

ADAPTEC INC
Form 10-K
June 04, 2009

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

FORM 10-K

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

For the fiscal year ended March 31, 2009

OR

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

For the transition period from to .

Commission file number: 000-15071

Adaptec, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

94-2748530

(I.R.S. Employer Identification Number)

691 S. Milpitas Blvd.
Milpitas, California 95035

(Address of Principal Executive Offices, including Zip Code)

(408) 945-8600

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(Registrant's Telephone Number, including Area Code)

Securities registered pursuant to Section 12(b) of the Act: **Common Stock, \$0.001 Par Value**
(Title of Class)

The NASDAQ Global Market
(Name of Each Exchange on which Registered)

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

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

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

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant was \$320,982,434 based on the closing sale price of the Registrant's common stock on The NASDAQ Global Market on the last business day of the Registrant's most recently completed second fiscal quarter. Shares of the Registrant's common stock beneficially owned by each executive officer and director of the Registrant and by each person known by the Registrant to beneficially own 10% or more of its outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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At May 19, 2009, the Registrant had 120,700,658 shares of common stock outstanding, \$.001 par value per share.

DOCUMENTS INCORPORATED BY REFERENCE: NONE

PDF provided as courtesy

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PART I

FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K 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 the market for our products and their benefits to our customers, our intention to continue to evaluate acquisitions, strategic alliances and/or strategic investments, our expectations regarding the decline in our revenues derived from large OEM customers, the levels of our expenditures and savings for various expense items, the level of savings we expect to realize from restructuring activities and our expected capital expenditures and liquidity in future periods. 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, current and prospective investors should consider carefully these factors in addition to the other information set forth in this document.

PART I

Item 1. *Business*

For your convenience, we have included, in Note 22 to the Consolidated Financial Statements, included in "Item 8: Financial Statements and Supplementary Data" of this Annual Report on Form 10-K, a Glossary that contains (1) a brief description of a few key acronyms commonly used in our industry that are used in this Annual Report and (2) a list of accounting rules and regulations that are also referred to herein. These acronyms and accounting rules and regulations are listed in alphabetical order.

Overview

We are a leading provider of innovative data storage hardware and software solutions. We provide storage solutions that reliably move, manage, store and protect critical data and digital content. We deliver software and hardware components that provide reliable storage connectivity and advanced data protection to leading OEMs and system integrators through distribution channel partners. Our software and hardware products include ASICs, HBAs, RAID controllers, Adaptec RAID software, storage management software, storage virtualization software and other solutions that span SCSI, SAS, SATA and iSCSI interface technologies. System integrators and white box suppliers build server and storage solutions based on Adaptec technology in order to deliver products with superior price and performance, data protection and interoperability to their clients and customers. We continue to innovate and build our intelligence in the I/O path, including products and technologies containing our Intelligent Power Management.

Our broad range of RAID controllers, add-in cards and ASICs provide end users with a variety of price and performance options for connecting their storage. These options range from low cost HBAs to high performance and

high availability RAID controller cards, with product features that address improved energy efficiencies and reduced operating costs. Our products are sold to enterprises, SMBs, government agencies and end users engaged in a broad range of vertical markets across geographically diverse markets principally through distribution channel customers, OEMs, system integrators, system builders, and value added resellers. Further, our products use a common management interface designed to simplify storage administration and reduce related costs.

We were incorporated in 1981 in California and completed our initial public offering in 1986. In March 1998, we reincorporated in Delaware. We are an S&P Small Cap 600 Index member. Our principal executive offices are located at 691 South Milpitas Boulevard, Milpitas, California 95035 and our telephone number at that location is (408) 945-8600. We also maintain our website at

www.adaptec.com. Information found on or accessible through our website is not part of and is not incorporated into, this Annual Report on Form 10-K.

Business Strategy

We are focused on delivering differentiated solutions for data storage. We simplify the latest storage technologies, making them affordable and accessible to a wide range of users through solutions that combine hardware and software. Our management team continuously reviews and evaluates all aspects of our business with the goal to become the leader in I/O technology and storage solutions. To strengthen our market position and scale down our operations relative to our revenue basis, we implemented the following steps in fiscal 2009:

- We implemented two restructuring plans in fiscal 2009 to reduce our operating expenses to better align our resources with our strategic business objectives and declining revenues, including the impact on our business from the deterioration of macroeconomic conditions. We expect to reduce our annual operating expenses by approximately \$15.7 million as a result of these restructuring actions.
- In June 2008, we sold the Snap NAS systems business to Overland Storage, Inc., or Overland, for \$3.3 million. The Snap NAS systems business consisted of the Snap Server branded file-based NAS storage systems, which were sold to end users through our network of distribution partners, solution providers, e-tailers and VARs.
 - In July 2008, we entered into a three-year strategic development agreement with HCL Technologies Limited, or HCL, to provide product development and engineering services for our product portfolio. Under the terms of the agreement, HCL agreed to employ certain of our former engineering employees, who will work exclusively on our engineering projects. We expect this partnership to help support and improve the competitiveness of our business in the channel.
- In September 2008, we acquired Aristos Logic Corporation, or Aristos, a provider of RAID technology to the data storage industry for a purchase price of approximately \$38.9 million, paid an additional \$1.4 million related to a management incentive pool as of March 31, 2009 and have an obligation to pay up to an additional \$1.0 million related to the remaining management incentive pool, which is contingent upon the employment of certain Aristos employees. Subsequent to year-end, we paid an additional \$0.7 million related to this management incentive pool. The ASIC capabilities we acquired through Aristos will provide us with product differentiation, more cost effective products and access to additional markets and OEM design opportunities.
 - In June 2008, in conjunction with the sale of our Snap Server NAS business, we revised our internal reporting structure and now operate in one segment. The majority of our former SSG segment, related to the Snap Server branded file-based NAS storage systems, represented results from discontinued operations. The remaining portion of our former SSG segment, related to the block-based iSCSI storage solution products, was retained.

We expect the revenue levels from sales of our serial legacy products sold to OEM customers to significantly decline within the next two quarters and from the sales of our parallel SCSI products to continue to decline in future quarters. As a result, our future revenue growth is largely dependent on the success of our new and future products, obtaining new OEM design wins, fulfilling our obligations on current OEM design wins, and growing our market share in the channel. We expect that the acquisition of Aristos will allow us to expand into adjacent RAID markets that we believe provide us with opportunities for growth, including blade servers, enterprise-class external storage systems and performance desktops, and will provide us with a strong ASIC roadmap. The Aristos acquisition should also enable us to pursue new OEM opportunities and expand our future channel product offerings containing unified serial technologies. For example, in October 2008, we announced a design win from IBM for our RAID Storage Processor technology, which was enabled by the Aristos acquisition. We will continue to seek additional growth opportunities beyond those presented by our existing product lines by entering into strategic alliances, partnerships or acquisitions of technologies or businesses in order to scale our business. We also intend to continue to evaluate structural alternatives that have the potential to achieve additional stockholder return.

Unless otherwise indicated, the following discussion pertains only to our continuing operations.

We focus on strengthening our market position through innovation, acquisition and new products, which included delivering a number of new products and features over the past four quarters.

- PCIe RAID Controllers

. We introduced two new Unified Serial HBA product families (Series-1 and Series-2), which maximize scalability for end users and connects to external RAID subsystems, tape devices and Solid State Disks, as well as provide a platform for legacy Ultra 320 to SAS transitions in the IT server enterprise.

- Green IT Features

. In fiscal 2009, we enhanced our Unified Serial RAID controllers by introducing `green' data center features. The Series-5 RAID controllers now include our Intelligent Power Management technology which allows users to reduce their power consumption without impacting storage performance. The energy savings varies based on the type of application being operated and whether the drives are operating during standby or when the power is off, and will be most beneficial for end users with data centers where controllers are deployed in large quantities.

