ADAPTEC INC
Form 10-Q
February 07, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2005

or

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

For the transition period from to

Commission file number 0-15071

ADAPTEC, INC.

(Exact name of registrant as specified in its charter)

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

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

N/A

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

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

Yes x No o

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

Yes x No o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes o No x

The number of shares of Adaptec s common stock outstanding as of January 31, 2006 was 114,036,179.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three-Month Period Ended December 31, 2005	Three-Month Period Ended December 31, 2004	Nine-Month Period Ended December 31, 2005	Nine-Month Period Ended December 31, 2004
	(in thousands, except per share amounts)			
Net revenues	$ 77,831	$ 93,473	$ 236,731	$ 292,299
Cost of revenues	48,857	59,577	156,442	164,912
Gross profit	28,974	33,896	80,289	127,387
Operating expenses:				
Research and development	14,404	21,293	47,254	68,237
Selling, marketing and administrative	15,739	17,785	49,717	55,044
Amortization of acquisition-related intangible assets	1,689	2,182	5,466	7,070
Restructuring charges	2,587	2,228	3,105	4,975
Goodwill impairment			90,602	
Other charges (gains)	1,472	(2,755)	1,472	(2,755)
Total operating expenses	35,891	40,733	197,616	132,571
Loss from continuing operations	(6,917)	(6,837)	(117,327)	(5,184)
Interest and other income	4,479	3,097	12,610	8,599
Interest expense	(758)	(1,083)	(2,598)	(3,350)
Income (loss) from continuing operations before income taxes	(3,196)	(4,823)	(107,315)	65
Provision for (benefit from) income taxes	(582)	(21,788)	3,206	(31,463)
Income (loss) from continuing operations	(2,614)	16,965	(110,521)	31,528
Discontinued operations, net of taxes (Note 4)				
Income (loss) from discontinued operations, net of taxes	(4,149)	5,524	(31,045)	(17,092)
Income (loss) from disposal of discontinued operations, net of taxes	3,502		(3,474)	
Income (loss) from discontinued operations	(647)	5,524	(34,519)	(17,092)
Net income (loss)	$ (3,261)	$ 22,489	$ (145,040)	$ 14,436
Net income (loss) per share:				
Basic				
Continuing operations	$ (0.02)	$ 0.15	$ (0.98)	$ 0.29
Discontinued operations	$ (0.01)	$ 0.05	$ (0.31)	$ (0.15)
Net income (loss)	$ (0.03)	$ 0.20	$ (1.28)	$ 0.13
Diluted				
Continuing operations	$ (0.02)	$ 0.13	$ (0.98)	$ 0.25
Discontinued operations	$ (0.01)	$ 0.04	$ (0.31)	$ (0.13)
Net income (loss)	$ (0.03)	$ 0.17	$ (1.28)	$ 0.12
Shares used in computing net income (loss) per share:				
Basic	113,531	111,136	112,980	110,429
Diluted	113,531	134,517	112,980	131,607

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

ADAPTEC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

	December 31, 2005	March 31, 2005
	(in thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 107,688	$ 441,588
Marketable securities	424,618	84,968
Restricted cash and marketable securities	1,647	1,766
Accounts receivable, net	57,086	70,159
Inventories	22,441	60,204
Prepaid expenses and other current assets	14,384	26,081
Assets held for sale	22,583	
Current assets of discontinued operations	4,597	
Total current assets	655,044	684,766
Property and equipment, net	32,750	56,180
Restricted marketable securities, less current portion	3,084	4,615
Goodwill		91,486
Other intangible assets, net	21,739	79,457
Other long-term assets	9,867	47,002
Long-term assets of discontinued operations	25,884	
Total assets	$ 748,368	$ 963,506
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 48,976	$ 61,637
Accrued liabilities	86,067	116,007
Current liabilities of discontinued operations	5,336	
Total current liabilities	140,379	177,644
¾% Convertible Senior Subordinated Notes	225,000	225,000
3% Convertible Subordinated Notes	11,992	35,190
Other long-term liabilities	3,656	15,349
Commitments and contingencies (Note 13)		
Stockholders equity:		
Common stock	114	112
Additional paid-in capital	168,604	165,707
Deferred stock-based compensation	(460)	(2,416)
Accumulated other comprehensive income (loss), net of taxes	(2,091)	706
Retained earnings	201,174	346,214
Total stockholders equity	367,341	510,323
Total liabilities and stockholders equity	$ 748,368	$ 963,506

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Nine-Month Period Ended December 31, 2005	Nine-Month Period Ended December 31, 2004
	(in thousands)	
Cash Flows From Operating Activities:		
Income (loss) from continuing operations	$ (110,521)	$ 31,528
Adjustments to reconcile income (loss) from continuing operations to net cash provided by (used for) operating activities:		
Non-cash restructuring charges		109
Impairment of goodwill	90,602	
Stock-based compensation	284	2,348
Non-cash effect of tax settlement		(26,009)
Loss on extinguishment of debt	102	
Loss (gain) on sale of long-lived assets	1,472	(2,755)
Depreciation and amortization	19,398	28,359
Deferred income taxes		(40)
Other non-cash items	378	(12)
Changes in assets and liabilities (net of acquired businesses)	(1,169)	(21,498)
Net Cash Provided by Operating Activities of Continuing Operations	546	12,030
Net Cash Provided by (Used for) Operating Activities of Discontinued Operations	7,876	(27,980)
Net Cash Provided by (Used for) Operating Activities	$ 8,422	$ (15,950)
Cash Flows From Investing Activities:		
Purchases of certain net assets in connection with acquisitions, net of cash acquired		(65,380)
Payment of holdback in connection with acquisition of Eurologic		(2,279)
Proceeds from sale of business	24,126	
Maturities of restricted marketable securities	1,688	2,213
Purchases of property and equipment	(6,452)	(8,102)
Proceeds from sale of long-lived assets		9,577
Proceeds from the sale of property and equipment	2,684	
Purchases of marketable securities	(495,893)	(270,249)
Sales of marketable securities	137,826	327,574
Maturities of marketable securities	16,084	65,541
Net Cash Provided by (Used for) Investing Activities of Continuing Operations	(319,937)	58,895
Net Cash Used for Investing Activities of Discontinued Operations	(1,655)	(63,048)
Net Cash Used for Investing Activities	(321,592)	(4,153)
Cash Flows From Financing Activities:		
Repurchases and redemption of long-term debt	(22,988)	
Proceeds from issuance of common stock	3,329	5,446
Net Cash Provided by (Used for) Financing Activities	(19,659)	5,446
Effect of Foreign Currency Translation on Cash and Cash Equivalents	(1,071)	822
Net Decrease in Cash and Cash Equivalents	(333,900)	(13,835)
Cash and Cash Equivalents at Beginning of Period	441,588	102,463
Cash and Cash Equivalents at End of Period	$ 107,688	$ 88,628

