STORAGE TECHNOLOGY CORP
Form 10-Q
November 12, 2002

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 27, 2002

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: 1-7534

STORAGE TECHNOLOGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	84-0593263
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
One StorageTek Drive, Louisville, Colorado	80028-4309
(Address of principal executive offices)	(Zip Code)

303-673-5151
(Registrant's telephone number, including area code)

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. [X] Yes [ ] No

The registrant had 106,505,944 shares of common stock outstanding as of November 4, 2002.

STORAGE TECHNOLOGY CORPORATION
INDEX TO FORM 10-Q
September 27, 2002

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED BALANCE SHEETS
(In Thousands, Except Share Amounts)

	09/27/02 (Unaudited)	12/28/01
ASSETS		

Current assets:		
Cash and cash equivalents	$ 549,957	$ 453,217
Accounts receivable	506,886	505,630
Inventories	115,250	183,980
Deferred income tax assets	95,352	95,459
Other current assets	2,307	16,240
Total current assets	1,269,752	1,254,526
Property, plant, and equipment	252,457	232,289
Spare parts for maintenance	37,856	35,674
Deferred income tax assets	121,359	121,826
Other assets	122,237	114,568
Total assets	$ 1,803,661	$ 1,758,883
LIABILITIES		
Current liabilities:		
Credit facilities	$ --	$ 73,401
Current portion of long-term debt	754	812
Accounts payable	94,354	66,648
Accrued liabilities	382,457	361,113
Income taxes payable	214,503	212,566
Other current liabilities	16,425	--
Total current liabilities	708,493	714,540
Long-term debt	9,923	9,523
Total liabilities	718,416	724,063
Commitments and contingencies (Note 6)		
STOCKHOLDERS' EQUITY		
Common stock, $0.10 par value, 300,000,000 shares authorized; 106,169,965 shares issued at September 27, 2002, and 105,032,665 shares issued at December 28, 2001	10,617	10,503
Capital in excess of par value	895,777	875,379
Retained earnings	199,086	150,129
Accumulated other comprehensive income (loss)	(8,456)	7,642
Treasury stock, 200,643 shares at September 27, 2002, and December 28, 2001, at cost	(3,777)	(3,777)
Unearned compensation	(8,002)	(5,056)
Total stockholders' equity	1,085,245	1,034,820

Total liabilities and stockholders' equity	$ 1,803,661	$ 1,758,883

The accompanying notes are an integral part of the consolidated financial statements.

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STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In Thousands, Except Per Share Amounts)

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Revenue				
Storage products	$307,335	$322,960	$ 889,379	$ 974,591
Storage services	194,370	175,039	560,167	504,361
Total revenue	501,705	497,999	1,449,546	1,478,952
Cost of revenue				
Storage products	166,719	174,204	497,027	538,184
Storage services	106,801	101,768	311,096	301,702
Total cost of revenue	273,520	275,972	808,123	839,886
Gross profit	228,185	222,027	641,423	639,066
Research and product development costs	53,354	60,563	162,385	185,770
Selling, general, administrative, and other income and expense, net	141,958	135,055	412,952	414,138
Operating profit	32,873	26,409	66,086	39,158
Interest income	2,837	2,465	7,439	7,222
Interest expense	(540)	(1,759)	(1,568)	(5,219)
Income before income taxes	35,170	27,115	71,957	41,161
Provision for income taxes	(11,300)	(9,200)	(23,000)	(14,000)
Net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161

EARNINGS PER COMMON SHARE

Basic earnings per share	$ 0.23	$ 0.17	$ 0.47	$ 0.26
Weighted-average shares	105,268	103,352	104,903	102,886
Diluted earnings per share	$ 0.22	$ 0.17	$ 0.46	$ 0.26
Weighted-average and dilutive potential shares	107,121	105,140	107,360	104,500

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In Thousands)

	Nine Months Ended	
	09/27/02	09/28/01
OPERATING ACTIVITIES		
Cash received from customers	$ 1,465,480	$ 1,548,705
Cash paid to suppliers and employees	(1,202,442)	(1,414,958)
Interest received	7,078	7,222
Interest paid	(1,288)	(4,197)
Income taxes paid	(11,229)	(11,252)
Net cash provided by operating activities	257,599	125,520
INVESTING ACTIVITIES		
Purchases of property, plant, and equipment	(83,003)	(50,029)
Proceeds from sale of property, plant, and equipment	354	82
Other assets	(14,321)	(6,173)
Net cash used in investing activities	(96,970)	(56,120)
FINANCING ACTIVITIES		
Repayments of credit facilities, net	(73,401)	(3,163)
Proceeds from employee stock plans	14,280	8,437
Proceeds from other debt	1,166	1,913
Repayments of other debt	(1,868)	(8,607)
Net cash used in financing activities	(59,823)	(1,420)
Effect of exchange rate changes on cash	(4,066)	4,712
Increase in cash and cash equivalents	96,740	72,692

Cash and cash equivalents - beginning of the period	453,217	279,731
Cash and cash equivalents - end of the period	$ 549,957	$ 352,423

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net income	$ 48,957	$ 27,161
Depreciation and amortization expense	70,501	87,418
Inventory writedowns	28,996	40,417
Translation gain	(461)	(19,433)
Other non-cash adjustments to income	17,433	25,116
Decrease in accounts receivable	15,934	70,120
(Increase) decrease in other current assets	531	(1,831)
(Increase) decrease in inventories	42,695	(62,364)
Increase in spare parts	(17,724)	(7,391)
(Increase) decrease in deferred income tax assets	993	(500)
Increase (decrease) in accounts payable	26,934	(24,231)
Increase (decrease) in accrued liabilities	8,938	(12,210)
Increase in other current liabilities	3,694	--
Increase in income taxes payable	10,178	3,248
Net cash provided by operating activities	$ 257,599	$ 125,520

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In Thousands)

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161
Other comprehensive income (loss), net of tax (benefit):				
Cumulative effect of change in accounting principle on adoption of Statement of Financial Accounting Standards No. 133 and 138, net of tax (benefit) of $0, $0, $0, and $(3,881)	--	--	--	(7,535)
Net gain (loss) on foreign currency cash flow hedges, net of tax (benefit) of $322, $(3,482), $(11,431), and $8,411	516	(6,759)	(18,338)	16,328
Reclassification adjustment for net (gains) losses included in net income, net of (tax) benefit of $3,402, $(432), $1,396, and $(3,725)	5,457	(838)	2,240	(7,231)
Other comprehensive income (loss)	5,973	(7,597)	(16,098)	1,562

Comprehensive income	$ 29,843	$ 10,318	$ 32,859	$ 28,723

The accompanying notes are an integral part of the consolidated financial statements.

STORAGE TECHNOLOGY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 - BASIS OF PREPARATION

The accompanying interim consolidated financial statements of Storage Technology Corporation and its wholly owned subsidiaries (StorageTek or the Company) have been prepared on substantially the same basis as the Company's annual consolidated financial statements and should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 28, 2001. In the opinion of management, the interim consolidated financial statements reflect all adjustments necessary for the fair presentation of results for the periods presented, and such adjustments are of a normal, recurring nature.

