditions continue to persist or deteriorate, our customers will likely further postpone spending, which would continue to adversely affect our financial results.

If we do not meet our restructuring objectives or if the economic slowdown continues, we may have to implement additional plans in order to reduce our operating costs. As a result of the economic slowdown, in the first and fourth quarters of fiscal 2002 and the second quarter of fiscal 2003, we implemented restructuring plans to reduce our operating costs to match the current business environment. The plans included primarily the reduction of our workforce and the consolidation of our manufacturing operations in Singapore. The goals of the plans are to support future growth opportunities, focus on investments that grow revenues and increase operating margins. If we do not meet our restructuring objectives or if the economic slowdown continues, we may have to implement additional plans to reduce our operating costs, which could have an adverse effect on our financial results.

If demand in the server, network storage and desktop computer markets declines, our net revenues may decline. Historically, our growth has been supported by increasing demand for systems that support:

client/server applications;

computer-aided engineering;

Internet/intranet applications;

data storage and digital content; and

multimedia and video.

Our business or operating results would be adversely affected by a decline in demand for our products. For example, for the first time in several years, the demand in the server market declined slightly in fiscal 2002, which contributed to a decline in our net revenues. We cannot predict when and if server sales growth will increase. In addition, other technologies may replace the technologies used in our existing products and the acceptance of our products using new technologies in the market may not be widespread, which could adversely affect our net revenues.

We expect that the products we are developing for the network storage marketplace will be an important component of our future growth, and these products may not be accepted by the market or reach the market in a timely fashion. In August 2001, we acquired Platys, a development stage company with no revenues, to enhance our technologies for this market. The marketplace for advanced storage products is highly competitive and our technology may never be broadly adopted. In addition, there are substantial risks that known and unknown challenges to successful deployment of our products, and of products incorporating our products, will cause delays in their reaching the market. We do not expect to begin shipping commercial quantities of our network storage products until the first half of fiscal 2004. If our network storage products, and our customers' products using our technology, do not achieve a broad level of market acceptance, or if we encounter substantial delays in entering the market, our growth will likely be impaired.

If demand for our customers' products declines or if our customers do not control their inventories effectively, our net revenues may be adversely affected. The volume and timing of orders received during a quarter are difficult to forecast. Our customers generally order based on their forecasts, and they frequently encounter uncertain and changing demand for their products. If demand falls below such forecasts or if our customers do not control their inventories effectively, they may cancel or reschedule shipments previously ordered from us. Our customers, from time to time in the past, have cancelled or rescheduled shipments previously ordered from us and we cannot assure you that they will not do so in the future. In addition, because our sales are made by means of standard purchase orders rather than long-term contracts, we cannot assure you that these customers will continue to purchase quantities of our products at current levels, or at all. Historically, backlog has not been a significant factor for us, and we have set our operating budget based on forecasts of future revenues. Because much of our operating budget is relatively fixed in the short-term, if revenues do not meet our expectations, then our financial results will be adversely affected.

If we do not provide adequate support during our customers' design and development stage, or if we are unable to provide such support in a timely manner, we may lose revenues to our competition. Certain of our products are designed to meet our customers' specifications and, to the extent we are not able to meet these expectations in a timely manner or provide adequate support during our customers' design and development stage, our customers may choose to buy similar products from another company. For example, we are currently in the design and development stage with potential customers for our products with iSCSI functionality. If we are unsuccessful in designing these products to meet our customers' needs, our financial results could be adversely affected.

Our reliance on industry standards and technological changes in the marketplace may cause our net revenues to fluctuate or decline. The computer industry is characterized by various, evolving standards and protocols. We design our products to conform to certain industry standards and protocols such as the following:

Technologies:

- ATA;
- Serial ATA;
- Fibre channel;
- FireWire/1394;
- InfiniBand;
- iSCSI;
- PCI;
- PCI-X;
- RAID;

- SCSI;
- Serial Attached SCSI;
- Ultra-DMA; and

USB.

Operating Systems:

Linux;

Macintosh;

Netware;

OS/2;

UNIX; and

Windows.