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

ADAPTEC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation

In the opinion of management, the accompanying Unaudited Condensed Consolidated Interim Financial Statements (financial statements) of Adaptec, Inc. and its wholly-owned subsidiaries (collectively, the Company) have been prepared on a consistent basis with the March 31, 2005 audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary to fairly state the information set forth therein. The financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), and, therefore, omit certain information and footnote disclosure necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2005, which was filed with the SEC on June 14, 2005. The third quarters of fiscal 2006 and 2005 ended on December 30, 2005 and December 31, 2004, respectively. For presentation purposes, the accompanying financial statements have been shown as ending on December 31. The results of operations for the third quarter and first nine months of fiscal 2006 are not necessarily indicative of the results to be expected for the entire fiscal year.

Certain reclassifications have been made to prior period reported amounts to conform to the current period presentation, including reclassification of auction rate securities from cash and cash equivalents to marketable securities. Previously, such auction rate securities were classified as cash and cash equivalents. Accordingly, the Company has revised its presentation and made adjustments to the accompanying Unaudited Condensed Consolidated Statement of Cash Flows to reflect the gross purchases and sales of these auction rate securities as investing activities. This adjustment resulted in a net increase in cash used for investing activities by $12.6 million in the first nine months of fiscal 2005. This reclassification had no impact on previously reported results of operations, operating cash flows or working capital of the Company.

In addition, as discussed in Note 4, on September 30, 2005, the Company completed the sale to International Business Machines (IBM) of its IBM i/p Series RAID component business (IBM i/p Series RAID Business) and on September 29, 2005 the Company s Board of Directors approved management s recommendation to divest its systems business. Both of these businesses have been accounted for as discontinued operations. Accordingly, the Company has reclassified the underlying Unaudited Condensed Consolidated Statements of Operations and Unaudited Condensed Consolidated Statements of Cash Flows and related disclosures for all periods presented to reflect the IBM i/p Series RAID Business and the systems business as discontinued operations. In the third quarter of fiscal 2006, in conjunction with the renegotiation of a customer supply contract, the Company decided to retain a product line that was previously classified within discontinued systems business. Accordingly, the Company has reclassified the underlying Unaudited Condensed Consolidated Statements of Operations and Unaudited Condensed Consolidated Statements of Cash Flows and related disclosures for all periods presented to reflect that product line as part of continuing operations.

Unless otherwise indicated and other than balance sheet amounts as of March 31, 2005, the Notes to the Unaudited Condensed Consolidated Financial Statements relate to the discussion of the Company s continuing operations.

The glossary of key acronyms used in the Company s industry and accounting rules and regulations referred to within this Quarterly Report on Form 10-Q is listed in alphabetical order in Note 20.

2. Recent Accounting Pronouncements

In June 2005, the FASB issued SFAS No. 154, which changes the requirements for the accounting for, and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles were required to be recognized by way of a cumulative effect adjustment within net income during the period of the change. SFAS No. 154 requires retrospective application to prior periods financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, the Statement does not change the transition provisions of any existing accounting pronouncements. The Company s results of operations and financial condition will only be impacted following the adoption of SFAS No. 154 if it implements changes in accounting principles that are addressed by the standard or corrects accounting errors in future periods.

In December 2004, the FASB issued SFAS No. 123(R). This statement replaces SFAS No. 123, amends SFAS No. 95 and supersedes APB Opinion No. 25. SFAS No. 123(R) requires companies to apply a fair-value based measurement method in accounting for share-based payment transactions with employees and to record compensation expense for all stock awards granted and to awards modified, repurchased or cancelled after the required effective date. In addition, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. In April 2005, the SEC approved that SFAS No. 123(R) will be effective for annual periods, as opposed to interim periods as originally issued by the FASB, beginning after June 15, 2005. In March 2005, the SEC issued SAB 107, which offers guidance on SFAS No. 123(R). SAB 107 was issued to assist preparers by simplifying some of the implementation challenges of SFAS No. 123(R) while enhancing the information that investors receive. The Company intends to use the modified prospective method, which will result in a significant increase to expenses on the Company s consolidated financial statements beginning April 1, 2006. The Company cannot currently quantify the impact of the adoption of SFAS No. 123(R) and SAB 107 as it will depend on the amount of share-based payments that the Company grants in the future as well as other variables that affect the fair market value estimates which cannot be forecasted at this time. The pro forma disclosures of the impact of SFAS No. 123 provided in Note 3 may not be representative of the impact of adopting this statement.

In November 2004, the FASB issued SFAS No. 151, which clarifies the accounting for abnormal amounts of facility expense, freight, handling costs and wasted materials (spoilage) to require them to be recognized as current-period charges. This statement is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted. The adoption of this standard is not expected to have a material impact on the Company s financial statements.

3. Stock-Based Compensation

The Company accounts for stock-based compensation using the intrinsic-value-based method, which is in accordance with APB Opinion No. 25 as interpreted by FIN 44, and complies with the disclosure provisions of SFAS No. 148, an amendment of SFAS No. 123. The Company accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF No. 96-18, which requires that such equity instruments be recorded at their fair value on the measurement date, which is typically the date of grant.