The consolidated results for interim periods are not necessarily indicative of expected results for the full fiscal year.

NOTE 2 - INVENTORIES

Inventories, net of associated reserves, consist of the following (in thousands of dollars):

	09/27/02	12/28/01
Raw materials	$ 8,836	$ 41,850
Work-in-process	42,365	57,641
Finished goods	64,049	84,489
	$115,250	$183,980

NOTE 3 - AGREEMENTS WITH EDS

On March 29, 2002, StorageTek and Electronic Data Systems Corporation (EDS) entered into a 10-year master secondary storage services agreement. On April 1, 2002, StorageTek and EDS entered into a 10-year agreement under which StorageTek outsourced certain internal information technology and customer call center operations to EDS. There are no cross-default provisions between the two agreements, and performance under each agreement by both StorageTek and EDS is not contingent upon performance under the other agreement. These agreements have been accounted for individually at their estimated fair values consistent with the provisions of Accounting Principles Board (APB) Opinion No. 29, "Accounting for Nonmonetary Transactions," based on management's estimates of fair value and a third-party appraisal.

Under the terms of the secondary storage services agreement, StorageTek will provide tape storage services for certain EDS-operated data center sites within the United States. StorageTek will receive a fee for these services calculated using a monthly base service fee adjusted for certain increases and decreases in the actual amount of data stored. The agreement also provides for adjustments to the fees in the event specified service level metrics are not achieved.

The secondary storage services agreement can be renewed on an annual basis after the expiration of the initial 10-year term. The agreement can be cancelled by either party upon certain events, and can be cancelled by EDS for convenience with six months notice no sooner than two-and-one-half years from the effective date of the agreement. In the event EDS terminates the agreement for convenience, a termination fee is payable to StorageTek with the amount of the fee based upon a declining scale from the effective date.

In connection with the secondary storage services agreement, StorageTek purchased certain secondary storage equipment for a purchase price of $52,200,000. Substantially all of the purchase price paid to EDS relates to equipment previously sold by StorageTek to EDS; however, none of the equipment purchased by StorageTek was sold to EDS subsequent to the companies entering into definitive negotiations of the secondary storage services agreement. The purchase price was paid in April 2002. Because StorageTek is only responsible for delivering secondary storage pursuant to the service level agreement, StorageTek makes all decisions on secondary storage equipment additions and retirements within the data centers. Upon the expiration or termination of the agreement, EDS has the option to purchase any secondary storage equipment owned by StorageTek at the data center sites at a purchase price equal to the greater of the net book value of the equipment or the fair market value of the equipment. In limited situations, EDS also has the right to repurchase a portion of the equipment prior to expiration or termination of the agreement at an assigned value declining on a straight-line basis over five years. The estimated fair value of the equipment subject to this repurchase right was $12,271,000 as of March 29, 2002. In the event EDS exercises this repurchase right, the exercise will not affect any other terms of the agreement.

StorageTek has agreed to reimburse certain lease payments made by EDS on equipment used to deliver secondary storage services under the agreement. EDS' gross remaining lease obligation associated with this equipment, assuming no lease terminations, was approximately $8,599,000 as of March 29, 2002.

Revenue is recognized under the secondary storage services agreement on a straight-line basis over the ten-year term of the agreement, based on the average per gigabyte price over the term of the contract. The Company had approximately $4,535,000 of billings to EDS for which the revenue has been deferred as of September 27, 2002. Lease reimbursement payments made to EDS are recognized as a reduction of service revenue. Costs and expenses to provide these services are recognized as incurred. The purchase price of $52,200,000 paid to EDS for the secondary storage equipment has been recorded within Property, Plant, and Equipment on the Consolidated Balance Sheet. The Company is depreciating the equipment on a straight-line basis over the estimated useful lives of the assets. Useful lives were determined based on the individual characteristics of the equipment, and range from one to seven years. The revenue and costs are included within storage services for segment reporting purposes.

NOTE 4 - GOODWILL

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." This statement addresses the accounting for goodwill and intangible assets subsequent to their acquisition. SFAS No. 142 requires that goodwill no longer be amortized. Under SFAS No. 142, goodwill will be tested for impairment on an annual basis or as necessary. The Company adopted SFAS No. 142 on the first day of the Company's fiscal year 2002. In the second quarter of 2002, the

Company completed the initial goodwill impairment test. No accounting charge resulted from the completion of this initial impairment test.

The following table presents the adjusted net income and earnings per share had SFAS No. 142 been in effect for all periods presented (in thousands, except per share amounts):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Reported net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161
Add back: Goodwill amortization	--	1,445	--	4,362
Adjusted net income	$ 23,870	$ 19,360	$ 48,957	$ 31,523
Basic earnings per common share:				
Reported net income	$ 0.23	$ 0.17	$ 0.47	$ 0.26
Goodwill amortization	--	0.01	--	0.04
Adjusted net income	$ 0.23	$ 0.18	$ 0.47	$ 0.30
Diluted earnings per common share:				
Reported net income	$ 0.22	$ 0.17	$ 0.46	$ 0.26
Goodwill amortization	--	0.01	--	0.04
Adjusted net income	$ 0.22	$ 0.18	$ 0.46	$ 0.30

NOTE 5 - DEBT AND FINANCING ARRANGEMENTS

The Company had a financing agreement with a bank that provided for the sale of promissory notes in the principal amount of up to $75,000,000 at any one time. This agreement expired in January 2002, and all outstanding promissory notes under the agreement were repaid at that time. The Company has historically utilized foreign currency forwards embedded in borrowing commitments under this financing agreement to hedge forecasted cash flows associated with revenue denominated in foreign currencies. The Company is currently using stand-alone foreign currency options and forwards to mitigate the risk that forecasted cash flows associated with revenue denominated in foreign currencies may be adversely affected by changes in foreign currency exchange rates.

See the Company's Annual Report on Form 10-K for the year ended December 28, 2001, for additional information regarding the Company's debt and financing arrangements, and derivative instruments.

NOTE 6 - LITIGATION

In 1994, Stuff Technology Partners II, a Limited Partnership (Stuff), filed suit in Boulder County, Colorado, District Court alleging that the Company breached a 1990 settlement that had resolved earlier litigation between the parties involving an unsuccessful optical disk drive storage development project. The suit seeks injunctive relief and damages. In September 2002, a jury confirmed the Company's interpretation of the settlement agreement that the limitations on the Company's use of the development project technology is restricted to its use in optical disk drives. Remaining claims to be tried include Stuff's allegation that the Company did not transfer all of the technology to it as required under the 1990 settlement agreement and its allegation that the Company is using the technology in optical disk drives. The Company will vigorously defend these claims and, at this time, the Company believes that the likelihood of a material adverse result on the remaining claims is remote.

The Company also is involved in various other less significant legal actions. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights.

NOTE 7 - OPERATIONS OF BUSINESS SEGMENTS

The Company is organized into two reportable segments based on the definitions provided in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information": storage products and storage services. The storage products segment includes sales of tape and tape automation products, disk products, and network products. The storage services segment includes maintenance and various storage consulting activities.