- RAID Storage Processors (RSPs)

. Our RSP ASIC products, which include Ultraslice and Ultraslice MPx, were an addition to the Adaptec product line as a result of the Aristos acquisition in September 2008. RSPs allow end users to create their own customized hardware designs and are ideal for power efficient, cost-effective, high density storage applications, such as Blade Servers and External Storage applications. When RSP ASICs are applied with our proprietary RAID software, our products further provide for disk-level data protection and high data throughput for both workstation and server applications.

Products Overview

We now operate in one segment. For an analysis of financial information about our geographic areas, see "Note 19 -Segment, Geographic and Significant Customer Information" to the Consolidated Financial Statements included in "Item 8: Financial Statements and Supplementary Data" of this Annual Report on Form 10-K.

Our business provides data protection storage products and currently sells a broad range of storage technologies, including ASICs, board-level I/O and RAID controllers, internal enclosures, sub-systems and stand-alone software. We sell these products directly to OEMs, ODMs that supply OEMs, system integrators, VARs and end users through our network of distribution and reseller channels. Following are discussions of our key product offerings.

Components.

RAID Controllers and HBAs. We offer a wide range of HBAs and RAID controllers for use with SATA, SAS and Parallel SCSI drives, including our line of Unified Serial™ cards which can be used with both SATA and SAS drives, including Solid State Disks. The SATA and SAS technologies are offered in our Series-1, Series-2, Series- 3 and Series-5 families. Our SATA products provide a flexible solution for cost effective, high capacity drives. Unified Serial RAID Controllers support both SATA and SAS disk drives with the same architecture to meet the need for maximum performance, reliability, scalability, and flexibility for enterprise-class applications, including NAS, online transaction processing, web, digital surveillance, and streaming applications. Our new family of products is designed to meet evolving storage needs by providing high performance, reliable storage management tools, hardware and software compatibility and high levels of support. While we have used our own ASICs in these products in the past, our latest generation of products uses ROC technology from Intel Corporation. Our controller cards include 4, 8, 12, 16, 20 and 24-port designs, which help end users simplify the design of their solutions.

Host I/O.

Driven by market needs for capacity and data protection, the host I/O interfaces support various connectivity requirements between the central processor and internal and external peripherals, including external storage and tape devices. Our host I/O products provide customers with high-speed PCI-X, PCIe, SCSI, SAS or SATA connectivity. These technologies can be applied to a variety of applications, including storage of email, medical records, digital images, and records of financial transactions.

RSP. RSPs are ASIC devices incorporating a collection of hardware engines that fully automate the operation of the data path and eliminate the performance bottlenecks found in traditional software RAID solutions. Our RSP products provide our customers with cost- and energy-efficiencies in data protection without jeopardizing the yield for high performance.

Software.

Our products incorporate software that simplifies data management and protection for businesses of all sizes. We distribute the software through various methods. Some of our software is licensed independent of the hardware to run on a range of products, including ours.

The primary software products that we license are as follows:

Host RAID.

Host RAID technology allows our customers to leverage the I/O components already incorporated on their servers to connect them with RAID-providing low cost data protection. Host RAID enables customers not only to protect their data drives but also to include protection for the boot drives.

The following software products are available in combination with hardware or can be purchased as an upgrade.

RAID

. Our RAID technology reduces a customer's dependence on the reliability of a single disk drive by encoding data across multiple drives. We apply our RAID technology independent of the disk drive interface to provide data protection on SCSI, SATA and SAS disk drives. This independence enables our RAID software, firmware and hardware to be available across the full spectrum of servers from entry to enterprise.

Adaptec Storage Manager.

Adaptec Storage Manager is a single storage management utility that enables customers and IT managers to easily manage storage across DAS and SAN environments, create IP SAN solutions and protect data (RAID) from disk drive failure. Standard features that are included with our new SATA or SAS RAID controllers allow our products to deliver a high level of data protection.

Other Software.

We also offer storage virtualization software that includes snapshot backup and replication functionality, which, when combined with our hardware, helps to simplify storage management, increase data protection, and lower total cost of ownership with quicker installation, simplified administration and automated monitoring. It allows the user to configure, expand, manage and monitor local and remote storage from a single client workstation.

Sales, Marketing and Customers

We sell our products through our sales force directly to OEMs worldwide who market our products under their brands. We work closely with our OEM customers to design and integrate current and next generation products to meet the specific requirements of end users. Our OEM sales force focuses on developing relationships with OEM customers. The sales process involved in gaining major design wins can be complex, lengthy, and expensive. Sales to these OEM customers accounted for approximately 56% of our total net revenues in fiscal 2009. Our primary OEM customers in fiscal 2009, in alphabetical order, were Dell, Hewlett-Packard, IBM and Intel. We expect net revenues obtained from our serial legacy products sold to OEM customers to significantly decline within the next two quarters as we believe the future growth opportunities for these products are limited due to the failure to secure design wins. However, we expect to gain future opportunities to sell serial products to OEMs, due in part to the Aristos acquisition, but our ability to capitalize on these opportunities may be adversely impacted by a reduction in IT spending as a result of current economic conditions.

We also sell through our sales force to distribution channels worldwide, which market our products under the Adaptec brand; they, in turn, sell to VARs, system integrators and retail customers. We provide training and support for our distribution customers and to VARs. We also sell board-based products and provide technical support to end users worldwide through major computer-product retailers. Sales to distribution customers accounted for approximately 44% of our total net revenues in fiscal 2009. Our primary distributors in fiscal 2009, in alphabetical order, were Bell Microproducts, CPI Computer Partner Handels GmbH, Ingram Micro, Synnex and Tech Data.

We emphasize customer service as a key element of our marketing strategy and maintain application engineers at our corporate headquarters and in the field. This includes assisting current and prospective customers in the use of our products, and providing the systems-level expertise and software experience of our engineering staff to customers with particularly difficult design problems. A high level of customer service is also maintained through technical support hotlines, email and dial-in-fax capabilities.

A small number of our customers account for a substantial portion of our net revenues. In fiscal 2009, IBM accounted for 36% of our total net revenues. In fiscal 2008, IBM accounted for 40% of our total net revenues. In fiscal 2007, IBM and Dell accounted for 38% and 15% of our total net revenues, respectively.

We have entered into several arrangements with IBM over the past several years. In May 2000, we entered into a patent cross-license agreement with IBM, which was subsequently amended in March 2002, and obtained a release of past infringement claims made prior to January 1, 2000 and received the right to use certain IBM patents from January 1, 2000 through June 30, 2007. Additionally, we granted IBM a license to use all of our patents for the same period. A number of the licensed patents have either expired or we no longer utilize them in our product offerings. In March 2002, we entered into a non-exclusive, perpetual technology licensing agreement and an exclusive three-year product supply agreement with IBM. The technology licensing agreement grants us the right to use IBM's ServeRAID technology for our internal and external RAID products. Under the product supply agreement, we deliver RAID software, firmware and hardware to IBM for use in IBM's xSeries servers.

International

We maintain operations in five foreign countries and sell our products in additional countries through various

representatives and distributors. We believe this geographic diversity allows us to draw on business and technical expertise from an international workforce, provides both stability to our operations and diversifies revenue streams to offset geographic economic trends and offers us an opportunity to penetrate new markets.

A summary of our net revenue and net property, plant and equipment by geographic area is set forth in Note 19 to the Consolidated Financial Statements included in "Item 8: Financial Statements and Supplementary Data" of this Annual Report on Form 10-K. We generated approximately 74% of our overall revenues in 2009 from outside of the United States primarily from commercial customers. These sales include sales to foreign subsidiaries of U.S. companies.

Competition

The markets for all of our products are highly competitive and are characterized by rapid technological advances, frequent new product introductions, evolving industry and customer standards and competitive pricing pressures. Our competitive strategy is to continue to leverage our technical expertise and concentrate on delivering a comprehensive set of highly reliable, high performance storage and connectivity products with features that deliver superior data protection, improved energy efficiencies and reduced operating costs that simplify storage management for organizations of all sizes. We design advanced features into our products, with a particular emphasis on data transfer rates, software-defined features and compatibility with major operating systems and most peripherals. As the usage models for storage devices continue to evolve, we will continue to innovate to achieve product differentiation.

