

Mossberg's Investor Digest

Best Idea Profile

Adaptec, Inc. (Nasdaq: ADPT)

DESCRIPTION:

Headquartered in Milpitas, California, 28-year-old Adaptec provides data storage hardware and software. The company produces:

- RAID Controllers - These are standard components that manage the storage and retrieval of data on multiple disk drives, thereby creating redundancy, reducing the risk of data loss, and increasing read/write speeds.
- Host I/O products - Technology that manages the connections between the components inside computing devices and between computing devices and peripherals such as external storage.
- ASICs - customized processors for data storage.

Most of the company's products are sold as components to Value Added Resellers and OEMs (56% of sales), such as Dell, HP, IBM and Intel. The company also provides software that is embedded in the hardware and helps manage the device, as well as storage management software that is sold independent of hardware.

KEY INVESTMENT CONSIDERATIONS:

Restructuring efforts saves costs, divest non-strategic businesses – The company sold its SNAP NAS systems business last year. The company was unsuccessful with SNAP, in part because this business provided a complete storage system, which requires a completely different business model than Adaptec's traditional component/OEM model. Divesting this business removed a distraction from its core operations. Combined with other restructuring efforts, the company expects to reduce expenses by almost \$16 million annually.

Revenue decline appears to have stabilized – The rate of decline in the company's legacy business appears to be slowing. With a more stable base of revenue and reduced costs, the company should continue to generate results near break-even until the end market demand improves. The company actually generated \$4 million in operating cash flow in the June quarter.

New technology could provide growth driver – During the latest quarter, the company launched its Series 5Z product family. This technology allows customers to eliminate the need for a battery backup to cache data in the event of a power failure. Not only is this a greener solution, it is also much more cost effective. Since it doesn't use a battery, the 5Z technology eliminates the need for replacing the batteries, which can be labor intensive.

Stock buyback program could be accelerating –

Since July 2008, ADPT has had an authorization to buy back \$40 million of its stock (roughly 10% at current valuation). Through the end of the June quarter, ADPT had only repurchased \$2.5 million. However, on the latest call, management commented they had repurchased 700,000 shares during the month of July, nearly equal to the amount of stock they have repurchased during the entire year.

VALUATION:

Shares have likely been artificially under pressure due to ADPT's largest shareholder, Steel Partners, decision to distribute approximately ½ of its shares (12+ million) to its investors. The fund is still ADPT's largest shareholder. Steel Partners is an activist hedge fund, who's co-founder, Jack Howard, joined the ADPT board in 2007. After nearly 14 years of delivering 22% annual performance, Steel Partners II Fund lost 39% during 2008. Instead of liquidating its portfolio, the fund will convert into a public company. Those investors who chose to redeem their investment in the Steel Partners Fund, received shares of the stocks held in the fund, such as ADPT, which has likely created temporary selling pressure. However, at current levels ADPT has a negative enterprise value, which means you could buy the whole company for free and get paid \$21 million for your trouble. This is an extremely pessimistic valuation that basically assumes that ADPT, its large patent portfolio with over 400 patents, future cash flows, etc., are worth nothing and that the management team will be destroying value. At these levels, the stock offers an attractive risk/ reward ratio.

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Investment Data (as of 8/25/09)

Recent Price	\$3.02
52-Week Range	2.20 - 4.00
Fiscal Year End	March
Shares Outstanding	120 MM
Average Trading Volume (3 mos)	887,000
Market Capitalization	360 MM
Cash	382 MM
Long Term Debt	N/A
Enterprise Value (EV)	-21 MM
LT Debt/ Equity	N/A
Tangible BV/ Share	3.30
TTM Revenue	105 MM
P/ Revenue	3.4x
TTM EPS (non-GAAP)	-0.12
P/ EPS	N/A

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