The Company does not have any intersegment revenue, and segment operating performance is evaluated based on gross profit. The aggregate gross profit by segment equals the consolidated gross profit, and the Company does not allocate research and product development costs; selling, general, administrative, and other income and expense; interest income; interest expense; or benefit (provision) for income taxes to the segments. The revenue and gross profit by segment is as follows (in thousands of dollars):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Revenue:				
Storage products	$307,335	$322,960	$ 889,379	$ 974,591
Storage services	194,370	175,039	560,167	504,361
Total revenue	$501,705	$497,999	$1,449,546	$1,478,952
Gross profit:				
Storage products	$140,616	$148,756	$ 392,352	$ 436,407
Storage services	87,569	73,271	249,071	202,659
Total gross profit	$228,185	$222,027	$ 641,423	$ 639,066

The following table provides supplemental financial data regarding revenue from the Company's storage products segment (in thousands of dollars):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Tape and tape automation				

products	$239,736	$258,125	$ 702,500	$ 791,325
Disk products	33,309	23,500	88,570	75,098
Network and other products	34,290	41,335	98,309	108,168
Total storage products revenue	$307,335	$322,960	$ 889,379	$ 974,591

NOTE 8 - EARNINGS PER COMMON SHARE

The following table presents the calculation of basic and diluted earnings per share (in thousands, except per share amounts):

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Net income	$ 23,870	$ 17,915	$ 48,957	$ 27,161
Weighted average common shares outstanding:				
Basic	105,268	103,352	104,903	102,886
Effect of dilutive common stock equivalents	1,853	1,788	2,457	1,614
Diluted	107,121	105,140	107,360	104,500
Earnings per common share:				
Basic	$ 0.23	$ 0.17	$ 0.47	$ 0.26
Diluted	$ 0.22	$ 0.17	$ 0.46	$ 0.26

For the quarters ended September 27, 2002, and September 28, 2001, options to purchase 7,239,457 and 6,081,221 shares of common stock, respectively, were excluded from the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the Company's common stock, and therefore, the effect would have been antidilutive. For the nine months ended September 27, 2002, and September 28, 2001, options to purchase 5,352,769 and 6,755,375 shares of common stock, respectively, were excluded from the computation of diluted earnings per share for the same reason.

NOTE 9 - RECENT ACCOUNTING PRONOUNCEMENTS

In August 2001, the FASB issued SFAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets." This statement addresses the accounting for the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. SFAS No. 143 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

In July 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses the accounting for costs associated with an exit activity or with a disposal of long-lived assets. SFAS No. 146 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

STORAGE TECHNOLOGY CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
SEPTEMBER 27, 2002

FORWARD-LOOKING STATEMENTS

All assumptions, anticipations, expectations, and forecasts contained in the following discussion regarding the Company, its future products, business plans, financial results, performance, and future events are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The Company's actual results may differ materially because of a number of risks and uncertainties. Some of these risks are detailed below in "Factors That May Affect Future Results" and elsewhere in this Form 10-Q. Forward-looking statements can be identified by the use of words such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue," or the negative of such terms, or other comparable words. Forward-looking statements also include the assumptions underlying or relating to any such statements. The forward-looking statements contained herein represent a good-faith assessment of the Company's future performance for which management believes there is a reasonable basis. The Company disclaims any obligation to update the forward-looking statements contained herein, except as may be otherwise required by law.

CONSOLIDATED STATEMENTS OF OPERATIONS DATA

The following table, stated as a percentage of total revenue, presents Consolidated Statements of Operations information and revenue by segment:

	Quarter Ended		Nine Months Ended	
	09/27/02	09/28/01	09/27/02	09/28/01
Storage products revenue:				
Tape and tape automation products	47.8%	51.9%	48.5%	53.5%
Disk products	6.7	4.7	6.1	5.1
Network and other products	6.8	8.3	6.8	7.3
Total storage products revenue	61.3	64.9	61.4	65.9
Storage services revenue	38.7	35.1	38.6	34.1
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue	54.5	55.4	55.7	56.8
Gross profit	45.5	44.6	44.3	43.2
Research and product development costs	10.6	12.2	11.2	12.5
Selling, general, administrative, and other income and expense, net	28.3	27.1	28.5	28.0
Operating profit	6.6	5.3	4.6	2.7
Interest income, net	0.4	0.1	0.4	0.1
Income before income taxes	7.0	5.4	5.0	2.8
Provision for income taxes	(2.2)	(1.8)	(1.6)	(1.0)

Net income	4.8%	3.6%	3.4%	1.8%
	=====	=====	=====	=====

REVENUE

STORAGE PRODUCTS

The Company's storage products revenue consists of sales of tape and tape automation products, disk products, and network products for the enterprise and open-systems markets. The open-systems market consists of products designed to operate in the UNIX, NT, and other non-MVS operating environments. Storage products revenue decreased 5% and 9% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to decreased revenue from tape and tape automation products.

Tape and Tape Automation Products

Tape and tape automation product revenue decreased 7% and 11% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to a reduction in the number of tape and tape automation units sold. The Company believes this decline is primarily attributable to the current economic conditions and the associated weakness in information technology spending. The Company has experienced a higher ratio of tape drives sold relative to tape libraries as customers appear to be buying only products essential to meeting their immediate storage needs. Also contributing to the decline in tape and tape automation product revenue during the third quarter of 2002 was the shift from storage products revenue to storage services revenue as a result of the secondary storage services agreement signed with EDS. These decreases were partially offset by increased revenue from LTO tape drives and enterprise and open-systems tape media products.

During the third quarter of 2002, the Company introduced two new tape drive offerings: the T9940B, which is a high-speed, high-capacity tape drive for the high-end tape market, and Quantum's SDLT 320, which is a high-speed, high-capacity tape drive for the mid-range tape market. See "New Products" under "Factors That May Affect Future Results" for a discussion of the risks associated with these and other new products.

Disk Products

Disk product revenue increased 42% and 18% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to increased sales of open-systems disk products. In January 2002, the Company announced a distribution agreement with LSI Logic Storage Systems (LSI). Under the terms of the agreement, StorageTek will sell LSI's full line of open-systems disk products. The increased revenue from open-systems disk products was partially offset by decreased revenue from the V-Series product family. The Company is focusing its disk sales efforts on opportunities to sell disk products in combination with its tape, network, and service offerings. Disk revenue continues to be affected by pricing pressures and intense competition in the disk market, as well as the current economic conditions and associated weakness in information technology spending.

During the third quarter of 2002, the Company introduced its V2X Shared Virtual Array (SVA(TM)) disk storage system, which is the latest V-Series offering for both mainframe and open-systems environments. The V2X is designed to eliminate the under-allocation and over-purchasing of disk storage capacity that is required with conventional enterprise disk storage systems. See "New Products" under "Factors That May Affect Future Results" for a discussion of the risks associated with this and other new products.