In particular, a majority of our revenues are currently derived from products based on the SCSI standards. If consumer acceptance of these standards declines, or if new standards emerge, and if we do not anticipate these changes and develop new products, these changes could adversely affect our business and financial results. For example, we believe that changes in consumers' perceptions of the relative merits of SCSI-based products and competing products incorporating lower cost solutions adversely affected our sales beginning in fiscal 1998 and are likely to affect our future sales. In addition, we are beginning to provide evaluation units of our Ultra320 SCSI products to our OEM customers for testing and evaluation as we transition our SCSI products to meet the next generation industry standard. If we are unsuccessful in these efforts, our business and financial results will be negatively impacted.

Our dependence on new products may cause our net revenues to fluctuate or decline. Our future success significantly depends upon our completing and introducing new products at competitive prices and performance levels in a timely manner. The success of new product introductions depends on several factors, including the following:

designing products to meet customer needs;

product costs;

timely completion and introduction of new product designs;

quality of new products;

differentiation of new products from those of our competitors; and

market acceptance of our products.

Our product life cycles in each of our segments may be as brief as 12 to 24 months. As a result, we believe that we will continue to incur significant expenditures for research and development in the future. We may fail to identify new product opportunities and may not develop and bring new products to market in a timely manner. In addition, products or technologies developed by others may render our products or technologies obsolete or noncompetitive, or our targeted customers may not select our products for design or integration into their products. The failure of any of our new product development efforts could have an adverse effect on our business and financial results. For example, sale of our SCSI based products in our DSG segment have declined in recent periods due to the availability of lower cost desktop solutions. In addition, our SNG segment is focused on developing 1 gigabit TCP/IP Offload Engine, or TOE, Network Accelerator Cards, which is expected to offer faster performance and result in a stronger return on investment for our customers. While we focus on TOE technology, we expect our SNG revenues from our 10/100 Network Interface Cards, or NICs, will continue to decline as OEMs transition their product lines to the 1 gigabit NIC products. And, to the extent that our TOE technology is not selected for design or integration by OEMs, our business and financial results could be adversely affected.

We are currently in the early states of a transition from our Ultra 160 product line, which is the major product family of our SSG segment, to the Ultra 320 line of products. We face intense competition, both in retaining existing customers and securing new customers, in the Ultra 320 market, and we cannot assure you that our products will achieve the same level of market acceptance as our Ultra 160 line of products. If they do not, our revenue and profitability will, over time, be adversely affected as the market adapts to this new technology.

If we are unable to compete effectively, our net revenues could be adversely affected. The markets for all of our products are intensely competitive and are characterized by the following:

- rapid technological advances;
- frequent new product introductions;
- evolving industry standards; and
- price erosion.

Consequently, we must continue to enhance our products on a timely basis to keep pace with market demands. If we do not do so, or if our competition is more effective in developing products that meet the needs of our existing and potential customers, we may lose market share and not participate in the future growth of our target markets. For example, we face intense competition in the transition from products employing Ultra 160 to solutions employing Ultra 320 technology. Further, we have recently introduced USB 2.0 hub products in our DSG segment, and we may face new competitors in the USB 2.0 market.

We believe that our future success will depend significantly on our ability to participate in the ongoing development of the network storage market. While we are focusing on solutions employing iSCSI technology for this market, many other companies are also focusing on network storage solutions based on identified technologies that include, but are not limited to, iSCSI. Even if iSCSI technology achieves broad market acceptance, our early technological advantage in this field may not afford us the advantages we had anticipated if such acceptance is delayed due to the continuing global slowdown in technology spending. If iSCSI technology is not accepted by the market, or if broad acceptance of iSCSI technology is delayed, our growth would be impaired. Other companies may have greater technical, marketing, manufacturing and financial resources than we do. We cannot assure you that we will have sufficient resources to accomplish any of the following:

- meet growing product demand;
- make timely introductions of new products;
- compete successfully in the future against existing or potential competitors;
- provide OEMs with design specifications in a timely manner; and
- prevent price competition from eroding margins.