We believe the principal competitive factors in the markets for our products are product price versus performance, product features and functionality, reliability, technical service and support, scalability and interoperability and brand awareness. We compete primarily with controller and HBA product offerings from Areca and LSI, and ASIC product offerings from LSI, Marvell and PMC-Sierra.

Backlog

We typically receive orders for our products within two weeks or less of the desired delivery date and most orders are subject to rescheduling and/or cancellation with little or no penalty. We maintain remote inventory locations at some of our largest OEMs' sites with product ordering and delivery occurring when the OEM customer accepts our product into their inventory. In light of industry practice and experience, we do not believe that backlog at any given time is a meaningful indicator of our ability to achieve any particular level of revenue or financial performance.

Manufacturing

We outsource the manufacturing of the majority of our products to Sanmina-SCI Corporation. We believe that Sanmina-SCI will be able to meet our anticipated needs for both current and future technologies. Our final assembly and test operations for our ASIC products are performed by Amkor Technology and Advanced Semiconductor Engineering. Advanced Semiconductor Engineering also warehouses and ships our products on our behalf.

Intellectual Property

We seek to establish and maintain our proprietary rights in our technology and products through the use of patents, copyrights, trademarks and trade secret laws. As of March 31, 2009, we had 442 issued patents, expiring between 2011 and 2026, covering various aspects of our technologies. In addition, the Adaptec name and logo are trademarks or registered trademarks of ours in the United States and other countries. We believe our patents and other intellectual property rights have value, but we do not consider any single patent to be essential to our business. We also seek to maintain our trade secrets and confidential information by non-disclosure policies and through the use of appropriate confidentiality agreements.

Research and Development

We continually enhance our existing products and develop new products to meet changing customer demands. The high technology industry is characterized by rapid technological innovation, evolving industry standards, changes in customer requirements and new product introductions and enhancements. We believe that our future performance will depend in large part on our ability to maintain and enhance our current product line, develop new products that achieve market acceptance, maintain competitiveness and meet an expanding range of customer requirements. To achieve this objective, we intend to continue to leverage our technical expertise and product innovation capabilities to address storage-access products across a broad range of users and platforms. We may also enter into strategic alliances or partnerships or acquire complementary businesses or technologies where appropriate. We entered into a three-year strategic development agreement with HCL to provide product development and engineering services for our product portfolio. HCL agreed to employ certain of our former engineering employees, who will work exclusively on our engineering projects, and their research and development center is located in Bangalore, India.

Approximately 44% of our employees were engaged in research and development at March 31, 2009 as compared to 42% and 44% at March 31, 2008 and 2007, respectively. Our research and development expenses were \$26.9 million, or 23% of total net revenues, \$34.0 million, or 23% of total net revenues, and \$49.5 million, or 22% of total net revenues, for fiscal years 2009, 2008 and 2007, respectively. Research and development expenses primarily consist of salaries and related costs of employees engaged in ongoing research, design and development activities and subcontracting costs.

Although we have experienced declines in research and development expense from fiscal 2007 to fiscal 2009, we anticipate that we will continue to have significant research and development expenditures in the future in order to continue to offer innovative, high-quality products and services to maintain and enhance our competitive position. Our investment in research and development primarily focuses on developing new products for external storage, storage software and server storage markets.

Environmental Laws

Certain of our operations involve the use of substances regulated under various federal, state and international environmental laws. It is our policy to apply strict standards for environmental protection to sites inside and outside the United States, even if not subject to regulations imposed by local governments. The liability for environmental remediation and related costs is accrued when it is considered probable and the costs can be reasonably estimated. Environmental costs are presently not material to our operations or financial position.

Employees

As of March 31, 2009, we had a total of 232 employees, which excludes outsourced partners. Overall employee headcount declined by 41% in fiscal 2009 compared to fiscal 2008, and declined by 35% in fiscal 2008 compared to fiscal 2007. We had a total of 391 and 598 employees at the end of fiscal 2008 and 2007, respectively.

We believe that we currently have favorable employee relations; however, due to the general uncertainty regarding the outlook of our company and the macroeconomic conditions, we may experience a higher level of attrition in our workforce. None of our employees are represented by a collective bargaining agreement, nor have we ever experienced work stoppages.

Available Information

We make available free of charge through our Internet website at <http://www.adaptec.com> the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the Securities and Exchange Commission: our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K,

proxy, information statements and all amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. The SEC also maintains a web site at <http://www.sec.gov> that contains reports, proxy and information statements, and other information that we file electronically with the SEC and may be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information regarding the operation of the SEC's Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

Item 1A. *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 results of operations and financial condition. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer, and the trading price of our common stock could decline.

Our operating results may be adversely affected by unfavorable economic and market conditions and the uncertain geopolitical environment.

Economic conditions have deteriorated significantly in many of the countries and regions in which we do business and may remain depressed for the foreseeable future. Global economic conditions have been challenged by worldwide liquidity and credit concerns and the related effects on economies around the world. Continuing adverse global economic conditions in our markets would likely negatively impact our business, which could result in:

- Reduced demand for our products;
- Increased price competition for our products;
- Increased risk of excess and obsolete inventories;
- Increased risk in the collectibility of cash from our customers;
- Increased risk in potential reserves for doubtful accounts and write-offs of accounts receivable; and
- Higher operating costs as a percentage of revenues.

If the global economic crisis causes demand in the server and network storage markets to decline, demand for our products would also likely be negatively affected. Some of the factors that could influence demand in the server and network storage markets include continuing increases in fuel and other energy costs, labor costs, access to credit, consumer confidence and other macroeconomic factors affecting corporate spending behavior. It is difficult to predict future server sales growth, if any. If global economic conditions remain uncertain or deteriorate further, we may experience material adverse impacts on our business, operating results and financial condition.

Actions that we have taken and the actions that we are considering could adversely affect our business and financial results in the short-term, and may not have the long-term beneficial results that we intend.

Our management team continuously reviews and evaluates all aspects of our business, including our product portfolio, our relationships with strategic partners, our research and development focus and sales and marketing efforts to better scale our operations relative to our cost basis.

The actions that we have taken in fiscal 2009, which include the acquisition of Aristos, the disposition of our Snap NAS Server business, the implementation of restructuring plans and impairment of goodwill, and the actions that we are considering could adversely affect our business and financial results in the short-term, may not have the long-term beneficial results that we intend and could result in the following:

- Loss of customers;
- Loss of employees;
- Increased dependency on suppliers;
- Supply issues;
- Reduced revenue base;
- Impairment of our assets;
- Increased operating costs;
- Material restructuring charges; and

- Loss of liquidity.

We may sustain losses in our investment portfolio due to adverse changes in the global credit markets.

Global economic conditions have been challenged by slowing growth and the sub-prime debt devaluation crisis, causing worldwide liquidity and credit concerns. A substantial portion of our assets consists of our investments in marketable securities that we hold as available-for-sale and mark them to market. While there has been a decline in the trading values of certain of the securities in which we have invested, we have not recognized a material loss on our securities as the unrealized losses incurred were not deemed to be other-than-temporary. We expect to realize the full value of all our marketable securities upon maturity or sale, as we have the intent and believe we have the ability to hold the securities until the full value is realized. However, we can not provide any assurance that our invested cash, cash equivalents and marketable securities will not be impacted by adverse conditions in the financial markets, which may require us to record an impairment charge that could adversely impact our financial results.