Network and Other Products

Network and other product revenue decreased 17% and 9% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to decreased sales of connectivity, software, and other miscellaneous products. The decrease was partially offset by increased sales of storage area networking (SAN) hardware, which includes the StorageNet(TM) 6000 series of domain managers and third-party equipment such as switches and bridges. Although sales of the Company's StorageNet(TM) 6000 increased during the third quarter and nine months of 2002, compared to the same periods in 2001, sales unit growth has been limited by the size of the market that this product can address. In October 2002, the Company announced its decision to outsource the development and manufacture of its StorageNet(TM) 6000 series of domain managers. This initiative will help the Company meet customer service objectives and improve time-to-market, cost, and manufacturing efficiency.

STORAGE SERVICES

The Company's storage services revenue primarily includes revenue associated with the maintenance of the Company's and third-party storage products, as well as service revenue associated with various storage consulting activities. Storage services revenue increased 11% during the third quarter and nine months of 2002, compared to the same periods in 2001. The growth in service revenue has been driven largely by an expanded effort to sell services that help customers successfully manage their storage requirements, as well as increased service revenue from the EDS agreement. See Note 3 of Notes to Consolidated Financial Statements for further discussion of the EDS secondary storage services agreement.

GROSS PROFIT

Gross profit margins remained flat at 45% for the third quarter of 2002, compared to the same period in 2001. Gross profit margins increased to 44% for the nine months of 2002, compared to 43% for the same period in 2001. The increase in gross profit margins for the nine months of 2002 is primarily a result of improvements in storage services profit margins. Gross profit margins for the storage products segment remained flat at 46% for the third quarter of 2002, compared to the same period in 2001. Gross profit margins decreased to 44% for the nine months of 2002, compared to 45% for the same period in 2001. Gross margins for the storage services segment increased to 45% and 44% for the third quarter and nine months of 2002, respectively, compared to 42% and 40% for the same periods in 2001. The increase in gross margins for the storage services segment reflects improvements in spare parts utilization and the service delivery process. The Company is continuing to assess its service delivery processes in an effort to improve efficiencies and eliminate unnecessary costs. These improvements may require additional investments and costs that could adversely impact service margins in future periods. Service margins may also decrease in future periods to the extent professional services, which generally carry lower margins, become a more significant source of service revenue.

RESEARCH AND PRODUCT DEVELOPMENT

Research and product development expenses decreased 12% and 13% during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to engineering initiatives designed to improve research and development productivity, increase strategic alignment, and eliminate non-essential spending. The Company continues to evaluate and prioritize research and product development programs and is focusing on the core businesses of tape automation, disk, virtual storage, and SAN products.

SELLING, GENERAL, ADMINISTRATIVE, AND OTHER INCOME AND EXPENSE

Selling, general, administrative, and other income and expense (SG&A) increased 5% during the third quarter of 2002, compared to the same period in 2001, primarily due to a pre-tax impairment charge of $4.5 million in connection with an equity investment. SG&A was unchanged during the nine months of 2002, as compared to the same period in 2001. As a percentage of revenue, SG&A was largely unchanged from the third quarter and nine months of 2001. In light of the prolonged economic downturn, the Company is continuing its efforts to control discretionary spending and identify new opportunities to drive increased profitability.

LITIGATION

In 1994, Stuff Technology Partners II, a Limited Partnership (Stuff), filed suit in Boulder County, Colorado, District Court alleging that the Company breached a 1990 settlement that had resolved earlier litigation between the parties involving an unsuccessful optical disk drive storage development project. The suit seeks injunctive relief and damages. In September 2002, a jury confirmed the Company's interpretation of the settlement agreement that the limitations on the Company's use of the development project technology is restricted to its use in optical disk drives. Remaining claims to be tried include Stuff's allegation that the Company did not transfer all of the technology to it as required under the 1990 settlement agreement and its allegation that the Company is using the technology in optical disk drives. The Company will vigorously defend these claims and, at this time, the Company believes that the likelihood of a material adverse result on the remaining claims is remote.

The Company also is involved in various other less significant legal actions. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights.

INTEREST INCOME AND EXPENSE

Interest income was largely unchanged during the third quarter and nine months of 2002, compared to the same periods in 2001. Interest expense decreased $1.2 million and $3.7 million during the third quarter and nine months of 2002, respectively, compared to the same periods in 2001, primarily due to a decrease in outstanding debt.

INCOME TAXES

The Company's effective tax rate was 32% for the third quarter and nine months of 2002, compared to 34% for the same periods in 2001. The decrease in the effective tax rate is primarily due to the Company's global tax strategies associated with the Company's manufacturing operations in Puerto Rico.

Statement of Financial Accounting Standards (SFAS) No. 109 requires that deferred income tax assets be recognized to the extent realization of such assets is more likely than not. Based on the currently available information, management has determined that the Company will more likely than not realize $216.7 million of deferred income tax assets as of September 27, 2002. The Company's valuation allowance of approximately $20.9 million as of September 27, 2002, relates principally to net deductible temporary differences, tax credit carryforwards, and net operating loss carryforwards.

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RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets." This statement addresses the accounting for goodwill and intangible assets subsequent to their acquisition. SFAS No. 142 requires that goodwill no longer be amortized. Under SFAS No. 142, goodwill will be tested for impairment on an annual basis or as necessary. The Company adopted SFAS No. 142 on the first day of the Company's fiscal year 2002. During the second quarter of 2002, the Company completed the initial goodwill impairment test. No accounting charge resulted from the completion of this initial impairment test. See Note 4 of Notes to Consolidated Financial Statements for a discussion of the financial impact on the Company's results of operations had SFAS No. 142 been in effect for all periods presented.

In August 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets." This statement addresses the accounting for the recognition and measurement of an asset retirement obligation and its associated asset retirement cost. SFAS No. 143 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

In July 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This statement addresses the accounting for costs associated with an exit activity or with a disposal of long-lived assets. SFAS No. 146 is effective for the Company's financial statements for the year ending December 26, 2003. The adoption of this statement is not currently anticipated to have a material impact on the Company's financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Working Capital

The Company's cash balance increased $96.7 million during the nine months of 2002 as a result of progress in the Company's efforts to more effectively manage working capital. The Company's operating activities provided cash of $257.6 million during the nine months of 2002, compared to cash of $125.5 million generated from operations during the same period in 2001. The increase in cash generated from operations during the nine months of 2002, compared to the same period in 2001, was primarily a result of significantly lower purchases of inventory, as well as other efforts to more effectively manage working capital. Cash used in investing activities increased to $97.0 million during the nine months of 2002 from $56.1 million during the nine months of 2001, primarily due to the repurchase of $52.2 million of secondary storage equipment from EDS in connection with the secondary storage services agreement. Cash used in financing activities increased to $59.8 million during the nine months of 2002, as compared to $1.4 million during the nine months of 2001. The increase in cash used in financing activities was primarily due to the repayment of borrowings under the Company's credit facilities during the nine months of 2002, partially offset by increased proceeds from employee stock plans.