Costs associated with acquisitions or strategic alliances may adversely affect our results of operations, which could be exacerbated if we are unable to integrate the acquired companies, products or technologies. In August 2001, we completed our acquisition of Platys, a developer of IP storage solutions. In December 1999, we acquired Distributed Processing Technology Corp., or DPT, to strengthen our position in the RAID market. In addition, we enter into strategic alliances from time to time with other companies. For example, we entered into a technology licensing agreement with IBM in March 2002. As part of our overall strategy, we may continue to acquire or invest in complementary companies, products or technologies and enter into strategic alliances with other companies. In order to be successful in these activities, we must:

- assimilate the operations and personnel of the combined companies;
- minimize the potential disruption of our ongoing business;

retain key technical and managerial personnel;

integrate the acquired company into our strategic and financial plans;

accurately assess the value of potential target businesses, products or technologies;

harmonize standards, controls, procedures and policies; and

minimize the impairment of relationships with employees and customers.

The benefits of acquisitions or strategic alliances may prove to be less than anticipated and may not outweigh the costs reported in our financial statements. Completing any potential future acquisitions or strategic alliances could cause significant diversions of management time and resources. If we acquire new businesses, products or technologies in the future, we may be required to assume contingent liabilities and amortize significant amounts of other intangible assets and, over time, recognize significant charges for impairment of goodwill. If we consummate any potential future acquisitions in which the consideration consists of stock or other securities, our existing stockholders' ownership may be significantly diluted. If we proceed with any potential future acquisitions in which the consideration is cash, we may be required to use a substantial portion of our available cash. We may not be successful in overcoming these risks or any other problems encountered in connection with these or other business combinations, investments or strategic alliances. These transactions may adversely affect our business, financial position and operating results.

If there is a shortage of components used in our customers' products, our sales may decline, which could adversely affect our results of operations and financial position. If our customers are unable to purchase certain components which are embedded into their products, their demand for our products may decline. For example, beginning in the fourth quarter of fiscal 2000, we experienced the impact of other companies' chip supply shortages, which reduced the demand for some of our SSG products. This negatively affected our net revenues in the first half of fiscal 2001. Similar shortages of components used in our customers' products could adversely affect our net revenues and financial results in future periods.

We depend on wafer suppliers whose failure to meet our manufacturing needs could negatively affect our operations. Independent foundries manufacture to our specifications all of the finished silicon wafers used for our products. We currently purchase all of our wafers through our agreements with TSMC. The manufacture of semiconductor devices is sensitive to a wide variety of factors, including the following:

the availability of raw materials;

the availability of manufacturing capacity;

transition to smaller geometries for semiconductor devices;

the level of contaminants in the manufacturing environment;

impurities in the materials used; and

the performance of personnel and equipment.

While we have been satisfied with the quality, yield and timeliness of wafer deliveries to date, we cannot assure you that manufacturing problems may not occur in the future. A shortage of raw materials or production capacity could lead our wafer suppliers to allocate available capacity to other customers. Any prolonged inability to obtain wafers with competitive performance and cost attributes, adequate yields or timely deliveries would delay our production and our product shipments, and could have an adverse effect on our business and financial results. We expect that wafer suppliers will continually seek to convert their fabrication process arrangements to smaller wafer geometries and to more advanced process technologies. Such conversions entail inherent technological risks that can affect yields and delivery times. If for any reason TSMC, or any other wafer supplier we may use, is unable or unwilling to satisfy our wafer needs, we

will be required to identify and qualify additional foundries. Additional wafer foundries may be unavailable, may take significant amounts of time to qualify or may be unable to satisfy our requirements on a timely basis.

If our manufacturing demand for silicon wafers falls below our projections, we may not be able to fully utilize our prepayments to TSMC, which could adversely affect our results of operations and financial position. From time to time, we have entered into "take or pay" contracts that have committed us to purchase specific wafer quantities over extended periods based on our projected needs. In addition, we have made prepayments to TSMC in order to secure guaranteed wafer capacity. If our demand for wafer units falls below our projections, we may not be able to fully utilize our prepayments. The unused portion of the prepayments may be impaired and written off as an asset impairment charge, which would adversely affect our financial results.