If the net book value of our long-lived assets is not recoverable, an impairment loss must be recognized which would adversely affect our financial results. Certain events or changes in circumstances would require us to assess the recoverability of the net book value amount of our long-lived assets. For example, in fiscal 2008, we recorded an impairment charge of \$2.2 million for our intangible assets related to our acquisition of Elipsan Limited due to a revision in our forecasts that resulted in expected negative long-term cash flows for these assets for the first time. In fiscal 2009, we recorded an impairment charge of \$16.9 million to write-off goodwill based on our annual review in the fourth quarter of fiscal 2009. We also assessed the fair values of the related intangible assets and determined that our other intangible assets were not impaired; however, due to the ongoing uncertainty in market conditions, we will continue to monitor and evaluate our net book value of our other intangible assets and other long-lived assets in future periods. If the deterioration of macroeconomic conditions continues to worsen and if our business performance declines, we may be required to record impairment charges in the future, which could adversely affect our financial results.

If our design wins do not result in significant sales, our revenues will continue to decline.

A "design win" occurs when a customer or prospective customer notifies us that our product has been selected to be integrated within its product. In October 2008, we announced a design win with IBM for our RSP technology, which will be implemented into its IBM BladeCenter S product. The success that we ultimately experience from a design win is largely a factor of the success of the customer's product into which our product has been integrated. We have virtually no control over, and sometimes have very little visibility as to, the success of our customer's products, which is dependent upon a number of factors including current market conditions. If our design wins do not result in significant sales, our revenues will continue to decline which could adversely affect our business.

As our revenue base continues to decline from our current operations, we may choose to exit or divest some or a substantial portion of our current operations to focus on new opportunities.

Our management team continuously reviews and evaluates our product portfolio, operating structure and markets to determine the future viability of our existing products and market positions. We may determine that the infrastructure and expenses necessary to sustain an existing business or product offering is greater than the potential contribution margin that will be obtainable in the future. As a result, we may determine that it is in our interest to exit or divest such existing business or product offering. For example, in the first quarter of fiscal 2009, we sold our Snap Server NAS business, which was the majority of our segment previously known as SSG, and reclassified all historical costs as discontinued operations. In fiscal 2007, we also decided not to invest further in our business related to our previous segment due to OEMs incorporating other connectivity technologies directly into their products, the increased level of competition entering the market and the complexities of the retail channel. As a result, we wound down this business throughout fiscal 2007 and exited it at March 31, 2007. However, we may seek growth opportunities beyond those presented by our existing product lines by entering into strategic alliances, partnerships or acquisitions in order to scale our business, and we may not succeed in these efforts.

We currently depend on a small number of large OEM customers for a significant portion of our revenues, and we have been unsuccessful in the past in obtaining designs wins, which may prevent us from sustaining or growing our revenues from OEM customers.

A small number of large OEMs have historically been responsible for a significant percentage of our revenues. However, we have failed to secure design wins from these OEM customers in connection with their new products, which have adversely affected our revenues and will continue to adversely affect our future revenues. For example, in the second quarter of fiscal 2008, a significant customer notified us that we did

not receive design wins for our next generation serial products, which will have a significant negative impact on our revenues over the next two quarters and we anticipate the revenue levels for these products beyond the second quarter of fiscal 2010 will be significantly smaller. We have evaluated this portion of our business, and we are only opportunistically pursuing future business from OEM customers with our current product portfolio, as the future growth opportunities for our current products are limited. While we have gained new OEM opportunities for products containing unified serial technologies as a result of the Aristos acquisition, we cannot predict the extent to which any such sales will offset the decline in OEM sales from our legacy products.

We depend on a few key customers and the loss of any of them could significantly reduce our net revenues.

Historically, a small number of our customers have accounted for a significant portion of our net revenues. For example, in fiscal 2009, IBM accounted for 36% of our total net revenues, in fiscal 2008, IBM accounted for 40% of our total net revenues, and in fiscal 2007, IBM and Dell accounted for 38% and 15% of our total net revenues, respectively. We believe that our major customers continually evaluate whether or not to purchase products from alternate or additional sources. Additionally, our customers' economic and market conditions frequently change, and many of our customers may be negatively impacted by the current global economic turmoil. Accordingly, we cannot assure you that one or more of our major customers will not reduce, delay or eliminate its purchases from us, which would likely cause our revenues to decline further. For example, in the second quarter of fiscal 2008, a significant customer notified us that we did not receive design wins for our next generation serial products, which will have a significant negative impact on our revenues within the next two quarters and we anticipate the revenue levels for these products beyond the second quarter of fiscal 2010 to be significantly smaller. While we have gained new OEM opportunities for products containing unified serial technologies as a result of the Aristos acquisition, we cannot predict the extent to which any such sales will offset the decline in OEM sales from our legacy products; therefore, we will currently be increasingly dependent on our channel products and customers for future revenue growth. 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.

If our customers or financial institutions that maintain our cash, cash equivalents and marketable securities, experience financial difficulties, which is more likely in the current weakened state of the economy, our revenues, operating results or cash balances may be adversely impacted.

We do not carry credit insurance on our accounts receivables and any difficulty in collecting outstanding amounts due from our customers, particularly customers that place larger orders or experience financial difficulties, could adversely affect our revenues and our operating results. In addition, we maintain our cash, cash equivalents and marketable securities with certain financial institutions in which our balances exceed the limits that are insured by the Federal Deposit Insurance Corporation. If the underlying financial institutions fail or other adverse conditions occur in the financial markets, our cash balances may be impacted.

In order to execute our strategies, we may enter into strategic alliances with, partner with, invest in or acquire companies with complementary or strategic products or technologies or make other structural changes to our business. Costs associated with these strategic alliances, investments or acquisitions may adversely affect our results of operations. This impact could be exacerbated if we are unable to integrate the acquired companies, products or technologies.

We may pursue strategic transactions, partnerships, investments and acquisitions in order to scale our business as sales of our core parallel products continue to decline. These may include both strengthening our partnerships in silicon-based technology and broadening our silicon-based intellectual property to improve our business opportunities. In order to be successful in the strategic alliances, partnerships, investments or acquisitions that we may enter into or make, we must:

- Conduct strategic alliances, partnerships, investments or acquisitions that enhance our time to market with new products;
- Successfully prevail over competing bidders for target strategic alliances, partnerships, investments or acquisitions at an acceptable price;
- Invest in companies and technologies that contribute to the profitable growth of our business;
- Integrate acquired operations into our business and maintain uniform standards, controls and procedures;
- Retain the key employees of the acquired operations;
- Develop the capabilities necessary to exploit newly acquired technologies; and
- Consider structural changes to achieve additional stockholder return.

In September 2008, we completed our acquisition of Aristos, a provider of RAID technology to the data storage industry. The benefits of this acquisition or any strategic alliances, partnerships, investments or other acquisitions may

prove to be less than anticipated and may not outweigh the costs reported in our financial statements, and we may not obtain the operational leverage or realize the improvements we intend or desire with the actions we take.

Completing any potential future strategic alliances, partnerships, investments or acquisitions could cause significant diversions of management time and resources and divert focus from the activities of our current operations. We may encounter difficulty in integrating and assimilating the operations and personnel of the acquired companies, including those associated with the Aristos acquisition, into our operations or the acquired technology and rights into our services. We may also lack the experience or expertise in the new products and markets, which may impair the relationships with customers or suppliers of the acquired business, including those associated with the Aristos acquisition. The acquisition of new operations may require us to develop additional internal controls to support these new operations. We may experience material deficiencies or weaknesses in our internal control over financial reporting as a result of the addition of new operations or due to changes to our internal controls, which could have a material impact on our results of operations when corrected. Additionally, we may not be successful in overcoming these risks or any other problems encountered in connection with these or other acquisitions, strategic alliances or investments, which could result in an adverse impact on our ability to develop or sustain the acquired business.

If we acquire new businesses, products or technologies in the future, we may be required to assume warranty claims or other contingent liabilities, including liabilities unknown at the time of acquisition, and amortize significant amounts of other intangible assets and, over time, recognize significant charges for impairment of goodwill, other intangible assets or other losses. For example, based on our annual review in the fourth quarter of fiscal 2009, we recorded an impairment charge of \$16.9 million to write-off goodwill in connection with our acquisition of Aristos.