Sources of Liquidity and Capitalization

The Company has a $150.0 million revolving credit facility (the Revolver) that expires in October 2004. The interest rates for borrowing under the Revolver are dependent on the Company's Total Debt to rolling four quarter Earnings Before Interest Expense, Taxes, Depreciation, and Amortization (EBITDA) ratio and the term of the outstanding borrowing. The rate ranges from the applicable LIBOR plus 1.75% to 2.50% or the agent bank's base rate plus 0.00% to 0.50%. The

Company had no outstanding borrowings under the Revolver as of September 27, 2002. The Revolver is secured by the Company's domestic accounts receivable and domestic inventory, and contains certain financial and other covenants, including restrictions on the payment of cash dividends on the Company's common stock.

The Company had a financing agreement with a bank that provided for the sale of promissory notes in the principal amount of up to $75.0 million at any one time. This agreement expired in January 2002, and all outstanding promissory notes under the agreement were repaid at that time.

The Company's cash flows from operations are currently expected to serve as the principal source of working capital. Cash flows from operations could be negatively impacted by a decrease in demand for the Company's products and services as a result of rapid technological changes and other risks described under "Factors That May Affect Future Results."

The Company believes it has adequate working capital and financing capabilities to meet its anticipated operating and capital requirements for the next 12 months. Over the longer term, the Company may choose to fund these activities through the issuance of additional debt or equity financing. The issuance of equity or convertible debt securities could result in dilution to the Company's stockholders. There can be no assurance that any additional long-term financing, if required, can be completed on terms that are favorable to the Company.

The Company's debt-to-capitalization ratio decreased from 7% as of December 28, 2001, to 1% as of September 27, 2002, primarily because of the repayment of borrowings under the Company's credit facilities. See "Working Capital" above for a discussion of cash sources and uses.

INTERNATIONAL OPERATIONS

International operations accounted for approximately 48% and 49% of the Company's revenue during the third quarter and nine months of 2002, respectively, compared to 49% and 50% during the same periods of 2001. The Company also sells products through domestic indirect distribution channels that have end-user customers located outside the United States. The Company expects that it will continue to generate a significant portion of its revenue from international operations. See "International Business" under "Factors That May Affect Future Results" for a discussion of the risks associated with conducting business outside the United States.

The majority of the Company's international operations involve transactions denominated in the local currencies of countries within western Europe, principally Germany, France, and the United Kingdom; Australia; Canada; and Japan. An increase in the exchange value of the U.S. dollar reduces the value of revenue and profits generated by the Company's international operations. As a result, the Company's operating and financial results can be materially affected by fluctuations in foreign currency exchange rates. In an attempt to mitigate the impact of foreign currency fluctuations, the Company employs a foreign currency hedging program. See "Market Risk Management" below.

MARKET RISK MANAGEMENT

Foreign Currency Exchange Rate Risk

The Company's primary market risk relates to changes in foreign currency exchange rates. The functional currency for the Company's foreign subsidiaries is the U.S. dollar. A significant portion of the Company's revenue is generated by its international operations. As a result, the Company's financial position, earnings, and cash flows can be materially affected by changes in foreign currency exchange rates. The Company attempts to mitigate this exposure as part

of its foreign currency hedging program. The primary goal of the Company's foreign currency hedging program is to reduce the risk of adverse foreign currency movements on the reported financial results of its non-U.S. dollar transactions. Factors that could have an impact on the effectiveness of the Company's hedging program include the accuracy of forecasts and the volatility of foreign currency markets. All foreign currency derivatives are authorized and executed pursuant to the Company's policies. The Company does not hold or issue derivatives for trading purposes.

To implement its foreign currency hedging program, the Company uses foreign currency options and forwards. These derivatives are used to hedge the risk that forecasted revenue denominated in foreign currencies might be adversely affected by changes in foreign currency exchange rates. Foreign currency forwards are also used to reduce the Company's exposure to foreign currency exchange rate fluctuations in connection with monetary assets and liabilities denominated in foreign currencies.

A hypothetical 10% adverse movement in foreign exchange rates applied to the Company's foreign currency exchange rate sensitive instruments held as of September 27, 2002, and as of December 28, 2001, would result in a hypothetical loss of approximately $65.6 million and $55.6 million, respectively. These hypothetical losses do not take into consideration the Company's underlying international operations. The Company anticipates that any hypothetical loss associated with the Company's foreign currency exchange rate sensitive instruments would be substantially offset by gains associated with its underlying international operations.

Interest Rate Risk

Changes in interest rates affect interest income earned on the Company's cash investments, as well as interest expense on short-term borrowings. A hypothetical 10% adverse movement in interest rates applied to cash investments and short-term borrowings held as of September 27, 2002, and as of December 28, 2001, would not have a material adverse effect on the Company's financial position, earnings, or cash flows.

Credit Risk

The Company is exposed to credit risk associated with cash investments, foreign currency derivatives, and trade receivables. The Company does not believe that its cash investments and foreign currency derivatives present significant credit risks, because the counterparties to the instruments consist of major financial institutions, and the Company manages the notional amount of contracts entered into with any one counterparty. Substantially all trade receivable balances are unsecured. The concentration of credit risk with respect to trade receivables is limited due to the large number of customers in the Company's customer base and their dispersion across various industries and geographic areas. Although the Company has a large number of customers who are dispersed across different industries and geographic areas, a prolonged economic downturn could increase the Company's exposure to credit risk on its trade receivables. The Company performs ongoing credit evaluations of its customers and maintains an allowance for potential credit losses.

FACTORS THAT MAY AFFECT FUTURE RESULTS

New Products

Short product life cycles are inherent in high-technology industries. The Company's results of operations and competitive strength depend on its ability to successfully develop, manufacture, and market innovative new products, as well as adapt its current products and services to new technologies.

The Company devotes significant resources to research and product development projects and must effectively manage the risks associated with new products. Developing new products is complex and involves various uncertainties, including possible delays in product development, manufacturing, or in customer evaluation and purchasing decisions. The manufacture of new products involves integrating complex designs and processes, collaborating with sole source suppliers for key components, and increasing manufacturing capacities to accommodate demand. A design flaw, inaccurate forecasting of customer demand, failure to obtain sufficient quantities of key components, or manufacturing constraints could adversely affect the Company's operating and financial results. The Company has experienced product development and manufacturing delays in the past that adversely affected its financial results and competitive position. There can be no assurance that the Company will be able to successfully manage the development and introduction of new products in the future.

New Services

As the Company and its competitors introduce new products, the Company must ensure that services related to those new products are in place, including the appropriate resources, training, and management. Proper training is key in delivering the Company's maintenance and professional services, and a lack of proper training could have a material adverse effect on the Company's financial condition and results of operations. In addition, the Company must accurately forecast the demand for maintenance and professional services, and must manage its employee base accordingly. Any failure by the Company to properly manage its new and existing services business could have a material adverse effect on the Company's financial condition and results of operations.

Emerging Markets

Future revenue growth is partially dependent on successfully developing and introducing products and services for two primary emerging markets: the open-systems market and the SAN market.