We depend on subcontractors, and if they fail to meet our manufacturing needs, it could negatively affect our results of operations. We rely on subcontractors for the assembly and packaging of the integrated circuits included in our products. We have no long-term agreements with our assembly and packaging subcontractors. We have, from time to time, used board subcontractors to better balance production runs and capacity. We cannot assure that such subcontractors will continue to be able and willing to meet our requirements for such components or services. Any significant disruption in supplies from, or degradation in the quality of components or services supplied by, such subcontractors could delay shipments and result in the loss of customers or revenues, which could have an adverse effect on our financial results.

We depend on the efforts of our distributors, which if reduced, would negatively affect our business and our results of operations. We derive a material percentage of our net revenues from independent distributor and reseller channels. Our financial results could be adversely affected if our relationship with these distributors or resellers were to deteriorate or if the financial condition of these distributors or resellers were to decline. Given the current economic environment, the risk of distributors and resellers going out of business has increased significantly.

Our distributors generally offer a diverse array of products from several different manufacturers. Accordingly, we are at risk that these distributors may give higher priority to selling products from other suppliers. A reduction in sales efforts by our current distributors could adversely affect our business and financial results. Our distributors build inventories in anticipation of future sales and if such sales do not occur as rapidly as they anticipate, our distributors will decrease the size of their product orders, as was the case from the second half of fiscal 2001 through the first half of fiscal 2003. If we decrease our price protection or distributor-incentive programs, our distributors may also decrease their orders from us. In addition, we have from time to time taken actions to reduce levels of products at distributors and may do so in the future. These actions may affect our net revenues and negatively affect our financial results.

Our operations depend on key personnel, the loss of whom could affect our business and reduce our future net revenues. In order to be successful, we must retain and motivate executives and other key employees, including those in managerial, technical, marketing and information technology support positions. In particular, our product generation efforts depend on hiring and retaining qualified engineers. The expansion of high technology companies in Silicon Valley where we operate our business has increased demand for experienced management, technical, marketing and support personnel and despite the economic slowdown, competition for their talents is intense. The loss of key employees could have a significant impact on our operations. We also must continue to motivate employees and keep them focused on our strategies and goals, which may be particularly difficult due to morale challenges posed by workforce reductions and general uncertainty.

Our international operations involve risks, and may negatively affect our net revenues and results of operations. Many of our subcontractors are primarily located in Asia and we have sales offices and customers located throughout Europe, Japan and other countries. Our international operations and sales are subject

to political and economic risks, including political instability, currency controls, exchange rate fluctuations, and changes in import/export regulations, tariffs and freight rates. We may use forward exchange contracts to manage any exposure associated with certain foreign currency-denominated commitments. In addition, because our primary wafer supplier, TSMC, is located in Taiwan, we may be subject to certain risks resulting from political instability in Taiwan, including conflicts between Taiwan and the People's Republic of China. These and other international risks could result in the creation of political or other non-economic barriers to our being able to sell our products in certain countries, create local economic conditions that reduce demand for our products among our target market or expose us to potential disruption in the supply of necessary components or otherwise adversely affect our ability to generate revenue and operate effectively.

If the carrying value of our long-lived assets is not recoverable, an impairment loss must be recognized which could adversely affect our results of operations and financial position. Certain events or changes in circumstances would require us to assess the recoverability of the carrying amount of our long-lived assets. In the second quarter of fiscal 2003, we recorded an impairment charge of $0.5 million relating to the decline in value of a minority investment. In fiscal 2002 we recorded impairment charges of $77.6 million relating to technology acquired in a prior acquisition and the decline in value of certain minority investments. In addition, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS No. 142 in July 2001, whereby goodwill must be evaluated annually and whenever events or circumstances occur which indicate that goodwill might be impaired. For acquisitions consummated prior to July 1, 2001, we adopted SFAS No. 142 on April 1, 2002. We will continue to evaluate the recoverability of the carrying amount of our long-lived assets, and we may incur substantial impairment charges which could adversely affect our financial results.