The following table illustrates the effect on net income (loss) and net income (loss) per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to employee and director stock option plans, including shares issued under the Company s ESPP, collectively called options, for all periods presented:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands, except per share amounts)			
Net income (loss), as reported	$ (3,261)	$ 22,489	$ (145,040)	$ 14,436
Add: Deferred stock-based compensation expense included in reported net income (loss)	223	775	1,526	2,453
Deduct: Total stock-based compensation expense determined under the fair value-based method, net of tax	(3,740)	(3,837)	(10,120)	(9,923)
Pro forma net income (loss)	$ (6,778)	$ 19,427	$ (153,634)	$ 6,966
Basic net income (loss) per share:				
As reported	$ (0.03)	$ 0.20	$ (1.28)	$ 0.13
Pro forma	$ (0.06)	$ 0.17	$ (1.36)	$ 0.06
Diluted net income (loss) per share:				
As reported	$ (0.03)	$ 0.17	$ (1.28)	$ 0.12
Pro forma	$ (0.06)	$ 0.15	$ (1.36)	$ 0.06

SFAS No. 123 requires the use of option pricing models that were not developed for use in valuing employee stock options. The Black-Scholes option pricing model, used by the Company, was developed for use in estimating the fair value of short-lived exchange traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the option s expected life and the price volatility of the underlying stock.

The fair value of options granted in the third quarter and first nine months of fiscal 2006 and 2005, as reported were estimated at the date of grant using the Black-Scholes valuation model with the following weighted average assumptions:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
Employee Stock Option Plans:				
Expected life (in years)	4.3	2.0	2.5	2.3
Risk-free interest rates	4.4 %	3.1 %	4.1 %	3.0 %
Expected volatility	52 %	39 %	38 %	44 %
Dividend yield				
ESPP:				
Expected life (in years)	1.3	1.4	1.1	1.4
Risk-free interest rates	3.9 %	2.1 %	3.8 %	2.1 %
Expected volatility	40 %	50 %	39 %	50 %
Dividend yield				

4. Discontinued Operations

IBM i/p Series RAID Business:

On September 30, 2005, the Company entered into a series of arrangements with IBM pursuant to which the Company sold its IBM i/p Series RAID Business to IBM for approximately $22.0 million plus $1.3 million for certain fixed assets. In addition, IBM purchased certain related inventory at the Company s net book value of $0.8 million. Expenses incurred in the transaction primarily included costs of approximately $0.5 million for legal and accounting fees. In addition, the Company accrued $0.3 million for lease obligations. Under the terms of the agreements, the Company granted IBM a nonexclusive license to certain intellectual property and sold to IBM substantially all of the assets dedicated to the engineering and manufacturing of RAID controllers and connectivity products for the IBM i/p Series RAID Business. Under the terms of the nonexclusive license, IBM will pay royalties to the Company for the sale of its board-level products over the next six quarters, which will be recognized as contingent consideration in discontinued operations when earned. In the third quarter of fiscal 2006, the Company received royalties of $3.5 million, which the Company recorded in Income (loss) from disposal of discontinued operations, net of taxes, in the Unaudited Condensed Consolidated Statements of Operations.

Net revenues and the components of income (loss) related to these discontinued operations, which were previously included in the Company s DPS segment, were as follows:

	Three-Month Period Ended		**Nine-Month Period Ended**	
	December 31, 2005	**December 31, 2004**	**December 31, 2005**	**December 31, 2004**
	(in thousands)			
Net revenues	$ 237	$ 9,870	$ 20,046	$ 15,056
Income (loss) from discontinued operations before income taxes	424	(3,341)	(14,239)	(8,945)
Provision for (benefit from) income taxes	282	(11,714)	(360)	(903)
Income (loss) from discontinued operations, net of taxes	$ 142	$ 8,373	$ (13,879)	$ (8,042)

The components of net assets, at the time of the sale of the IBM i/p Series RAID Business, were as follows:

	September 30, 2005
	(in thousands)
Inventories	$ 838
Prepaid expenses	11,139
Property and equipment, net	3,326
Other intangibles, net	10,958
Other long-term assets	24,507
Accrued liabilities	(10,051)
Other long-term liabilities	(10,625)
Net assets of discontinued operations	$ 30,092

Accounts receivable related to the IBM i/p Series RAID Business were not included in discontinued operations as the Company will be retaining these assets.

Systems Business:

On September 29, 2005, the Company s Board of Directors approved management s recommendation to divest its systems business, which includes substantially all of the operating assets and cash flows that were obtained through the Snap Appliance and Eurologic Systems acquisitions as well as internally developed hardware and software. In connection with this action, the Company has classified the systems business as a discontinued operation in the financial statements. The Company has entered into an exclusive arrangement with an investment banker to sell this business and expects to receive proceeds, less cost to sell, in excess of its carrying value.

In the third quarter of fiscal 2006, in conjunction with the renegotiation of a customer supply contract, the Company decided to retain a product line that was previously classified within discontinued systems business. Accordingly, the Company has reclassified the underlying Unaudited Condensed Consolidated Statements of Operations and Unaudited Condensed Consolidated Statements of Cash Flows and related disclosures for all periods presented to reflect that product line as part of continuing operations.

Net revenues and the components of net loss related to the discontinued operations, were as follows:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands)			
Net revenues	$ 18,958	$ 23,205	$ 53,704	$ 56,395
Loss from discontinued operations before provision for income taxes	(3,501)	(2,729)	(16,651)	(10,510)
Provision for (benefit from) income taxes	790	120	515	(1,460)
Loss from discontinued operations, net of taxes	$ (4,291)	$ (2,849)	$ (17,166)	$ (9,050)

The components of net assets related to the discontinued operations were as follows:

	December 31, 2005
	(in thousands)
Inventories	$ 4,522
Prepaid expenses	75
Current assets of discontinued operations	4,597
Property and equipment, net	1,145
Other intangibles, net	24,730
Other long-term assets	9
Total assets of discontinued operations	30,481
Accrued liabilities	(5,336)
Current liabilities of discontinued operations	(5,336)
Net assets of discontinued operations	$ 25,145

Accounts receivable related to the systems business were not included in discontinued operations as the Company intends to retain these assets.