The open-systems market includes products designed to operate in the UNIX, NT, and other non-MVS operating environments. Competition in the open-systems market is aggressive and is based primarily on functionality, technology, performance, reliability, quality, system scalability, price, product availability, customer service, and brand recognition. The open-systems market encompasses a broad range of customers, including customers outside of the Company's traditional customer base. Many of the Company's potential customers in the open-systems market purchase their storage requirements as part of a bundled product, which may provide a competitive advantage to the Company's competitors. The Company expects to address these competitive factors by delivering storage solutions that utilize its expertise in tape, disk, and SANs in order to provide customers with superior functionality, performance, and quality. The Company's customer base continues to shift to the open-systems market, and there can be no assurance that the Company's strategy will be effective in expanding its open-systems market revenue.

The current and potential market for SAN solutions and technologies is continually evolving, and is characterized by rapidly changing technology and standards. The Company is still developing the necessary product modifications and professional services knowledge to successfully implement its SAN solutions in various operating environments. Customers may be reluctant to adopt new data storage standards, and competing standards may emerge that will be preferred by customers. Because this market is new and standards are still being defined, it is difficult to predict the potential size of the SAN market or the future rate of adoption of the Company's SAN solutions.

Competition

In the third quarter and nine months of 2002, approximately 80% of the Company's storage products revenue was derived from sales of tape and tape automation products. Additionally, a significant portion of the Company's service revenue is derived from the service of tape and tape automation products. One of the key competitive advantages that the Company's tape and tape automation products have over the competition's disk storage products is that the Company's tape and tape automation products store digitized data at a fraction of the cost of disk storage. The Company must continue to develop and introduce new tape and tape automation products that reduce the cost of storage at a rate that is similar to the decline in disk storage costs in order to maintain this competitive advantage.

Competition has resulted in price erosion in the past, and the Company expects this trend to continue. The cost of disk storage continues to decrease at a rapid rate due to competition and new disk drive technologies such as Advanced Technology Attachment (ATA). The Company recently announced that its ATA solution, the BladeStore disk subsystem, is scheduled for general availability in the fourth quarter of 2002. The Company believes that its ATA solution will complement enterprise-class disk by driving down costs and will complement tape with faster access. While the Company has unique competitive advantages with respect to its established customer base and a broad range of storage solution offerings, the Company's ability to compete in the disk market may be limited by the resources available for further development of its disk products, the effectiveness of disk product distribution, the competition, and market dynamics, including significant annual price erosion.

Price competition for the Company's products and services may have a significant impact on the Company's gross profit margins. The Company's ability to sustain or improve total gross margins is significantly dependent on designing, developing, and manufacturing competitive products, as well as reducing costs associated with the sourcing of production materials. This pressure on product margins is expected to increase as the Company's disk revenue shifts from its enterprise-class products to open-systems products developed and manufactured by a third party. Storage product gross margins also may be affected in future periods by inventory reserves and writedowns resulting from rapid technological changes or delays in gaining market acceptance for products.

The Company continues to purchase and use third-party products in delivering storage solutions to customers. Some of these third-party products are manufactured by the Company's competitors, including LTO tape drives and certain SAN products. The Company may be at a cost disadvantage in acquiring these products, and gross margins may be adversely affected by the use of these products in storage solutions.

Indirect Channels

The Company continues to develop its indirect distribution channels, including original equipment manufacturers (OEMs), value-added distributors (VADs), value-added resellers (VARs), and other distributors. Increasing the Company's sales through these indirect channels is critical to the Company's successful expansion into the open-systems market. There can be no assurance that the Company will be successful in expanding its indirect channel sales. Furthermore, there can be no assurance that profit margins on indirect channel sales will not deteriorate due to competitive pressures. Maintenance revenue also may be adversely affected in future periods to the extent that customers of these indirect channel partners elect to purchase maintenance services from vendors other than the Company.

The Company's ability to forecast future demand for its products may be adversely affected by unforeseen changes in demand from its indirect channel partners. The Company's worldwide indirect channel sales were adversely impacted

during 2001 by the global economic downturn. Although there was slight improvement in U.S. indirect channel sales during the nine months of 2002, the Company has limited visibility to future indirect channel sales and the future financial condition of its channel partners. The Company's financial results may be negatively affected if the financial condition of one or more of these channel partners weakens or if the current economic downturn continues.

Key Personnel

The future success of the Company depends in large part on its ability to attract, retain, and motivate its management team and other key employees. The Company faces significant competition for individuals who possess the skills required to design, develop, manufacture, and market the Company's products and services. An inability to successfully attract, retain, and motivate these employees could have an adverse effect on future operating results.

Ability to Develop and Protect Intellectual Property Rights

The Company relies heavily on its ability to develop new intellectual property rights that do not infringe on the rights of others in order to remain competitive and to develop and manufacture products that are competitive in terms of technology and cost. There can be no assurance that the Company will continue to be able to develop such new intellectual property.

The Company relies on a combination of U.S. patent, copyright, trademark, and trade secret laws to protect its intellectual property rights. With respect to certain of the Company's international operations, the Company files patent and trademark registration applications with foreign governments. However, many foreign countries do not have intellectual property laws that are as well developed as those of the United States. The Company enters into confidentiality agreements relating to its intellectual property with its employees and consultants. In addition, the Company includes confidentiality provisions in license and non-exclusive sales agreements with its customers.

Despite all of the Company's efforts to protect its intellectual property rights, unauthorized parties may attempt to copy or otherwise obtain or use the Company's intellectual property. Monitoring the unauthorized use of the Company's intellectual property rights is difficult, particularly in foreign countries. There can be no assurance that the Company will be able to protect its intellectual property rights, particularly in foreign countries.

Suppliers

The Company has reduced its inventory levels by over 35% during the nine months of 2002 in its efforts to more effectively manage working capital. The Company generally uses standard parts and components for its products and believes that, in most cases, there are a number of alternative, competent vendors for most of those parts and components. Many nonstandard parts are obtained from a limited group of suppliers. However, the Company believes there are other vendors who could produce these parts in satisfactory quantities after a period of prequalification and product ramping. Certain suppliers have experienced occasional technical, financial, or other problems that have delayed deliveries in the past. An unanticipated failure of suppliers to meet the Company's requirements for an extended period, or the inability to secure comparable components in a timely manner, could result in a shortage of key components or products, longer lead times, reduced control over production and delivery schedules, and an inability to fulfill customer orders in a timely manner. In addition, the Company will become increasingly dependent on a limited supplier base as it moves toward a lean manufacturing environment. An inability of a supplier to deliver required components or products could have a material adverse effect on revenue and operating results.

Sole Source Suppliers

Certain key components and products are purchased from sole source suppliers that the Company believes are currently the only manufacturers of the particular components that meet the Company's qualification requirements and other specifications or for which alternative sources of supply are not readily available. In the event a sole source supplier did not continue to supply components, the Company would need to identify and qualify other acceptable suppliers. This process could take an extended period, and there can be no assurance that any additional source would become available or would be able to satisfy production requirements on a timely basis or at a price acceptable to the Company.

Significant sole source suppliers include Imation Corporation (Imation), Sanmina-SCI Corporation (Sanmina), and Herald Datanetics Ltd. (HDL). There can be no assurance that significant sole source suppliers will be able to meet the Company's ongoing quality or delivery requirements necessary to satisfy customer needs. Failure to meet these requirements may have a material adverse impact on the Company's financial condition and results of operations.