If we consummate any potential future acquisitions in which the consideration consists of our common 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. If we were to use a substantial portion of our available cash, we might need to repatriate cash from our subsidiaries, which may cause us to incur additional income taxes at a rate up to 40%, which is our blended (federal and state) statutory rate in the United States. In addition, we may be required to invest significant resources in order to perform under a strategic alliance or partnership, or to complete an acquisition or investment, which could adversely affect our results of operations, at least in the short-term, even if we believe the acquisition, strategic alliance or investment will benefit us in the long-term.

If we are not successful in completing additional acquisitions of or strategic alliances or partnerships with companies with complementary or strategic products or technologies, our future growth may be hindered. In September 2008, we completed our acquisition of Aristos, a provider of RAID technology to the data storage industry. In order to scale our operations relative to our cost basis, we may need to identify additional attractive acquisition, strategic alliance or partnership candidates and complete a transaction with them. If we fail to identify and complete additional successful acquisitions or strategic alliances or partnerships, we expect that our revenues will continue to decline and we may be at a competitive disadvantage or we may be adversely affected by negative market perceptions, any of which may have a material adverse effect on our financial results.

We depend on contract manufacturers and subcontractors, and if they fail to meet our manufacturing needs, it could delay shipments of our products and result in the loss of customers or revenues and increased manufacturing costs, which would have an adverse effect on our results.

We rely on contract manufacturers for manufacturing our products and subcontractors for the assembly and packaging of the integrated circuits included in our products. On December 23, 2005, we entered into a three-year contract manufacturing agreement with Sanmina-SCI. Under this agreement, Sanmina-SCI assumed manufacturing operations for the majority of our products. In February 2009, we entered into a new contract manufacturing agreement with Sanmina-SCI for another three years. We must work closely with Sanmina-SCI to ensure that products are delivered on a timely basis. In addition, we must ensure that Sanmina-SCI continues to provide quality products. If Sanmina-SCI is unwilling or unable to meet our supply needs, as was the case in the earlier stages of our contract with them, including timely delivery and adherence to standard quality, we could lose customers or revenues and incur increased manufacturing costs, which would have an adverse

effect on our operating results.

Due to the nature of this relationship, and the continuous changes in the prices of components and parts, we are in ongoing negotiations with Sanmina-SCI concerning product pricing. Any adverse outcome of future disputes concerning product pricing could adversely impact our gross margins. We have no long-term agreements with our assembly and packaging subcontractors. We also employ Amkor Technology and Advanced Semiconductor Engineering to final assemble and test operations related to our ASIC products. We cannot assure you that these subcontractors will continue to be able and willing to meet our requirements. Any significant disruption in supplies from or degradation in the quality of components or services supplied by these contract manufacturers and subcontractors could delay shipments and result in the loss of customers or revenues, which could have an adverse effect on our operating results.

Our operations depend on the efforts of our workforce, particularly our executives, principal engineers and other key employees, the loss of whom could affect the growth and success of our business.

In order to be successful, we must retain and motivate our executives, our principal engineers 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. Competition for experienced management, technical, marketing and support personnel such as these remains intense. We must also continue to motivate all of our other employees and keep them focused on our strategies and goals, which may be particularly difficult due to morale challenges posed by continued workforce reductions, including absorbing additional responsibilities as we become a smaller company, as well as the uncertainty regarding the outlook of our company as revenues continue to decline. Each of our employees is an "at-will" employee, and, as a result, any of our employees could terminate their employment with us at any time without penalty and may seek employment with one or more of our competitors. The loss of any of our key employees as well as a high level of attrition from all our other employees could have a significant impact on our operations.

If we do not meet our expense reduction and cost containment goals, we may have to continue to implement additional restructuring plans in order to reduce our operating costs. This may cause us to incur additional material restructuring charges and result in adverse effects on our employee capacities.

We have implemented several restructuring plans to reduce our operating costs and recorded related restructuring charges of \$6.1 million, \$6.3 million and \$3.7 million in fiscal years 2009, 2008 and 2007, respectively. These restructuring plans primarily involved the reduction of our workforce and the closure of certain facilities. The goals of our restructuring plans that were implemented prior to fiscal 2007 were to support future growth opportunities, focus on investments that grow revenues and increase operating margins. Our recent goals involve better alignment of our cost structure with our anticipated revenue stream and improving our results of operations and cash flow. We have in the past not realized, and in the future may not realize, the anticipated benefits of the restructuring plans we initiated. To the extent that we do not meet our expense reduction goals, we may be required to implement further restructuring plans, which may lead us to incur material restructuring charges. Further, our restructuring plans could result in a potential adverse effect on employee capabilities that could harm our efficiency and our ability to act quickly and effectively in the rapidly changing technology markets in which we sell our products.

The impact of industry technology transitions and market acceptance of our new products may cause our revenues to continue to decline.

We have experienced a significant decline in our revenues as the industry continues to transition from parallel to serial connectivity, as the revenues we generate from sales of our serial products has not grown at a fast enough rate to offset declines in sales of our parallel products. We expect this trend to continue in future periods. In addition, products that we may develop may not gain sufficient market acceptance to offset the decline in revenues from certain of our existing products or otherwise contribute significantly to revenues. These factors, individually or in the aggregate, could cause our revenues to continue to decline.

Our dependence on new products may cause our net revenues to fluctuate or decline.

Our future success significantly depends upon our completing and introducing enhanced and 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 may be as brief as 12 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.

We have introduced RAID-enabled products based on the next generation SATA technology and delivered our products based on SAS technology to certain major customers for testing and integration. We will not succeed in generating significant revenues from our new SATA and SAS technology products if the market does not adapt to these new technologies, which would, over time, adversely affect our net revenues and operating results.

If we lose the cooperation of other hardware and software producers whose products are integral to ours, our ability to sustain or grow our revenues could be adversely affected.

We must design our products to operate effectively with a variety of hardware and software products supplied by other manufacturers, including the following:

- I/O and RAID ASICs;
- Microprocessors;
- Peripherals;
- Operating system software;
- Server and desktop motherboards; and
- Enclosures.

We depend on significant cooperation from these manufacturers to achieve our design objectives and develop products that operate successfully with their products. These companies could, from time to time, elect to 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 that as a result of competition or other factors, our 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. If any of these events were to occur, our revenues and financial results could be adversely affected.

If we are unable to compete effectively, our net revenues and gross margins 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.

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. Revenues for our SATA products sold to our OEM customers have declined and we expect these revenues to continue to decline, as our products are at the end of their life cycles and certain of our customers have moved to other suppliers to obtain next generation SATA technologies. We also expect a significant negative impact on our net revenues from our serial

legacy products sold to OEMs within the next two quarters and we anticipate the revenue levels for these products beyond the second quarter of fiscal 2010 to be minimal as a significant customer notified us in the second quarter of fiscal 2008 that we did not receive design wins for our next generation serial products.

Our future revenue growth remains largely dependent on the success of our new products addressing unified serial technologies and growing our market share in the channel, and our future operating results will be influenced by our ability to participate in the development of the network storage market in which we face intense competition from other companies that are also focusing on networked storage products. If we experience an incremental decline in our revenues beyond the declines anticipated, and we are unable to effectively manage our inventory levels, we may be required to record additional inventory-related charges, which would adversely impact our gross margins.

We cannot assure you that we will have sufficient resources to accomplish any or all of the following:

- Satisfy any growth in demand for our products;
- Make timely introductions of new products;
- Compete successfully in the future against existing or potential competitors; or
- Prevent price competition from eroding margins.

We depend on the efforts of our distributors, which if reduced, could result in a loss of sales of our products in favor of competitive offerings.