5. Balance Sheet Details

Inventories:

	December 31, 2005	March 31, 2005
	(in thousands)	
Raw materials	$ 10,775	$ 15,914
Work-in-process	6,334	7,435
Finished goods	5,332	36,855
Total	$ 22,441	$ 60,204

Accrued Liabilities:

	December 31, 2005	March 31, 2005
	(in thousands)	
Tax related	$ 46,632	$ 57,538
Acquisition related	3,604	6,748
Accrued compensation and related taxes	19,676	18,304
IBM distribution agreement		11,575
Other	16,155	21,842
Total	$ 86,067	$ 116,007

6. Goodwill and Other Intangible Assets

Goodwill:

Goodwill allocated to the Company s reportable segments and changes in the carrying amount of goodwill for the first nine months of fiscal 2006 was as follows:

	OEM	Channel	Total
	(in thousands)		
Balance at March 31, 2005	$ 48,783	$ 42,703	$ 91,486
Goodwill adjustments	(166)	(718)	(884)
Goodwill impairment	(48,617)	(41,985)	(90,602)
Balance at December 31, 2005	$	$	$

In the first quarter of fiscal 2006, adjustments were made to goodwill for changes to the acquisition-related restructuring reserves and other purchase price adjustments for the IBM i/p Series RAID business and Snap Appliance. As a result of the segment reorganization, discussed in Note 15, an assessment of the recoverability of goodwill was performed. Impairment of goodwill is tested at the Company s operating segment level by comparing each segment s carrying amount, including goodwill, to the fair value of that segment. To determine fair value, the Company s review process uses the income, or discounted cash flows, approach and the market approach. In performing its analysis, the Company uses the best information available under the circumstances, including reasonable and supportable assumptions and projections. If the carrying amount of the operating segment exceeds its implied fair value, goodwill is considered impaired and a second step is performed to measure the amount of impairment loss, if any. As a result of this review, the Company wrote-off its entire balance of goodwill of $90.6 million in the second quarter of fiscal 2006. Factors that led to this conclusion were industry technology changes such as the shift from parallel to serial technology and the migration of core functionality to server chipsets; required increased investments that eventually led the Company to sell the IBM i/p Series RAID Business and the proposed sale of the systems business; continued losses associated with sales of systems to IBM; and general market conditions.

Other Intangible Assets:

	December 31, 2005		March 31, 2005	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in thousands)			
Acquisition-related intangible assets:				
Patents, core and existing technologies	$ 39,578	$ (27,861)	$ 74,009	$ (26,265)
Supply agreement			7,600	(1,140)
Customer relationships	1,047	(708)	1,290	(631)
Trade names	674	(577)	10,930	(1,523)
Foundry agreement			600	(90)
Subtotal	41,299	(29,146)	94,429	(29,649)
Intellectual property assets and warrants	41,623	(32,037)	41,942	(27,265)
Total	$ 82,922	$ (61,183)	$ 136,371	$ (56,914)

Amortization of other intangible assets was $3.3 million and $4.1 million in the third quarter of fiscal 2006 and 2005, respectively. Amortization of other intangible assets was $10.5 million and $12.5 million in the first nine months of fiscal 2006 and 2005, respectively.

The annual amortization expense of the other intangible assets that existed as of December 31, 2005 is expected to be as follows:

	Estimated Amortization Expense	
	Acquisition-related Intangible Assets	Intellectual Property Assets
	(in thousands)	
Fiscal Years:		
2006 (remaining three months)	$ 1,688	$ 1,579
2007	5,726	6,316
2008	2,534	1,691
2009	2,205	
2010 and thereafter		
Total	$ 12,153	$ 9,586

7. Interest and Other Income

The components of interest and other income for the third quarter and first nine months of fiscal 2006 and 2005, were as follows:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands)			
Interest income	$ 4,450	$ 2,833	$ 11,993	$ 8,593
Payment of license fee with NSE		(442)		(1,692)
Loss on redemption of debt			(102)	
Foreign currency transaction gains (losses)	(241)	461	(621)	800
Other	270	245	1,340	898
Total	$ 4,479	$ 3,097	$ 12,610	$ 8,599

In the first nine months of fiscal 2006, the Company repurchased $23.2 million in aggregate principal amount of its 3% Convertible Subordinated Notes (3% Notes) on the open market for an aggregate price of $23.1 million, resulting in an immaterial loss. The loss on extinguishment of debt has been included in Interest and other income in the Company s Unaudited Condensed Consolidated Statement of Operations. Subsequent to the third quarter of fiscal 2006, the Company repurchased $1.4 million of the 3% Notes on the open market for $1.3 million, resulting in an immaterial gain. The gain on extinguishment of debt will be included in Interest and other income in the Company s Consolidated Statement of Operations in the fourth quarter of fiscal 2006.

In June 2004, the Company, Nevada SCSI Enterprises, Inc. and Thomas A. Gafford (jointly, NSE) entered into a license and release agreement, pursuant to which the Company paid NSE $1.3 million as a one-time, fully paid-up license payment fee to settle NSE s claims that some of the Company s products infringed certain patents. The license and release agreement expressly excluded any sales of products made by Eurologic prior to the Company s April 2003 acquisition of Eurologic. In November 2004, the Company exercised its option to secure a license and release with respect to such Eurologic sales by payment to NSE of a royalty fee of $0.4 million. The Company has filed a claim against the Eurologic acquisition Holdback for the $0.4 million royalty it paid with respect to Eurologic s pre-acquisition sales. The Eurologic shareholders are disputing the Company s right to withhold the $0.4 million from the Holdback. See Note 13 for further discussion of the Eurologic Holdback.