Imation is a sole source supplier for the 9840 and 9940 tape media, and the Company is dependent on Imation to economically produce large volumes of high-quality tape media at a cost acceptable to the Company and its customers. In the second quarter of 2002, the Company announced it had outsourced its card manufacturing to Sanmina. The Company is dependent on Sanmina for the manufacture of printed circuit boards and for certain other manufacturing and repair services.

HDL is a sole subcontractor that manufactures a key component used in certain tape products. HDL is located in the People's Republic of China (PRC). The Company's dependence on HDL is subject to additional risks beyond those associated with other sole source suppliers, including the lack of a well-established court system or acceptance of the rule of law in the PRC, the degree to which the PRC permits economic reform policies to continue, the political relationship between the PRC and the United States, and broader political and economic factors. To date, the Company has not experienced any material problems with HDL; however, there can be no assurance that the Company will not experience any material problems with HDL in the future.

Manufacturing

The Company manufactures and assembles a significant portion of its products in Puerto Rico, and the Company's ability to perform these activities may be significantly affected by weather-related risks beyond the control of the Company. If the Puerto Rico facility were significantly affected by adverse weather, the Company believes it could relocate operations within a reasonable period of time without substantial delays or disruption. However, there can be no assurance that the Company would be able to relocate its Puerto Rico operations in a timely manner to avoid a material adverse impact on its financial condition or results of operations.

International Business

The Company's international business may be affected by changes in demand resulting from global and localized economic, business, and political conditions. The Company is subject to the risks of conducting business outside the United States, including adverse political and economic conditions; impositions of, or changes in, tariffs, quotas, and legislative or regulatory requirements; difficulty in obtaining export licenses; potentially adverse taxes; the burdens of complying with a variety of foreign laws; and other factors outside the Company's control. The Company expects these risks to increase in the future as it expands its operations in eastern Europe, Asia, and Latin America. There can be no assurance that these factors will not have a

material adverse effect on the Company's business or financial results in the future.

Restructuring Activities

The Company's ability to generate revenue growth during 2001 and the nine months of 2002 was adversely affected by the slowdown in the global economy as some customers delayed purchase decisions, reevaluated their information technology spending budgets, required higher purchase approval levels, and reduced capital expenditures by maximizing the current capacities of their data storage equipment. The Company does not currently foresee any significant improvement in information technology spending during the fourth quarter of 2002 or during 2003. In light of this economic environment, the Company has implemented various cost-saving measures, including reduced discretionary spending, delayed employee merit increases, and the outsourcing of certain manufacturing and development activities. There can be no assurance that a prolonged economic downturn will not have additional adverse effects on the Company's future revenue or operating results. Furthermore, there can be no assurance that these cost-saving measures will be successful or sufficient to allow the Company to continue to generate improved operating results in future periods. The Company has recognized significant restructuring charges in the past and it is possible that changes in the Company's business or its industry may necessitate restructuring activities in the future. The necessity for restructuring activities may result in expenses that adversely affect results of operations and may require incremental cash payments.

Earnings Fluctuations

The Company's financial and operating results may fluctuate from quarter to quarter for a number of reasons. Many of the Company's customers undertake detailed procedures relating to the evaluation, testing, implementation, and acceptance of the Company's products, which results in a variable sales cycle and makes it difficult to predict if or when revenue will be earned. Furthermore, gross margins may be adversely impacted in an effort to complete the sales cycle.

In the past, the Company's results have followed a seasonal pattern, which reflects the tendency of customers to make their purchase decisions at the end of a calendar year. During any fiscal quarter, a disproportionately large percentage of the total product sales are earned in the last weeks or days of the quarter. It is difficult to predict the extent to which these historical trends will continue in the future, especially in light of the recent slowdown in the global economy.

A number of other factors also may cause revenue to fall below expectations, such as product and technology transitions announced by the Company or its competitors, delays in the availability of new products, inability to manufacture to meet customer demand, changes in the purchasing patterns of the Company's customers and distribution partners, or adverse global economic conditions. The Company has recently experienced changes in the purchasing patterns of its customers in the form of smaller purchases, delayed purchase decisions, and higher level approvals. The mix of sales among the Company's business segments and sales concentration in particular geographic regions may carry different gross profit margins and may cause the Company's operating margins to fluctuate. These factors make the forecasting of revenue inherently difficult. Because the Company plans its operating expenses on expected revenue, a shortfall in revenue may cause earnings to be below expectations in that period.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required under this Item 3 is included in the section above entitled "Market Risk Management."

ITEM 4 - CONTROLS AND PROCEDURES

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, the Company conducted an evaluation of its disclosure controls and procedures, as such term is defined under Rule 13a-14 promulgated under the Securities Exchange Act of 1934, within 90 days of the filing date of this report. Based on their evaluation, the principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation referenced above.

STORAGE TECHNOLOGY CORPORATION
PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

In 1994, Stuff Technology Partners II, a Limited Partnership (Stuff), filed suit in Boulder County, Colorado, District Court alleging that the Company breached a 1990 settlement that had resolved earlier litigation between the parties involving an unsuccessful optical disk drive storage development project. The suit seeks injunctive relief and damages. In September 2002, a jury confirmed the Company's interpretation of the settlement agreement that the limitations on the Company's use of the development project technology is restricted to its use in optical disk drives. Remaining claims to be tried include Stuff's allegation that the Company did not transfer all of the technology to it as required under the 1990 settlement agreement and its allegation that the Company is using the technology in optical disk drives. The Company will vigorously defend these claims and, at this time, the Company believes that the likelihood of a material adverse result on the remaining claims is remote.

The Company also is involved in various other less significant legal actions. While the Company currently believes that the amount of any ultimate potential loss would not be material to the Company's financial position, the outcome of these actions is inherently difficult to predict. In the event of an adverse outcome, the ultimate potential loss could have a material adverse effect on the Company's financial position or reported results of operations in a particular quarter. An unfavorable decision, particularly in patent litigation, could require material changes in production processes and products or result in the Company's inability to ship products or components found to have violated third-party patent rights.

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

The exhibits listed below are filed as part of this Quarterly Report on Form 10-Q or are incorporated by reference into this Quarterly Report on Form 10-Q:

3.1 Restated Certificate of Incorporation of Storage Technology Corporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)

3.2 Certificate of Amendment dated May 22, 1989, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)

3.3 Certificate of Second Amendment dated May 28, 1992, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)

3.4 Certificate of Third Amendment dated May 21, 1999, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 1999, filed on August 9, 1999, and incorporated herein by reference)

3.5 Restated Bylaws of Storage Technology Corporation, as amended through November 11, 1998 (previously filed as Exhibit 3.1 to the Company's Current Report on Form 8-K dated November 19, 1998, and incorporated herein by reference)

4.1 Specimen Certificate of Common Stock, $0.10 par value of Registrant (previously filed as Exhibit (c)(2) to the Company's Current Report on Form 8-K dated June 2, 1989, and incorporated herein by reference)

10.1(1) Storage Technology Corporation Amended and Restated 1987 Employee Stock Purchase Plan, as amended (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

10.2(1) Storage Technology Corporation Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999, filed on March 10, 2000, and incorporated herein by reference)

10.3(1) Storage Technology Corporation Management by Objective Bonus Plan (previously filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

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1 Contract or compensatory plan or arrangement in which directors and/or officers participate.
2 Indicates exhibits filed with this Quarterly Report on Form 10-Q.