We derived approximately 44% of our total net revenues for fiscal 2009 from independent distributor and reseller channels. Our financial results could be adversely affected if our relationships with these distributors or resellers were to deteriorate or if the financial condition of these distributors or resellers were to decline. We continue to monitor and evaluate our distributors and may terminate distributor relationships to improve our product placement or improve distribution channels; however, the termination of a distributor may adversely affect our financial results in the short term.

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. 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.

We currently purchase all of the finished production silicon wafers, chips and other key components used in our products from suppliers, and if they fail to meet our manufacturing needs, it would delay our production and our product shipments to customers and negatively affect our operations.

Independent foundries manufacture to our specifications all of the finished silicon wafers and chips used for our products. We currently purchase finished production silicon wafers used in our products from Taiwan Semiconductor Manufacturing Company, or TSMC, and purchase finished production chips from LSI Corporation. In addition, we purchase some of our key components used in our products from sole-source suppliers. The manufacture of semiconductor devices and other components are sensitive to a wide variety of factors, including the following:

- The availability of raw materials;
- The availability of manufacturing capacity;
- Transition to smaller geometries of semiconductor devices;
- The level of contaminants in the manufacturing environment;
- Impurities in the materials used; and
- The performance of personnel and equipment.

We cannot assure you that manufacturing problems may not occur in the future. A shortage of raw materials or production capacity could lead our suppliers to allocate available capacity to other customers. Any prolonged inability to obtain wafers and other key components 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 our suppliers will continually seek to convert their processes for manufacturing wafers and key components to more advanced process technologies. Such conversions entail inherent technological risks that can affect yields and delivery times. If for any reason the suppliers we use are unable or unwilling to satisfy our wafer and other key component needs, we will be required to identify and qualify additional suppliers. Additional suppliers for wafers and other key components may be unavailable, may take significant amounts of time to qualify or may be unable to satisfy our requirements on a timely basis.

Because our sales are made by means of standard purchase orders rather than long-term contracts, if demand for our customers' products declines or if our customers do not control their inventories effectively, they may cancel or reschedule shipments previously ordered from us or reduce their levels of purchases from us.

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 have from time to time in the past canceled or rescheduled shipments previously ordered from us, and we cannot assure you that they will not do so in the future. For example, in the third quarter of fiscal 2007, the demand for our products from certain OEM customers substantially declined from their initial forecasts, which adversely affected our operating results. As 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, we have set our operating budget based on forecasts of future revenues because we do not have significant backlog. 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 fail to adequately forecast demand for our products, we may incur excess product inventory costs and our financial results will be adversely affected.

As the sales of our products are completed through standard purchase orders rather than long-term contracts, we provide our contract manufacturer forecasts based on anticipated future demand from our customers. To the extent that our customers' demands fall below their initial forecasts and we are unable to sell the product to another customer, and because our purchase commitment lead time to manufacture products with our contract manufacturer is longer than the lead time for a customer to cancel or reschedule an order, we may be exposed to excess product inventory costs and our financial results will be adversely affected. For example, in the third quarter of fiscal 2007, we incurred significant inventory-related charges due to a decline in our revenue stream.

Our operating results have fluctuated in the past, and are likely to continue to fluctuate, and if our future results are below the expectations of investors or securities analysts, the market price of our common stock would likely decline significantly.

Our quarterly operating results have fluctuated in the past, and are likely to vary significantly in the future, based on a number of factors related to our industry and the markets for our products. Factors that are likely to cause our operating results to fluctuate include those discussed in this Risk Factors section. For example, in fiscal 2009, our operating results were materially impacted by unusual charges, such as a goodwill impairment charge of \$16.9 million.

Our operating expenses are largely based on anticipated revenues, and a large portion of our expenses, including facility costs and salaries, are fixed in the short term. As a result, lower than anticipated revenues for any reason could cause significant variations in our operating results from quarter to quarter.

Due to the factors summarized above, and the other risks described in this section, we believe that you should not rely on period-to-period comparisons of our financial results as an indication of our future performance. In the event that our operating results fall below the expectations of securities analysts or investors, the market price of our common stock could decline substantially.

We may be subject to a higher effective tax rate that could negatively affect our results of operations and financial position.

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We are subject to income and other taxes in the United States and in the foreign taxing jurisdictions in which we operate. The determination of our worldwide provision for income taxes and current and deferred tax assets and liabilities requires judgment and estimation and is subject to audit and redetermination by the taxing authorities. Although we believe our tax estimates are reasonable, the following factors could cause our effective tax rate to be materially different than tax amounts recorded in our Consolidated Financial Statements:

- The jurisdiction in which profits are determined to be earned and taxed;
- Adjustments to estimated taxes upon finalization of various tax returns;
- Changes in available tax credits;
- Changes in share-based compensation expense;
- Changes in tax laws, the interpretation of tax laws either in the United States or abroad or the issuance of new interpretative accounting guidance related to uncertain transactions and calculations where the tax treatment was previously uncertain; and
- The resolution of issues arising from tax audits with various tax authorities.

The factors noted above may cause a higher effective tax rate that could materially affect our income tax provision, results of operations or cash flows in the period or periods for which such determination is made.

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:

- CIFS
- Ethernet
- Fibre channel
- FTP
- HTTP
- IPsec
- iSCSI
- NFS
- PCI
- PCIe
- PCI-X
- RAID
- SAS
- SATA
- SCSI
- SMI-S

Operating Systems:

- Linux
- MacOS
- Netware
- UNIX
- VMware
- Windows

If user 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.

We are subject to various environmental laws and regulations that could impose substantial costs upon us and may adversely affect our business.

We may from time to time be subject to various state, federal, and international laws and regulations governing the environment, including laws regulating the manufacture and distribution of chemical substances and laws restricting the presence of certain substances in electronics

products. Although not currently mandated by any laws and regulations, we experienced a delay in sales from some of our customers that required halogen-free products, which eliminated the use of environmentally sensitive materials, including certain "salt-formers." If our products become non-compliant with the various environmental laws and regulations, or no longer meets our customer specification for environmental products, we may suffer a loss of revenues, be unable to sell affected products in certain markets or countries and be at a competitive disadvantage. We could also incur substantial costs to comply our products to meet the environmental needs of our customers, laws and regulations, which could negatively affect our results of operations and financial position.

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 competitors.

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. If this were to occur, we may lose revenues and market share to our competitors.

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. In addition, we or our customers may be impacted by component shortages if components that comply with the RoHS directive are not available. Similar shortages of components used in our products or our customers' products could adversely affect our net revenues and financial results in future periods.

Product quality problems could lead to reduced revenues and gross margins.

We produce highly complex products that incorporate leading-edge technologies, including both hardware and software. Software often contains "bugs" which can interfere with expected operations. We cannot assure you that our pre-shipment testing programs will be adequate to detect all defects which might interfere with customer satisfaction, reduce sales opportunities, or affect our gross margins if the costs of remedying the problems exceed reserves established for that purpose. An inability to cure a product defect could result in the failure of a product line, and withdrawal, at least temporarily, from a product or market segment, damage to our reputation, inventory costs, product reengineering expenses, and a material impact on revenues and gross margins.

Some of our products contain "open source" software, and any failure to comply with the terms of one or more of these open source licenses could negatively affect our business.

Some of our products are distributed with software licensed by its authors or other third parties under so-called "open source" licenses, including, for example, the GNU General Public License, or GPL, GNU Lesser General Public License, or LGPL, the Mozilla Public License, the BSD License and the Apache License. Some of those licenses may require as a condition of the license that we make available source code for modifications or derivative works we create based upon, incorporating, or using the open source software, that we provide notices with our products, and/or that we license such modifications or derivative works under the terms of a particular open source license or other license granting third parties certain rights of further use. If an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of those open source licenses, we could be required to incur legal expenses in defending against such allegations, and if our defenses were not successful we could be enjoined from distribution of the products that contained the open source software and required to either make the source code for the open source software available, to grant third parties certain rights of further use of our software, or to remove the open source software from our products, which could disrupt our distribution and sale of some of our products. In addition, if we combine our proprietary software with open source software in a certain manner, we could under some of the open source licenses, be required to release the source code of our proprietary software. If an author or other third party that distributes open source software were to obtain a judgment against us based on allegations that we had not complied with the terms of any such open source licenses, we could also be subject to liability for copyright infringement damages and breach of contract for our past distribution of such open source software.