If actual results or events differ materially from those contemplated by us in making estimates and assumptions, our reported financial condition and results of operation for future periods could be materially affected. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended March 31, 2002 describes the significant accounting policies essential to preparing our consolidated financial statements. The preparation of these financial statements requires estimates and assumptions that affect the reported amounts and disclosures. Although we believe that our judgments and estimates are appropriate and correct, actual future results may differ materially from our estimates. Also, see our Critical Accounting Policies in Item 7 of our Annual Report on Form 10-K for the year ended March 31, 2002.

If we are unable to protect and enforce our intellectual property rights, we may be unable to compete effectively. Although we actively maintain and defend our intellectual property rights, we may be unable to adequately protect our proprietary rights. In addition, the laws of certain territories in which our products are or may be developed, manufactured or sold, including Asia and Europe, may not protect our products and intellectual property rights to the same extent as the laws of the United States.

Despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property, which could harm our business and ability to compete effectively. We have from time to time discovered counterfeit copies of our products being manufactured or sold by others. Although we have programs to detect and deter the counterfeiting of our products, significant availability of counterfeit products could reduce our net revenues and damage our reputation and goodwill with customers.

Third parties may assert infringement claims against us, which may be expensive to defend and could adversely affect our business and results of operations. From time to time, third parties assert exclusive patent, copyright and other intellectual property rights to our key technologies, and we expect to continue to receive such claims in the future. For example, we entered into a patent cross-license agreement with IBM in May 2000. Under this agreement, which was amended in March 2002, we received a release from infringement claims prior to January 1, 2000 and received the right to use certain of IBM's patents through June 30, 2007. In consideration, we are paying, in annual installments, an aggregate patent fee of $13.3 million, and we granted IBM a license to use all of our patents for the same period. The risks of our receiving additional claims from third parties may be enhanced in periods such as the one that we are currently entering as we continue to offer product lines employing new technologies relative to our existing products.

We cannot assure you that third parties will not assert other infringement claims against us in the future, that assertions by third parties will not result in costly litigation or that we would prevail in such litigation or be able to license any valid and infringed patents from third parties on commercially reasonable terms. In addition to claims brought against us by third parties, we may also bring litigation against others to protect our rights. Intellectual property litigation, regardless of the outcome, could result in substantial costs to us and diversion of our resources, and could adversely affect our business and financial results.

We may be engaged in legal proceedings that could negatively affect our business operations or financial position. From time to time we are subject to litigation or claims that could negatively affect our business operations and financial position. For instance, a class action lawsuit was filed during 1998 in the United States District Court for the Northern District of California against us and certain of our current and former officers and directors. In March 2002, the plaintiffs voluntarily dismissed their claim without any recovery or settlement, and this case is now concluded. Such disputes could cause us to incur unforeseen expenses, could occupy a significant amount of our management's time and attention, and could negatively affect our business operations and financial position. Also see Item 1 "Legal Proceedings" contained in Part II of this report.

If we repatriate cash from our foreign subsidiaries, we may incur additional income taxes which would negatively affect our results of operations and financial condition. A significant portion of our cash, cash equivalents and marketable securities are held in our subsidiary in Singapore. From time to time we may need to repatriate our cash from Singapore to the United States. If we do so, we may incur additional income taxes at the combined United States Federal and state statutory rate of approximately 40% from the repatriation, which would negatively affect our results of operations and financial condition.

We may be subject to a higher effective tax rate that could negatively affect our results of operations and financial position. Our effective tax rate is benefited by a Singapore tax holiday relating to certain of our products. The terms of the tax holiday provide that profits derived from certain products will be exempt from tax through fiscal 2005, subject to certain conditions. If we do not continue to meet the conditions and requirements of the tax holiday in Singapore, our effective tax rate will increase, which would adversely affect our financial results.