8. Restructuring Charges

In the third quarter of fiscal 2006, management approved and initiated a plan to restructure the operations of the Company by simplifying its infrastructure. The third quarter of fiscal 2006 restructuring plan eliminated certain duplicative resources in all functions of the organization worldwide, due in part, to the discontinued operations and vacated redundant facilities in order to reduce the combined cost structure of the Company. This resulted in a restructuring charge of $2.4 million for the third quarter of fiscal 2006.

The Company recorded provision adjustments of $0.2 million and $0.7 million in the third quarter of fiscal 2006 and first nine months of fiscal 2006, respectively, related to severance and benefits as actual costs were lower than anticipated and additional lease costs related to the estimated loss on facilities that the Company subleased. The provision adjustments also include additional lease costs related to the estimated loss on facilities that the Company subleased in connection with Snap Appliance acquisition (Note 18). These provision adjustments pertained to the restructuring plans that the Company implemented in each quarter of fiscal 2005, and restructuring plans that it implemented in fiscal 2004, fiscal 2003, fiscal 2002 and fiscal 2001. The fiscal 2004 restructuring plan was completed in the first quarter of fiscal 2006. The third quarter of fiscal 2005 restructuring plan and fourth quarter of fiscal 2005 restructuring plan were completed in the third quarter of fiscal 2006. For a complete discussion of all restructuring actions that were implemented prior to fiscal 2006, please refer to the Notes to Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2005. All expenses, including adjustments, associated with the Company s restructuring plans are included in Restructuring charges in the Unaudited Condensed Consolidated Statements of Operations and are not allocated to segments, but are managed at the corporate level.

The activity in the accrued restructuring reserves related to all of the plans was as follows for the first nine months of fiscal 2006:

	Severance And Benefits	Other Charges	Total
	(in thousands)		
Reserve balance at March 31, 2005	$ 896	$ 1,627	$ 2,523
Q3 06 Restructuring Plan	1,738	695	2,433
Provision adjustments	(288)	716	428
Cash paid	(1,886)	(1,037)	(2,923)
Reserve balance at December 31, 2005	$ 460	$ 2,001	$ 2,461

The Company anticipates that the remaining restructuring reserve balance of $2.5 million will be substantially paid out by the first quarter of fiscal 2009, primarily attributable to longer term lease obligations. The remaining restructuring reserve balance is reflected both in Accrued liabilities and Other long-term liabilities in the Unaudited Condensed Consolidated Balance Sheet.

9. Other Charges (Gains)

In January 2006, the Company entered into a three-year contract manufacturing agreement with Sanmina-SCI whereby Sanmina-SCI has assumed manufacturing operations of Adaptec products. In addition, the Company sold certain manufacturing assets, buildings and improvements and inventory located in Singapore to Sanmina-SCI. In connection with this agreement, the Company recorded a loss on disposal of assets of $1.5 million that was recorded in the third quarter of fiscal 2006 in Other charges (gains) on the Unaudited Condensed Consolidated Statements of Operations. Please refer to Note 17 for further details.

In October 2004, the Company completed the sale of certain properties in Milpitas, California that were previously classified as held for sale. Net proceeds from the sale of the properties aggregated $9.6 million, which exceeded the Company s final revised fair value of $6.8 million. As a result, a gain on the sale of the properties of $2.8 million was recorded in the third quarter of fiscal 2005 as a credit to Other charges (gains) in the Unaudited Condensed Consolidated Statements of Operations.

10. Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share gives effect to all potentially dilutive common shares outstanding during the period, which include certain stock options and warrants, calculated using the treasury stock method, and convertible notes which are potentially dilutive at certain earnings levels, and are computed using the if-converted method.

A reconciliation of the numerator and denominator of the basic and diluted income (loss) per share computations for continuing operations, discontinued operations and net income (loss) were as follows:

	Three-Month Period Ended					
	Continuing Operations		**Discontinued Operations**		**Net Income (Loss)**	
	December 31, 2005	**December 31, 2004**	**December 31, 2005**	**December 31, 2004**	**December 31, 2005**	**December 31, 2004**
	(in thousands, except per share amounts)					
Numerators:						
Income (loss)	$ (2,614)	$ 16,965	$ (647)	$ 5,524	$ (3,261)	$ 22,489
Adjustment for interest expense on ¾% Notes, net of taxes		454				454
Adjustment for interest expense on 3% Notes, net of taxes		196				196
Adjusted income (loss)	$ (2,614)	$ 17,615	$ (647)	$ 5,524	$ (3,261)	$ 23,139
Denominators:						
Weighted average shares outstanding basic	113,531	111,136	113,531	111,136	113,531	111,136
Effect of dilutive securities:						
Employee stock options and other		1,859		1,859		1,859
¾% Notes		19,224		19,224		19,224
3% Notes		2,298		2,298		2,298
Weighted average shares and potentially dilutive common shares outstanding diluted	113,531	134,517	113,531	134,517	113,531	134,517
Income (loss) per share:						
Basic	$ (0.02)	$ 0.15	$ (0.01)	$ 0.05	$ (0.03)	$ 0.20
Diluted	$ (0.02)	$ 0.13	$ (0.01)	$ 0.04	$ (0.03)	$ 0.17

	Nine-Month Period Ended					
	Continuing Operations		Discontinued Operations		Net Income (Loss)	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands, except per share amounts)					
Numerators:						
Income (loss)	$ (110,521)	$ 31,528	$ (34,519)	$ (17,092)	$ (145,040)	$ 14,436
Adjustment for interest expense on ¾% Notes, net of taxes		1,371				1,371
Adjustment for interest expense on 3% Notes, net of taxes						
Adjusted income (loss)	$ (110,521)	$ 32,899	$ (34,519)	$ (17,092)	$ (145,040)	$ 15,807
Denominators:						
Weighted average shares outstanding basic	112, 980	110,429	112,980	110,429	112,980	110,429
Effect of dilutive securities:						
Employee stock options and other		1,954		1,954		1,954
¾% Notes		19,224		19,224		19,224
3% Notes						
Weighted average shares and potentially dilutive common shares outstanding diluted	112,980	131,607	112,980	131,607	112,980	131,607
Income (loss) per share:						
Basic	$ (0.98)	$ 0.29	$ (0.31)	$ (0.15)	$ (1.28)	$ 0.13
Diluted	$ (0.98)	$ 0.25	$ (0.31)	$ (0.13)	$ (1.28)	$ 0.12