Our international operations involve a number of political, economic and other risks that could adversely affect our ability to sell our products in certain countries, create local economic conditions that reduce demand for our products among our target markets and expose us to potential disruption in the supply of necessary components.

Our international operations and sales are subject to political and economic risks, including political instability, currency controls, and changes in import/export regulations, tariffs and freight rates. Many of our subcontractors are primarily located in Asia and we have sales offices and customers located throughout Europe, Japan and other countries. 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 markets, expose us to potential disruption in the supply of necessary components or otherwise adversely affect our ability to generate revenues and operate effectively. In addition, the operations of our remote locations are subject to management oversight and control. If our business practices and corporate controls are not adhered to worldwide, our business and financial results could be adversely affected.

We depend on third parties to transport our products.

We rely on independent freight forwarders to move our products between manufacturing plants and our customers. Any transport or delivery problems because of their errors, or because of unforeseen interruptions in their activities due to factors such as strikes, political instability, terrorism, natural disasters and accidents, could adversely affect our business, financial condition and results of operations and ultimately impact our relationship with our customers.

If actual results or events differ materially from those contemplated by us in making estimates and assumptions, our reported financial condition and results of operations 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. For example, we have identified key accounting estimates in our Critical Accounting Policies included in "Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations" of this Annual Report on Form 10-K, which include revenue recognition, cash, cash equivalents and marketable securities valuation, inventory, goodwill, stock-based compensation and income taxes. Furthermore, Note 1 to the Consolidated Financial Statements included in "Item 8: Financial Statements and Supplementary Data" of in this Annual Report on Form 10-K 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.

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. Because we conduct a substantial portion of our operations outside of the United States and sell to a worldwide customer base, we are more dependent on our ability to protect our intellectual property in international environments than would be the case if a larger portion of our operations were domestic.

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 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 divert our resources.

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. The risks of receiving additional claims from third parties may be increased in periods when we begin 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, directly or indirectly, 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 intellectual property from third parties on commercially reasonable terms. These claims may be asserted in respect of intellectual property that we own or that we license from others. 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 management time and attention, and could adversely affect our business and financial results.

We may be required to pay additional federal income taxes which could negatively affect our results of operations and financial position.

We were previously subject to IRS audits for our fiscal years 1994 through 2003. During fiscal 2007, we reached resolution with the United States taxing authorities on all outstanding audit issues relating to those fiscal years. However, our tax provision continues to reflect judgment and estimation regarding components of the settlement such as interest calculations and the application of the settlements to state and local taxing jurisdictions. Although we believe our tax estimates are reasonable, the ultimate tax outcome may materially differ from the tax amounts recorded in our Consolidated Financial Statements and may cause a higher effective tax rate that could materially affect our income tax provision, results of operations or cash flows in the period or periods for which such determination is made. In fiscal 2009, the IRS concluded its audit of our federal income tax returns for the fiscal 2004 through 2006 audit cycle. The IRS issued a No Change Report indicating no change to our tax liability; however, the IRS continues to have the ability to adjust tax attributes relating to these years in subsequent audits. We believe that we have provided sufficient tax provisions for these years and that the ultimate outcome of any future IRS audits that include the tax attributes will not have a material adverse impact on our financial position or results of operations in future periods. However, we cannot predict with certainty how these matters will be resolved and whether we will be required to make additional tax payments.

Future changes in financial accounting standards or practices or existing taxation rules or practices may cause adverse unexpected revenue fluctuations and affect our reported results of operations.

A change in accounting standards or practices or a change in existing taxation rules or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation practices have occurred and may occur in the future. For example, upon our adoption of FIN 48 on April 1, 2007, we revised our policy in conformity with the liability classification requirements of FIN 48, which clarifies the accounting for uncertainty in income tax positions. This interpretation requires that we recognize in our financial statements the impact of a tax position if that position is more likely than not to be sustained on audit, based on the technical merits of the position. At March 31, 2009, we had recorded gross liabilities of \$8.2 million for uncertain tax positions related to FIN 48, of which \$2.4 million and \$5.8 million were reflected in "Accrued and other liabilities" and "Other long-term liabilities," respectively, and we continue to recognize interest expense for, and or penalties related to, these uncertain tax positions in the Consolidated Statements of Operations within "Provision for (benefit from) income taxes."

We may be engaged in legal proceedings that could cause us to incur unforeseen expenses and could occupy a significant amount of our management's time and attention.

From time to time we are subject to litigation or claims that could negatively affect our business operations and financial position. 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.

We are exposed to fluctuations in foreign currency exchange rates.

Because a significant portion of our business is conducted outside the United States, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could have an adverse impact on our financial results and cash flows. Historically, our exposures have related to non-dollar-denominated operating expenses in Europe and Asia. We began Euro-denominated sales to our distribution customers in the European Union in the fourth quarter of fiscal 2003; however, we switched back to United States dollar-denominated sales to our distribution customers in the European Union in the fourth quarter of fiscal 2008. An increase in the value of the dollar could increase the real cost to our customers of our products in markets outside the United States where we sell in dollars, and a weakened dollar could increase the cost of local operating expenses and procurement.

We hold non-controlling interests in privately held venture funds, and if these venture funds face financial difficulties in their operations, our investments could be impaired.

We continue to hold non-controlling interest in privately held venture funds. At March 31, 2009, the carrying value of such investments aggregated \$1.2 million. These investments are inherently risky because these venture funds invest in companies that may still be in the development stage or depend on third parties for financing to support their ongoing operations. In addition, the markets for the technologies or products of these companies 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, the venture funds' investments in these companies may be impaired, which in turn, could result in impairment of our investment in these venture funds. For example, in the fiscal 2009, the value of our non-controlling interest in privately held venture funds declined resulting in a recorded charge of \$0.4 million. The carrying value of these investments is based on quarterly statements we receive from the funds. The statements are generally received one quarter in arrears, as more timely valuations are not practical. Given the recent downturn in equity investments and current market conditions, we may be

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required to record an impairment charge against all or a portion of the investments in the future. Such an action would adversely affect our financial results.

Changes in securities laws and regulations have increased and may continue to increase our costs.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and rules promulgated by the Securities and Exchange Commission, have increased and may continue to increase our expenses as we devote resources to respond to their requirements. In particular, we incurred additional administrative expense to implement Section 404 of the Sarbanes-Oxley Act, which requires management to report on, and our independent registered public accounting firm to attest to, our internal control over financial reporting.

In addition, the NASDAQ Global Market, on which our common stock is listed, has also adopted comprehensive rules and regulations relating to corporate governance. These laws, rules and regulations have increased and may continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices. We also expect these developments may make it more difficult and more expensive for us to obtain director and officer liability insurance in the future, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Further, our board members, Chief Executive Officer and Chief Financial Officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which would adversely affect our business.

Internal control deficiencies or weaknesses that are not yet identified could emerge.

Over time we may identify and correct deficiencies or weaknesses in our internal control over financial reporting and, where and when appropriate, report on the identification and correction of these deficiencies or weaknesses. However, the internal control procedures can provide only reasonable, and not absolute, assurance that deficiencies or weaknesses are identified. Deficiencies or weaknesses that are not yet identified could emerge, and the identification and corrections of these deficiencies or weaknesses could have a material impact on our results of operations.

Internal control issues that appear minor now may later become material weaknesses.