10.4(1) Storage Technology Corporation Amended and Restated Stock Option Plan for Non-Employee Directors (previously filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 1996, filed on August 12, 1996, and incorporated herein by reference)

10.5(1) Storage Technology Corporation Flexible Option Plan, dated December 2001 (previously filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)

10.6(1) Agreement between the Company and Gary Francis, dated August 19, 1997 (previously filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended December 26, 1997, filed on March 6, 1998, and incorporated herein by reference)

10.7(1) CEO Employment Agreement, dated July 11, 2000, between the Company and Patrick J. Martin (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2000, filed on August 11, 2000, and incorporated herein by reference)

10.8(1) Severance Agreement, dated as of July 1, 2001, between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.9(1) Restricted Stock Award Agreement, dated as of September 27, 2001, by and between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)

10.10(1) Offer Letter, dated May 10, 2001, from the Company to Michael McLay (previously filed as Exhibit 10.17 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

10.11(1) Offer Letter, dated February 9, 2001, from the Company to Jill F. Kenney (previously filed as Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

10.12(1) Offer Letter, dated February 9, 2001, from the Company to Roger Gaston (previously filed as Exhibit 10.20 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)

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10.21 Security Agreement, dated as of October 10, 2001, by and among the Company, Bank of America, N.A., as Collateral Agent for itself and other Secured Parties referred to therein (previously filed as Exhibit 10.14 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.22 Guaranty, dated as of October 10, 2001, by StorageTek Holding Corporation, in favor of the Banks party to a certain Credit Agreement and Bank of America, N.A., as Agent and Issuing Bank and Collateral Agent (previously filed as Exhibit 10.15 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.23(1) Form of Executive Severance Agreement (previously filed as Exhibit 10.32 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2002, filed on May 13, 2002, and incorporated herein by reference)

10.24 Master Services Agreement (MSA), between each of the Company, Electronic Data Systems Corporation, and EDS Information Services L.L.C., dated as of April 1, 2002 (previously filed as Exhibit 10.33 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 29, 2002, filed on May 13, 2002, and incorporated herein by reference)

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99.1(2) Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

99.2(2) Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K.

Current Report on Form 8-K, filed on July 24, 2002, relating to an Item 5, Other Events and Regulation FD Disclosure, regarding an announcement by the Company of its results of operations for the fiscal quarter ended June 28, 2002, including a copy of the script of the prepared remarks of the Company's Chief Executive Officer and Chief Financial Officer from a conference call regarding such results of operation.

Current Report on Form 8-K, filed on August 13, 2002, relating to an Item 5, Other Events and Regulation FD Disclosure, regarding an announcement by the Company that the Chief Executive Officer and the Chief Financial Officer had filed sworn statements with the Securities and Exchange Commission in compliance with SEC Order No. 4-460.

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2 Indicates exhibits filed with this Quarterly Report on Form 10-Q.

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SIGNATURES

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

STORAGE TECHNOLOGY CORPORATION
(Registrant)

November 11, 2002	/s/ ROBERT S. KOCOL
(Date)	Robert S. Kocol Corporate Vice President

and Chief Financial Officer
(Principal Financial Officer)

November 11, 2002	/s/ THOMAS G. ARNOLD
(Date)	Thomas G. Arnold Vice President and Corporate Controller (Principal Accounting Officer)

CERTIFICATIONS

I, Patrick J. Martin, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Storage Technology Corporation;

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

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

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

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

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

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

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

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

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

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

Date: November 11, 2002

/s/ PATRICK J. MARTIN

Patrick J. Martin
Chairman, President and CEO

I, Robert S. Kocol, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Storage Technology Corporation;

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

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

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

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

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

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

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

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

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

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

Date: November 11, 2002

/s/ ROBERT S. KOCOL

Robert S. Kocol
Corporate Vice President, Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Description
3.1	Restated Certificate of Incorporation of Storage Technology Corporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)
3.2	Certificate of Amendment dated May 22, 1989, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)
3.3	Certificate of Second Amendment dated May 28, 1992, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2000, filed on February 21, 2001, and incorporated herein by reference)
3.4	Certificate of Third Amendment dated May 21, 1999, to the Restated Certificate of Incorporation dated July 28, 1987 (previously filed as Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 25, 1999, filed on August 9, 1999, and incorporated herein by reference)

3.5	Restated Bylaws of Storage Technology Corporation, as amended through November 11, 1998 (previously filed as Exhibit 3.1 to the Company's Current Report on Form 8-K dated November 19, 1998, and incorporated herein by reference)
4.1	Specimen Certificate of Common Stock, $0.10 par value of Registrant (previously filed as Exhibit (c)(2) to the Company's Current Report on Form 8-K dated June 2, 1989, and incorporated herein by reference)
10.1(1)	Storage Technology Corporation Amended and Restated 1987 Employee Stock Purchase Plan, as amended (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)
10.2(1)	Storage Technology Corporation Amended and Restated 1995 Equity Participation Plan (previously filed as Exhibit 10.6 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999, filed on March 10, 2000, and incorporated herein by reference)
10.3(1)	Storage Technology Corporation Management by Objective Bonus Plan (previously filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2001, filed on May 14, 2001, and incorporated herein by reference)
10.4(1)	Storage Technology Corporation Amended and Restated Stock Option Plan for Non-Employee Directors (previously filed as Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 28, 1996, filed on August 12, 1996, and incorporated herein by reference)

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10.5(1)	Storage Technology Corporation Flexible Option Plan, dated December 2001 (previously filed as Exhibit 10.5 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)
10.6(1)	Agreement between the Company and Gary Francis, dated August 19, 1997 (previously filed as Exhibit 10.25 to the Company's Annual Report on Form 10-K for the fiscal year ended December 26, 1997, filed on March 6, 1998, and incorporated herein by reference)
10.7(1)	CEO Employment Agreement, dated July 11, 2000, between the Company and Patrick J. Martin (previously filed as Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 30, 2000, filed on August 11, 2000, and incorporated herein by reference)
10.8(1)	Severance Agreement, dated as of July 1, 2001, between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended September 28, 2001, filed on November 8, 2001, and incorporated herein by reference)

10.9(1) Restricted Stock Award Agreement, dated as of September 27, 2001, by and between the Company and Robert S. Kocol (previously filed as Exhibit 10.9 to the Company's Annual Report on Form 10-K for the fiscal year ended December 28, 2001, filed on March 4, 2002, and incorporated herein by reference)

10.10(1) Offer Letter, dated May 10, 2001, from the Company to Michael McLay (previously filed as Exhibit 10.17 to the Company's Quarterly Report on Form 10-Q for the fiscal quarter ended June 29, 2001, filed on August 9, 2001, and incorporated herein by reference)

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