Diluted loss per share from continuing operations, discontinued operations and net loss for the third quarter and first nine months of fiscal 2006 was based only on the weighted-average number of shares outstanding during the period, as the inclusion of any common stock equivalents would have been anti-dilutive. In addition, certain potential common shares were excluded from the diluted computation from continuing operations, discontinued operations and net income for the third quarter and first nine months of fiscal 2005 because their inclusion would have been anti-dilutive. The items excluded for the third quarters and first nine months of fiscal 2006 and 2005 from continuing operations, discontinued operations and net income (loss) were as follows:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands)			
Outstanding employee stock options	23,549	13,971	22,939	14,478
Warrants(1)	19,874	19,624	19,874	19,624
¾% Notes	19,224		19,224	
3% Notes	783		1,030	2,298

(1) In connection with the issuance of its ¾% Notes, the Company entered into a derivative financial instrument to repurchase up to 19,224,000 shares of its common stock, at the Company s option, at specified prices in the future to mitigate any potential dilution as a result of the conversion of the ¾% Notes. For further discussion on this derivative financial instrument, please refer to Note 6 of the Notes to Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2005.

11. Comprehensive Income (Loss)

The Company s comprehensive income (loss), which consisted of net loss and the changes in net unrealized gains (losses) on marketable securities, net of taxes, and foreign currency translation adjustments, net of taxes, were as follows:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands)			
Net income (loss)	$ (3,261)	$ 22,489	$ (145,040)	$ 14,436
Net unrealized losses on marketable securities, net of taxes	(739)	(921)	(1,549)	(3,955)
Foreign currency translation adjustment, net of taxes	(286)	1,089	(1,248)	1,036
Comprehensive income (loss)	$ (4,286)	$ 22,657	$ (147,837)	$ 11,517

The components of accumulated other comprehensive income (loss), net of taxes, were as follows:

	December 31, 2005	March 31, 2005
	(in thousands)	
Unrealized losses on marketable securities	$ (2,095)	$ (546)
Foreign currency translation, net of tax of $3 at December 31, 2005 and $834 at March 31, 2005	4	1,252
Total	$ (2,091)	$ 706

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12. Income Taxes

Income tax provisions for interim periods are based on the Company s estimated annual income tax. The estimated annual tax for fiscal 2006 primarily consists of foreign taxes related to the Company s foreign subsidiaries and interest accrued on prior years tax disputes. The Company currently has a full valuation allowance on its net U.S. deferred tax assets. The Company is in ongoing negotiations with the IRS with regard to its various tax disputes that may result in settlement of certain issues. The Company s tax rate for the period in which a settlement is reached will be impacted if the settlement materially differs from the amounts previously accrued. The tax rate for the third quarter and the first nine months of fiscal 2005 also differed from the combined United States Federal and state statutory income tax rate of 40% due to tax benefits of $21.9 million and $31.9 million respectively from discrete events relating to the method and amount of settled controversies. As a result of the settlements, $21.9 million previously recorded as a tax provision was reversed during the third quarter of fiscal 2005. In addition, $4.1 million previously recorded as a tax provision was reclassified as a reduction to additional paid-in capital, $1.8 million previously recorded as a tax provision has been reversed, and a $4.0 million tax benefit associated with a refund claim has been recognized during the second quarter of fiscal 2005.

13. Commitments and Contingencies

The Company has been, or is, subject to IRS audits for its fiscal years 1994 through 2003. The fiscal 1994 through fiscal 1996 cycle, which is docketed in the United States Tax Court, was resolved in December 2001. The outcome did not have a material adverse effect on the Company s financial position or results of operations, as sufficient tax provisions had been made. The final Tax Court stipulation will be filed when the subsequent audit cycles are completed. Tax credits that were generated but not used in subsequent years may be carried back to the fiscal 1994 to 1996 audit cycle.

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

In addition, the IRS is currently auditing the Company s Federal income tax returns for fiscal 1998 through fiscal 2003. In the third quarter of fiscal 2005, the Company resolved all issues for fiscal 1998 through fiscal 2001, other than the rollover impact of any potential resolution on the remaining fiscal 1997 issue and tax credits that were generated but not used in subsequent years that may be carried back. The Company believes that it has provided sufficient tax provisions for these years and the ultimate outcome of the IRS audits will not have a material adverse impact on its financial position or results of operations in future periods. However, the Company cannot predict with certainty how these matters will be resolved and whether it will be required to make additional tax payments.

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

In connection with the Company s acquisitions of Snap Appliance, Eurologic, Elipsan Limited (Elipsan), and Platys Communications, Inc. (Platys), a portion of the purchase price and other future payments totaling $6.7 million, $3.8 million, $2.0 million and $15.0 million, respectively, were held back (the Holdbacks) for unknown liabilities that may have existed as of the acquisition dates. The Company has asserted claims against the Snap Appliance, Eurologic and Platys Holdbacks totaling $3.0 million, $1.5 million and $0.7 million, respectively. The Elipsan Holdback of $2.0 million was paid in the second quarter of fiscal 2006.

14. Guarantees

Intellectual Property Indemnification Obligations

The Company has entered into agreements with customers and suppliers that include intellectual property indemnification obligations. These indemnification obligations generally require the Company to compensate the other party for certain damages and costs incurred as a result of third party intellectual property claims arising from these transactions. In each of these circumstances, payment by the Company is conditional on the other party making a claim pursuant to the procedures specified in the particular contract, which procedures typically allow the Company to challenge the other party s claims. Further, the Company s obligations under these agreements may be limited in terms of time and/or amount, and in some instances, the Company may have recourse against third parties for certain payments made by it under these agreements. It is not possible to make a reasonable estimate of the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company s obligations and the unique facts and circumstances involved in each particular agreement. Historically, the Company has not incurred significant costs to defend lawsuits or settle claims related to such agreements and no amount has been accrued in the accompanying financial statements with respect to these indemnification guarantees.