We are required to publicly report on deficiencies or weaknesses in our internal control over financial reporting that meet a materiality standard as required by law and related regulations and interpretations. Management may, at a point in time, accurately categorize a deficiency or weakness as immaterial or minor and therefore not be required to publicly report such deficiency or weakness. Such determination, however, does not preclude a change in circumstances such that the deficiency or weakness could, at a later time, become a material weakness that could have a material impact on our results of operations.

We may encounter natural disasters, which could cause disruption to our employees or interrupt the manufacturing process for our products.

Our 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 would 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.

Manmade problems such as computer viruses or terrorism may disrupt our operations and harm our operating results.

Despite our implementation of network security measures, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. Any such event could have an adverse effect on our business, operating results, and financial condition. In addition, the effects of war or acts of terrorism could have an adverse effect on our business, operating results, and financial condition. In addition, as a 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.

We may experience significant fluctuations in our stock price.

Our stock has experienced substantial price volatility, particularly as a result of quarterly variations in our operating results, the published expectations of securities analysts and as a result of announcements by our competitors and us. In addition, the stock market has experienced significant price and volume fluctuations, particularly in recent months, that have affected the market price of many technology companies, in particular, and that have often been related to the extraordinary conditions in the broader macroeconomic and financial markets. 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.

Item 1B. *Unresolved Staff Comments*

Not applicable.

Item 2.

Properties

As of March 31, 2009, we owned and leased various properties in the United States and in foreign countries totaling approximately 309,000 square feet, of which approximately 185,000 square feet were leased/subleased or available to lease/sublease to third parties. The building leases expire at varying dates through fiscal 2012 and include renewals at our option. During fiscal 2009, we reduced our owned and leased properties by approximately 33% from the 462,000 square feet we owned or leased at March 31, 2008. During fiscal 2008, we reduced our owned and leased properties by approximately 34% from the 701,000 square feet we owned or leased at March 31, 2007. These consolidation efforts include having certain facilities, located in California, Minnesota, North Carolina and Washington, subleased or available for sublease and closing or substantially downsizing operations in Florida, Bangalore, India and Ireland.

Our principal executive offices are located in Milpitas, California, which includes research and development, technical support, sales, marketing and administrative functions. In addition, we lease buildings in Foothill Ranch, California, and Orlando, Florida. We use these properties primarily for research and development, technical support, sales and marketing functions. Internationally, we operate in Australia, England, Germany, Japan and Singapore. We use these properties primarily for research and development, technical design, technical support, sales and administrative functions.

The table below is a summary of the facilities we owned and leased at March 31, 2009:

	United States		Other Countries		Total
	-----		-----		-----
			(in square feet)		
Owned Facilities	104,000	(a)	--		104,000
Leased Facilities	185,000	(b)	20,000	(c)	205,000
	-----		-----		-----
Total Facilities	289,000		20,000		309,000
	=====		=====		=====

(a) There are leases to third parties on approximately 4,000 square feet and approximately 36,000 square feet are available for lease.

(b) There are subleases to third parties on approximately 82,000 square feet and approximately 62,000 square feet are available for sublease.

(c) Approximately 1,000 square feet are available for sublease.

We operate in one segment; therefore, all of our facilities are managed at the corporate level. We believe our existing facilities and equipment are well maintained and in good operating condition, and we believe our facilities are sufficient to meet our needs for the foreseeable future. Our future facilities requirements will depend upon our business, and we believe additional space, if required, can be obtained on reasonable terms.

Item 3. *Legal Proceedings*

We are a party to other litigation matters and claims, including those related to intellectual property, which are normal in the course of our operations, and while the results of such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of such matters will not have a material adverse impact on our financial position or results of operations. However, because of the nature and inherent uncertainties of litigation, should the outcome of these actions be unfavorable, our business, financial condition, results of operations and cash flows could be materially and adversely affected.

In connection with our acquisitions of Aristos, Snap Appliance Inc., or Snap Appliance, Eurologic Systems Group Limited, or Eurologic, and Platys Communications, Inc., or Platys, a portion of the respective purchase prices and other future payments totaling \$4.3 million, \$6.7 million, \$3.8 million, and \$15.0 million, respectively, were held back, which we refer to as the Holdbacks, to secure potential indemnification obligations of Aristos, Snap Appliance, Eurologic and Platys stockholders for unknown liabilities that may have existed as of each acquisition date. As of March 31, 2009, the Aristos Holdback of \$4.3 million remains outstanding for potential unknown liabilities that may arise. In fiscal 2009, we resolved the remaining disputed, outstanding claims against the Eurologic Holdback by entering into a Deed of Indemnity and a written settlement agreement with the Representative of the Eurologic shareholders, which resulted in an additional payment of \$1.3 million. Our initial payment of \$2.3 million to the Eurologic shareholders was recorded in fiscal 2005. The remaining Eurologic Holdback balance of \$0.2 million was retained by us and was recognized as a gain in fiscal 2009 in "Income (loss) from discontinued operations, net of taxes" in the Consolidated Statements of Operations. In fiscal 2007, we resolved all outstanding claims against the Snap Appliance Holdback and the Platys Holdback.

For an additional discussion of certain risks associated with legal proceedings, see "Item 1A: Risk Factors" of this Annual Report on Form 10-K.

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

No matters were submitted to a vote of our security holders, through the solicitation of proxies or otherwise, during the fourth quarter of fiscal 2009.

PART II

Item 5.

Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information for Common Stock

Our common stock is traded on the NASDAQ Global Market under the symbol "ADPT." The following table sets forth the high and low sales prices of our common stock for the periods indicated as reported by the NASDAQ Global Market. The market price of our common stock has been volatile. See "Item 1A: Risk Factors" of this Annual Report

on Form 10-K.

	Fiscal 2009		Fiscal 2008	
	High	Low	High	Low
First quarter	\$ 3.40	\$ 2.58	\$ 4.17	\$ 3.60
Second quarter	4.24	3.10	3.93	3.23
Third quarter	3.71	2.41	3.95	3.15
Fourth quarter	3.61	2.20	3.42	2.34

As of May 19, 2009, there were approximately 552 stockholders of record of our common stock.

Dividends

We have not declared or paid cash dividends on our common stock and do not expect to pay cash dividends on our common stock in the foreseeable future. It is presently our policy to reinvest earnings for our business.

Issuer Purchases of Equity Securities

The following table summarizes information about our repurchase of our stock during the fourth quarter of fiscal 2009:

	Total Number of Shares Repurchased	Average Price Paid per Share	Total Number of Shares Repurchased as part of Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Repurchased Under the Plans or Programs
December 27, 2008 - January 30, 2009	--	\$ --	--	\$ 40,000,000 (1)
January 31, 2009 - February 27, 2009	258,400	2.30	258,400	39,406,783
February 28, 2009 - March 31, 2009	775,000	2.29	775,000	37,629,978
Total	1,033,400	\$ 2.29	1,033,400	\$ 37,629,978

(1) In July 2008, our Board of Directors authorized a stock repurchase program to purchase up to \$40 million of our common stock. All purchases made under the program were made in the open market.

Stock Performance Graph

The following graph compares the cumulative total stockholder return of our common stock to the NASDAQ Composite Index and the NASDAQ Computer and Data Processing Index. The graph assumes that \$100 was invested on March 31, 2004 and its relative performance was tracked through March 31, 2009 in our common stock and in each index, and that all dividends were reinvested. These indices, which reflect formulas for dividend reinvestment and weighting of individual stocks, do not necessarily reflect returns that could be achieved by an individual investor. Notwithstanding anything to the contrary set forth in any of our previous or future filings under the Securities Act of

1933 or the Securities Exchange Act of 1934 that might incorporate this Annual Report or future filings made by us under those statutes, the stock price performance graph is not considered "soliciting material," is not deemed "filed" with the SEC and is not deemed to be incorporated by reference into any of those prior filings or into any future filings made by us under those statutes.

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03/31/07

03/31/08

03/31/09

Adaptec, Inc.

100.00

54.68

63.13

44.18

33.56

27.40