We may be required to pay additional federal income taxes which could negatively affect our results of operations and financial position. On June 27, 2000, we received a statutory notice of deficiency from the Internal Revenue Service, or IRS, with respect to our federal income tax returns for fiscal 1994 through 1996. In December 2001, our 1994 through 1996 tax audits were resolved and settlement agreements were filed with the U.S. Tax Court. On December 15, 2000, we received a statutory notice of deficiency from the IRS with respect to our federal income tax return for fiscal 1997. We filed a Petition with the United States Tax Court on March 14, 2001 contesting the asserted deficiencies. The IRS is currently auditing our federal income tax returns for fiscal 1998 and 1999. While we believe we have meritorious defenses against the asserted deficiencies and any proposed adjustments, and that sufficient taxes have been provided, we

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cannot predict the final outcome of these matters, and the final resolution could adversely affect our results of operations and financial position.

If our products do not operate effectively with other products, our net revenues could be negatively affected. We must design our products to operate effectively with a variety of hardware and software products supplied by other manufacturers, including the following:

- microprocessors;
- peripherals; and
- operating system software.

We depend on significant cooperation with these manufacturers to achieve our design objectives and develop products that operate successfully with their products. We believe that we generally have good relationships with leading system, peripheral, and microprocessor suppliers; however, these suppliers may, from time to time, make it more difficult for us to design our products for successful operability with their products. For example, if one or more of these companies were to determine, as a result of competition or other factors, that our technology or products would not be broadly accepted by the markets we target, these companies may no longer work with us to plan for new products and new generations of our products, which would make it more difficult to introduce products on a timely basis, or at all. Further, some of these companies might decide not to continue to offer products that are compatible with our technology and our markets could contract. In addition, these suppliers may decide to compete with us. If any of these events were to occur, our revenues could be adversely affected.

We finance our capital expenditure needs from operating cash flows, bank financing and capital market financing. As of September 30, 2002, we had approximately $332.4 million in aggregate principal amount of convertible subordinated notes outstanding. While we believe that our current liquidity will be sufficient to support our operations over the next twelve months, we may need to seek additional equity or debt financing from time to time, including issuance of warrants, and cannot be certain that additional financing will be available on favorable terms. Moreover, any future equity or convertible debt financing will decrease the percentage of equity ownership of existing stockholders and may result in dilution, depending on the price at which the equity is sold or the debt is converted.

We are exposed to fluctuations in foreign currency exchange rates. We have international subsidiaries and distributors that operate and sell our products globally. Further, we purchase a substantial portion of our raw materials and manufacturing equipment from foreign suppliers, and incur labor and other operating costs in foreign currencies, particularly in our Singapore manufacturing facilities. As a result, we are exposed to the risk of changes in foreign currency exchange rates or declining economic conditions in these countries.

Failure to execute planned cost reductions successfully could result in total costs and expenses that are greater than expected. Historically, we have undertaken restructuring plans to bring operational expenses to appropriate levels for our business, while simultaneously implementing extensive new company-wide expense control programs. In addition to previously announced workforce reductions, we may have additional workforce reductions in the future. Significant risks associated with these actions that may impair our ability to achieve anticipated cost reductions or that may otherwise harm our business include delays in implementation of anticipated reductions in force in highly regulated locations outside of the United States, particularly in Europe and Asia, redundancies among restructuring programs, and the failure to meet operational targets due to the loss of employees or decrease in employee morale.

We hold minority interests in certain non-public companies, and if these companies face financial difficulties in their operations, our investments could be impaired. We continue to hold minority interests in certain privately held companies. These investments are inherently risky because these companies are still in the development stage and depend on third parties for financing to support their ongoing operations. In

addition, the markets for their technologies or products are typically in the early stages and may never develop. If these companies do not have adequate cash funding to support their operations, or if they encounter difficulties developing their technologies or products, especially in the current economic downturn, our investments in these companies may be impaired, which could adversely affect our financial results. For example, we recorded impairment charges in the second quarter of fiscal 2003 and in the first and third quarters of fiscal 2002 related to a decline in the values of certain minority investments deemed to be other than temporary.