Product Warranty

The Company provides an accrual for estimated future warranty costs based upon the historical relationship of warranty costs to sales. The estimated future warranty obligations related to product sales are recorded in the period in which the related revenue is recognized. The estimated future warranty obligations are affected by product failure rates, material usage and replacement costs incurred in correcting a product failure. If actual product failure rates, material usage or replacement costs differ from the Company s estimates, revisions to the estimated warranty obligations would be required; however, the Company made no adjustments to pre-existing warranty accruals in the first nine months of fiscal 2006 and 2005.

A reconciliation of the changes to the Company s warranty accrual for the first nine months of fiscal 2006 and 2005 was as follows:

	Nine-Month Period Ended	
	December 31, 2005	December 31, 2004
	(in thousands)	
Balance at beginning of period	$ 2,084	$ 1,598
Warranties assumed		2,562
Warranties provided	3,958	3,932
Actual costs incurred	(4,053)	(4,188)
Warranties classified as current liabilities of discontinued operations (Note 4)	(359)	
Balance at end of period	$ 1,630	$ 3,904

15. Segment Reporting

In the second quarter of fiscal 2006, the Company reorganized its internal organization structure related to its OEM and Channel segments. Where previously the Company s former OEM and Channel segments each offered an integrated set of customer-focused products, the new organization is managed at the product level.

Following the reorganization, the Company operated in two reportable segments: DPS and DSG. A description of the types of customers or products and services provided by each reportable segment is as follows:

- DPS provides storage products and currently sells all of its storage technologies in various form factors, such as board-level products, ASICs, RAID enclosures and stand-alone software. The Company sells these products directly to OEMs, ODMs that supply OEMs, VARs and end users through its network of distribution and reseller customers.

- DSG provides high-performance I/O connectivity and digital media products for personal computing platforms, including notebook and desktop PCs. The Company sells these products to retailers, OEMs and distributors.

The unallocated corporate income and expenses, which are in the Other category, include amortization of acquisition-related intangible assets, restructuring charges, goodwill impairment, other charges (gains), interest and other income, interest expense, all administrative expenses and certain research and development, selling and marketing expenses.

Summarized financial information on the Company s reportable segments, under the new organizational structure, is shown in the following table. The segment financial data for the third quarter of fiscal 2005 and first nine months of fiscal 2005 and fiscal 2006 has been restated to reflect this change. There were no inter-segment revenues for the periods shown below. The Company does not separately track all tangible assets or depreciation by operating segments nor are the segments evaluated under these criteria. Segment financial information is summarized as follows for the third quarters and first nine months of fiscal 2006 and 2005:

	DPS	**DSG**	**Other**	**Consolidated**
	(in thousands)			
Three-Month Period Ended December 31, 2005:				
Net revenues	$ 69,130	$ 8,701	$	$ 77,831
Segment income (loss)	16,778	(403)	(19,571)	(3,196)
Three-Month Period Ended December 31, 2004:				
Net revenues	$ 84,888	$ 8,585	$	$ 93,473
Segment income (loss)	16,034	(402)	(20,455)	(4,823)
Nine-Month Period Ended December 31, 2005:				
Net revenues	$ 208,114	$ 28,617	$	$ 236,731
Segment income (loss)	42,794	(1,875)	(148,234)	(107,315)
Nine-Month Period Ended December 31, 2004:				
Net revenues	$ 263,756	$ 28,543	$	$ 292,299
Segment income (loss)	62,917	5,558	(68,410)	65

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The following table presents the details of unallocated corporate income and expenses for the third quarters and first nine months of fiscal 2006 and 2005:

	Three-Month Period Ended		Nine-Month Period Ended	
	December 31, 2005	December 31, 2004	December 31, 2005	December 31, 2004
	(in thousands)			
Unallocated corporate expenses, net	$ (19,233)	$ (22,996)	$ (63,067)	$ (71,439)
Restructuring charges	(2,587)	(2,228)	(3,105)	(4,975)
Other charges (gains)	(1,472)	2,755	(1,472)	2,755
Goodwill impairment			(90,602)	
Interest and other income	4,479	3,097	12,610	8,599
Interest expense	(758)	(1,083)	(2,598)	(3,350)
Total	$ (19,571)	$ (20,455)	$ (148,234)	$ (68,410)

16. Supplemental Disclosure of Cash Flows

	Nine-Month Period Ended	
	December 31, 2005	December 31, 2004
	(in thousands)	
Non-cash investing and financial activities:		
Deferred stock-based compensation	$	$ 7,060
Adjustment for deferred stock-based compensation	430	116
Unrealized loss on available-for-sale securities	(1,549)	(3,955)
Restricted stock		118

17. Assets Held for Sale

The Company entered into on December 23, 2005 and subsequently closed on January 9, 2006 a three-year contract manufacturing agreement with Sanmina SCI whereby Sanmina SCI has assumed manufacturing operations of Adaptec products. In addition, the Company sold certain manufacturing assets , buildings and improvements and inventory located in Singapore with respect to printed circuit board assemblies and storage system manufacturing operations to Sanmina SCI for the Company s net book value of approximately $27.0 million, subject to final closing adjustments for $25.5 million (net of closing costs of $0.5 million) resulting in a loss on disposal of assets of $1.5 million that was recorded in the third quarter of fiscal 2006 in Other charges (gains) on the Unaudited Condensed Consolidated Statements of Operations. Those assets have been reclassified to Assets held for sale on the Unaudited Condensed Consolidated Balance Sheets.