Our spin-off of Roxio may have potential subsequent tax liabilities that could negatively affect our results of operations. Pursuant to our distribution of the Roxio common stock, we have received an opinion from PricewaterhouseCoopers LLP, or PwC, regarding the tax-free nature of the transaction to us and to our stockholders under Section 355 of the Internal Revenue Code. IRS regulations provide that if another entity acquires a controlling interest in Roxio or our common stock within two years of the distribution, a presumption will arise that the acquisition was made in connection with the distribution, potentially causing the distribution to become taxable to us. The validity of the PwC opinion relating to the qualification of the distribution as a tax-free transaction is subject to factual representations and assumptions. We are not aware of any facts or circumstances that would cause such representations and assumptions to be untrue. In addition, the opinion of PwC is not binding on the IRS. If we or Roxio fail to conform to the requirements set forth in the IRS regulations, it could cause the distribution to be taxable to us and to our stockholders, and our financial results could be adversely affected.

We may have potential business conflicts of interest with Roxio with respect to our past and ongoing relationships, and we may not resolve these conflicts on terms favorable to us. Conflicts of interest may arise between Roxio and us in a number of areas relating to our past and ongoing relationship, including:

- labor, tax, employee benefits, indemnification and other matters arising from the separation;
- intellectual property matters;
- employee retention and recruiting;
- the nature, quality and pricing of transitional services we have agreed to provide to Roxio; and
- business opportunities that may be attractive to both Roxio and us.

These and other business conflicts could adversely affect the growth of our business in the future.

Failure to improve our infrastructure may adversely affect our business.

We need to continue to implement and maintain a variety of operational, financial and management information systems, procedures and controls. The enactment of the Sarbanes-Oxley Act of 2002 and final and anticipated Securities and Exchange Commission regulations in 2002 will require us to devote additional resources to our operational, financial and management information systems, procedures and controls to ensure our continued compliance with current and future laws and regulations. Failure to implement and maintain appropriate operational, financial and management information systems, procedures and controls could have a material adverse effect on our business, results of operations and financial condition.

We may encounter natural disasters, which may negatively affect our results of operations and financial position. Our worldwide operations could be subject to natural disasters and other business disruptions, which could seriously harm our revenues and financial condition and increase our costs and expenses. Our corporate headquarters are located in California, near major earthquake faults. Additionally, our primary wafer supplier, TSMC, is located in Taiwan, which has experienced significant earthquakes in the past. A severe earthquake could cause disruption to our employees or interrupt the manufacturing process, which could affect TSMC's ability to supply wafers to us, which could negatively affect our business and financial

results. The ultimate impact on us and our general infrastructure of being located near major earthquake faults is unknown, but our net revenues and financial condition and our costs and expenses could be significantly impacted in the event of a major earthquake. In addition, some areas, including California, have experienced, and may continue to experience, ongoing power shortages, which have resulted in "rolling blackouts." These blackouts could cause disruptions to our operations or the operations of our suppliers, distributors and resellers, or customers. We are predominantly uninsured for losses and interruptions caused by earthquakes, power outages and other natural disasters.

Terrorist acts and acts of war may seriously harm our business and net revenues, costs and expenses and financial condition. Terrorist acts or acts of war (wherever located around the world) may cause damage or disruption to our employees, facilities, partners, suppliers, distributors, resellers, or customers, which could significantly impact our net revenues, costs and expenses and financial condition. The terrorist attacks that took place in the United States on September 11, 2001 were unprecedented events that have created many economic and political uncertainties, some of which may materially harm our business and results of operations. The long-term effects on our business from the September 11, 2001 attacks are unknown. The potential for future terrorist attacks, the national and international responses to terrorist attacks, and other acts of war or hostility have created many economic and political uncertainties, which could adversely affect our business and results of operations in ways that cannot presently be predicted. In addition, as a multi-national company with headquarters and significant operations located in the United States, we may be impacted by actions against the United States. We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war.

The price of our securities may be subject to wide fluctuations. Our stock has experienced substantial price volatility, particularly as a result of quarterly variations in our operating results, the published expectations of analysts, and as a result of announcements by our competitors and us. In addition, the stock market has experienced price and volume fluctuations that have affected the market price of many technology companies, in particular, and that have often been unrelated to the operating performance of such companies. In addition, the price of our securities may also be affected by general global, economic and market conditions, and the cost of operations in one or more of our product markets. While we cannot predict the individual effect that these factors may have on the price or our securities, these factors, either individually or in the aggregate, could result in significant variations in the price of our common stock during any given period of time. These fluctuations in our stock price also impact the price of our outstanding convertible securities and the likelihood of the convertible securities being converted into cash or equity.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For financial market risks related to changes in interest rates, equity price and foreign currency exchange rates, reference is made to "Quantitative and Qualitative Disclosures About Market Risk" in Part II, Item 7A, of our Annual Report on Form 10-K for the year ended March 31, 2002.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. Regulations under the Securities Exchange Act of 1934 require public companies to maintain "disclosure controls and procedures," which are defined to mean a Company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Our Chief Executive Officer and our Chief Financial Officer, based on their evaluation of the effectiveness of our disclosure controls and procedures within 90 days before the filing date of this report, concluded that our disclosure controls and procedures were effective for this purpose.

(b)

Changes in Internal Controls. There were no significant changes in our internal controls or to our knowledge, in other factors that could significantly affect our disclosure controls and procedures subsequent to the date of the evaluation referenced above.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In December 1999, the Company purchased Distributed Processing Technology Corp. ("DPT") and, as part of the purchase agreement, $18.5 million of the purchase price was held back, (the "Holdback Amount") from former DPT stockholders, for unknown liabilities that may have existed as of the acquisition date. For accounting purposes, the Holdback Amount was included as part of the acquisition purchase price. Subsequent to the date of purchase, the Company determined that certain representations and warranties made by the DPT stockholders were incomplete or inaccurate, which resulted in a loss of revenues and additional expenses to the Company. In addition, certain DPT products were found to be defective. In December 2000, the Company filed a claim against the DPT stockholders for the entire Holdback Amount of $18.5 million. In January 2001, the DPT stockholders notified the Company as to their objection to the Company's claim. Under the terms of the purchase agreement, the Company's claim has been submitted to arbitration. The arbitration hearings began in October 2002. While the Company believes that its claims are meritorious, the Company cannot predict with certainty how the matter will be resolved.

Item 4. Submission of Matters to a Vote of Security Holders

Our Annual Meeting of Stockholders was held on August 22, 2002 at our principal executive offices located in Milpitas, California. Of the total 106,507,406 shares of our common stock outstanding as of the record date, 88,131,221 shares (83%) were present or represented by proxy at the meeting. The table below presents the voting results of election of our Board of Directors.

	Votes	Votes Withheld
Carl J. Conti	83,374,890	4,756,331
Victoria L. Cotten	59,328,847	28,802,374
John C. East	83,475,842	4,655,379
Lucie J. Fjeldstad	82,524,078	5,607,143
Joseph S. Kennedy	83,470,954	4,660,267
Ilene H. Lang	82,549,271	5,581,950
Robert J. Loarie	81,091,104	7,040,117
Robert N. Stephens	83,398,963	4,732,258
Douglas E. Van Houweling	78,735,421	9,395,800

In addition, our stockholders ratified and approved the appointment of PricewaterhouseCoopers LLP as our independent accountants for the fiscal year ending March 31, 2003. The proposal received 84,352,673 affirmative votes, 3,666,537 negative votes, 112,011 abstentions and no broker non-votes.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit 99.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K:

No reports on Form 8-K were filed during the quarter ended September 30, 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

ADAPTEC, INC.

By: /s/ DAVID A. YOUNG Date: January 14, 2003

David A. Young
Vice President and Chief Financial Officer
(principal financial officer)

By: /s/ KENNETH B. AROLA Date: January 14, 2003

Kenneth B. Arola
Vice President and Corporate Controller
(principal accounting officer)

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO RULE 13A-14 OR 15D-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Robert N. Stephens, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Adaptec, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b)

evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: January 14, 2003

/s/ ROBERT N. STEPHENS

Robert N. Stephens
Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO RULE 13A-14 OR 15D-14 OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, David A. Young, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Adaptec, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: January 14, 2003	/s/ DAVID A. YOUNG
	David A. Young Chief Financial Officer

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EXHIBIT INDEX

Exhibit 99.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002.

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