18. Business Acquisitions

The acquisitions described below were previously accounted for as purchase transactions and, accordingly, the results of operations and financial position of the acquired businesses were included in the Company s financial statements as of the respective effective dates of the acquisitions. However, as a result of the sale of the IBM i/p Series RAID Business and the Company s plan to divest its systems business, the assets expected to be sold have been reclassified as Assets and Liabilities of Discontinued Operations on the Unaudited Condensed Consolidated Balance Sheet at December 31, 2005 and the related operations have been reclassified to Income (loss) from discontinued operations, net of taxes on the Unaudited Condensed Consolidated Statements of Operations, as discussed in Note 4.

IBM i/p Series RAID: On June 29, 2004, the Company completed the acquisition of the IBM i/p Series RAID component business line consisting of certain purchased RAID data protection intellectual property, semiconductor designs and assets, and licensed from IBM related RAID intellectual property.

The licensing agreement granted the Company the right to use IBM s RAID technology and embedded Power PC technology for the Company s internal and external RAID products to be sold to IBM and other customers. In conjunction with the acquisition, the Company also entered into a three-year exclusive product supply agreement under which the Company agreed to supply RAID software, firmware and hardware to IBM for use in IBM s iSeries and pSeries servers. The Company also entered into an agreement for IBM to provide silicon wafer manufacturing processing services to the Company for the term of the supply agreement at agreed upon rates.

The final purchase price was $49.3 million, which consisted of a cash payment to IBM of $47.5 million, warrants valued at $1.1 million, net of registration costs, and transaction costs of $0.7 million. This purchase price included a final adjustment of $0.2 million in the first quarter of fiscal 2006 to both goodwill and acquisitions costs. In connection with the acquisition, the Company issued a warrant to IBM to purchase 250,000 shares of the Company s common stock at an exercise price of $8.13 per share. The warrant has a term of 5 years from the date of issuance and is immediately exercisable. The warrant was valued using the Black- Scholes valuation model using a volatility rate of 62%, a risk-free interest rate of 3.9% and an estimated life of 5 years. The transaction costs consisted primarily of legal, valuation and other fees. The IBM i/p Series RAID business was included in the Company s DPS segment.

Snap Appliance: On July 23, 2004, the Company completed the acquisition of Snap Appliance, a provider of NAS products, to expand its product offerings in the external storage market and to deliver cost-effective, scalable and easy-to-use DAS, NAS, Fibre Channel and IP-based SAN products from the workgroup to the data center. The final purchase price was $83.7 million, consisting of $76.7 million in cash and transaction fees and $7.0 million related to the fair value of assumed stock options to purchase 1.2 million shares of the Company s common stock. This purchase price included a final adjustment of $0.7 million in the first half of fiscal 2006 to both goodwill and acquisitions costs. The assumed stock options were valued using the Black-Scholes valuation model with the following assumptions: volatility rate of 58%; a risk-free interest rate of 2.6%; and an estimated life of 2.25 years. In the first quarter of fiscal 2006, adjustments of $0.7 were made to both goodwill and the acquisition costs.

Of the total assumed stock options, stock options to purchase approximately 0.7 million shares of the Company s common stock, with exercise prices ranging between $1.42 and $5.66 per share, were unvested (the Snap Unvested Options). The Snap Unvested Options have a ten-year term and vest primarily over four years from the date of grant. The intrinsic value of the Snap Unvested Options of $3.6 million was accounted for as deferred stock-based compensation and is being recognized as compensation expense over the related vesting periods.

In addition, a management incentive program was established to pay former employees of Snap Appliance cash payments totaling $13.8 million, which is being paid, contingent upon their employment with the Company, over a two-year period through the second quarter of fiscal 2007. Payments under the management incentive program will be expensed as employees meet their employment obligations or are recorded as part of the Snap Appliance acquisition-related restructuring for involuntary terminations by the Company. Any amounts outstanding as of the completion of the sale of the systems business will be accelerated.

Acquisition-Related Restructuring:

During the first quarter of fiscal 2006, the Company finalized its Snap Appliance integration plan to eliminate certain duplicative resources, including severance and benefits in connection with the involuntary termination of approximately 24 employees, exiting duplicative facilities and disposing of duplicative assets. The acquisition-related restructuring liabilities were accounted for under EITF No. 95-3 and therefore were included in the purchase price allocation. The Company recorded a total liability of $6.7 million for these activities, of which the original estimate of $6.0 million was recorded in the second quarter of fiscal 2005 and adjustments were recorded in each subsequent quarter through the first quarter of fiscal 2006 totaling $0.7 million. Any further changes to the Company s finalized plan will be accounted for under SFAS No. 146 and will be recorded in Restructuring charges in the Unaudited Condensed Consolidated Statements of Operations. In the third quarter of fiscal 2006, the Company recorded additional adjustments of $0.2 million due to additional lease costs related to the estimated loss of facilities that the Company subleased, which was recorded in Restructuring charges in the Unaudited Condensed Consolidated Statements of Operations (Note 8). As of December 31, 2005, the Company had utilized $4.2 million of these charges. The Company anticipates that the remaining restructuring reserve balance of $2.7 million will be paid out by the third quarter of fiscal 2012, primarily related to long-term facility leases.

The activity in the accrued restructuring reserve related to the Snap Appliance acquisition-related restructuring plan was as follows for the first nine months of fiscal 2006:

	Severance And Benefits (in thousands)	Other Charges	Total
Snap Appliance Acquisition-Related Restructuring Plan:			
Reserve balance at March 31, 2005	$ 155	$ 2,901	$ 3,056
Adjustments	(49)	244	195
Cash paid	(60)	(538)	(598)
Reserve balance at December 31, 2005	$ 46	$ 2,607	$ 2,653

In-process Technology

As part of the purchase agreements of the IBM i/p Series RAID business and Snap Appliance, certain amounts of the purchase prices were allocated to acquired in-process technology which were determined through established valuation techniques in the high-technology computer industry and written off in the first and second quarter of fiscal 2005, respectively, because technological feasibility had not been established and no alternative future uses existed. The values were determined by estimating the net cash flows and discounting the estimated net cash flows to their present values. A summary of the amounts written off were as follows:

	Acquired